Q | QUARTER NOTES

First Quarter 2020

Paul R. Mancuso

"Thank you, may I have another?"

For many investors 2019 was a very good year. In fact, *The Wall Street Journal* noted in mid-December that "it was pretty hard to lose money in 2019." Bond yields fell through the year. The yield on the ten-year Treasury bond fell from 2.7% at the start of the year to 1.9%, which gave the holders of those bonds a 10% return, including coupons. Gold was up 18%, crude oil up 34% (with considerable volatility). The S&P 500 gained 33.07%, with dividends reinvested. Stocks and bonds have not moved upward together in this fashion since 1998.

But the comparison to 1998 should put investors on their guard. Is another recession coming soon? The current economic expansion has been underway since 2009, which has some observers concerned about its age. Gross Domestic Product slowed from about 3% in 2018 to about 2.3% in 2019. One does not welcome a downward GDP trend, and yet growth simply fell to the average for this period of expansion.

Few expect the financial markets to do as well in 2020 as in 2019, but at the same time, few predict a major correction. The economic fundamentals appear sound.

Key themes for 2020

- After the strong performance in 2019, returns in stocks and bonds may be muted in 2020.
- Many equity sectors have higher than average valuations.
- Volatility has been below average, and may pick up.
- A diversified portfolio may be the best strategy for mitigating risks.

Employment

The unemployment rate stands at lows not seen in half of a century. Low unemployment means there is more household spending and greater consumer confidence, which in turn creates the foundation for more spending and economic growth, a virtuous cycle.

However, unemployment is a lagging indicator; it typically does not go up until

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Looking ahead

The year 2019 was a pleasure for many investors, as owners of stocks and bonds both did very well. Will 2020 be different? *QuarterNotes* takes a look at how the economy and market trends may affect your portfolio.

On page 3 you'll find "New IRA rules for 2020." If you haven't yet made your IRA contributions for the 2019 tax year, it's time!

Please bring us your questions about saving and investing. Put our experience to work for you.

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after a recession is underway. The leading indicator in this area is new claims for unemployment. These have ticked upward before each of the last seven recessions. New claims remain low in absolute numbers by historical standards, but this measure should be watched closely in 2020. See the graph below for the historical relationship between recessions and new claims for unemployment since 1995.

Consumer debt

Another sign of strength for the economy is a relatively low level of consumer debt compared to net disposable income. Before the Great Recession of 2008, consumers were spending about 13.2% of their disposable income on their debt service. Debt has since been repaid, and income has grown, so that consumers now must dedicate less than 10% of disposable income to their debt service. That fact suggests that consumer spending can continue strong in 2020—indeed, holiday shopping was up a reported 3.4% in 2019.

Stocks

Currently, the price/earnings ratio of the S&P 500 is in the 92nd percentile over a 15-year period, which means that P/E ratios have only been higher 8% of the time. The S&P 500 Growth Index is in the 93rd percentile. P/E ratios trending at such high levels introduce concerns over the development of a price bubble.

That's why a diversified approach and limiting concentrations in any one sector or asset class may be prudent. While valuations are on the high end in some cases, they may be helped by low interest rates, which make it easier for companies to borrow money, and lower yields in the bond market, which continue to make equities a more attractive option for investors seeking greater potential returns.

Bonds

Bond markets are mixed, as bond investors seem more pessimistic than stock investors. On the high-quality side of things, the Treasury yield curve could be signaling that bond investors feel that future economic growth is sputtering, as longer maturity bonds are paying nearly the same yield as shorter maturity bonds, but with much more interest-rate risk.

But the high-yield side suggests a different story. The amount of yield one receives for taking credit risk is higher than last year, but at moderate levels, suggesting defaults aren't likely to pick up anytime soon. High-yield investors seem to agree with equity investors that growth may be slow, but sustainably slow.

Similar to equity markets, diversification is key in bond portfolios. Make sure that the bond portfolio acts like a bond portfolio and as a countermeasure against falling equity prices. Understanding what one owns is critical. A bond portfolio that correlates to equities by having too much high-yield exposure could be detrimental in a market sell-off.

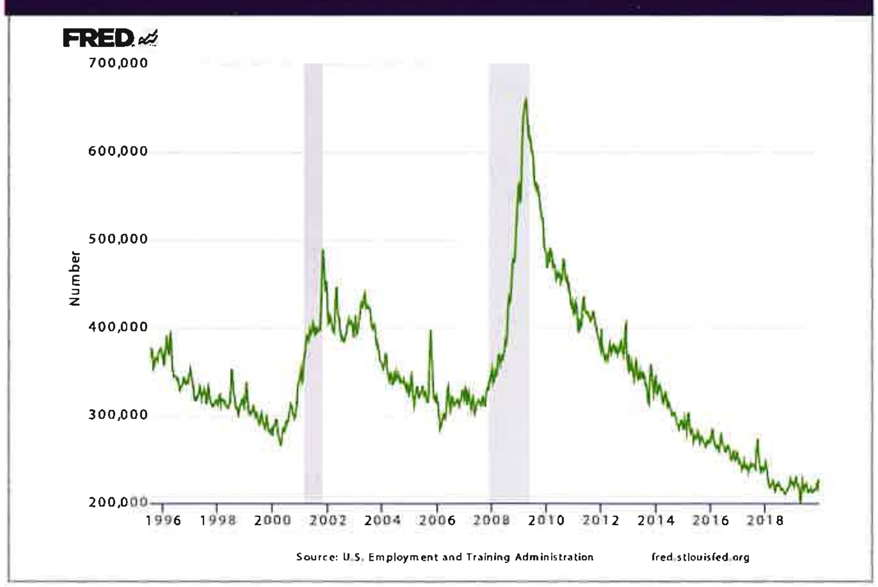
May we help you?

Finding good help for investment management is no easy matter. It's a bit like selecting a doctor or a lawyer. You have to find someone you can trust, someone with whom you feel comfortable.

That someone should be us. We offer unbiased investment advice, designed with the needs of you and your family in mind. We utilize a team approach to investment and financial management, with professionals from a range of disciplines to provide you with a complete financial management solution.

If you haven't yet taken advantage of our services for investors, we invite you to make an early appointment to learn more about our offerings.

4-Week Moving Average of Initial Unemployment Claims



Investors cannot invest directly in indexes. The performance of any index is not indicative of the performance of any investment and does not take into account the effects of inflation and the fees and expenses associated with investing.

The S&P 500 is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

A diversified portfolio does not assure a profit or protect against loss in a declining market.

In December Congress revisited the rules for qualified retirement plans and IRAs, with an eye toward boosting retirement savings. To that end, the age limit of 70½ for making a contribution to a traditional, deductible IRA has been eliminated, beginning in 2020. What's more, the age at which required minimum distributions from IRAs must begin has been lifted to 72. These changes should be helpful to older workers. Note that one still needs to have earned income to make an IRA contribution—investment and pension income does not qualify.

The amount that may be contributed to traditional and Roth IRAs has not changed, $6,000 for 2020, as it was in 2019. Those 50 and older may make an additional $1,000 "catch-up" contribution. You have until the tax-filing deadline to make a contribution for the 2019 tax year, and it would be wise to go ahead with your 2020 contribution as soon as practical for maximum tax-deferred growth.

A contribution is one thing, the deduction is something else. Those who have no employer retirement coverage are permitted a full deduction for IRA contributions, regardless of income. Those who have such coverage will find the deduction phases out as their modified adjusted gross income (MAGI) grows, as shown in the table below. A person whose spouse has an employer-provided retirement plan also has limits on the deduction.

The Roth IRA should also be considered, especially by those whose income exceeds the deductibility threshold. There is no deduction for the contribution, but there is the possibility of complete tax freedom for all distributions. Income limits apply to Roth IRAs as well, but those limits are higher than for deductible IRAs.

Key IRA boundaries

		2019	2020
Contribution limit		$6,000	$6,000
MAGI phase-out range for IRA deduction for those covered by employer plan	Single	$64,000 - $74,000	$65,000 - $75,000
	Married filing joint	$103,000 - $123,000	$104,000 - $124,000
	Married filing separately	$0 - $10,000	$0 - $10,000
MAGI phase-out range if only spouse has employer coverage	Married filing joint	$193,000 - $203,000	$196,000 - $206,000
	Married filing separately	$0 - $10,000	$0 - $10,000
MAGI phase-out range for allowable Roth IRA contributions	Single	$122,000 - $137,000	$124,000 - $139,000
	Married filing joint	$193,000 - $203,000	$196,000 - $206,000
	Married filing separately	$0 - $10,000	$0 - $10,000

Source: Internal Revenue Code; M.A. Co.

Distributions from traditional IRAs and employer sponsored retirement plans are taxed as ordinary income and, if taken prior to reaching age 59½, may be subject to an additional 10% IRS tax penalty. A Roth IRA offers tax free withdrawals on taxable contributions. To qualify for the tax-free and penalty-free withdrawal of earnings, a Roth IRA must be in place for at least five tax years, and the distribution must take place after age 59½ or due to death, disability, or a first time home purchase (up to a $10,000 lifetime maximum). Depending on state law, Roth IRA distributions may be subject to state taxes

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Just Ask Us

I've heard that the SECURE Act changes the rules for inherited IRAs. What are the new requirements?

Under the old law, someone who inherited an IRA had required minimum distributions (RMDS) geared to his or her lifetime. Younger people have very low RMDs, so the IRA had the potential to provide lifetime financial security. The strategy was called the "stretch IRA" by estate planners.

The strategy is largely eliminated as of 2020. Those who inherit an IRA this year and in the future will need to take the entire amount from the account within ten years of the account owner's death. This will both shorten the period of tax-deferred growth and increase the tax drag on the necessarily larger distributions.

The stretch IRA is still permitted for surviving spouses and heirs who are less than ten years younger than the account owner (such as siblings). For children who are still minors, the ten-year period does not begin until they reach the age of majority.

If an IRA will be a significant part of your estate, see your tax advisors soon to learn more about your planning choices.