January 2020 – Are We a Hare or a Tortoise?

The road goes on forever and the party never ends.
-Robert Earl Keen lyrics

Invest like Aesop. Not Robert Earl Keen

Many of us like to look at things in intervals. We just noted sector performance for the quarter and the year. Interestingly if you looked at the decade, it was up 13.6% annually; however, it was only the fourth best performing decade for the last 100 years. The 50's were the best as it was a decade without major wars and economies were growing although people in Eastern Europe and other Communist countries weren't seeing much prosperity. This last decade the S&P grew about as much annually (13.6%) as the Roaring 20's (14.6%).

But we are always concerned about the future. Where do we go from here?

The news coverage of current events is almost always worrisome. The Middle East is seemingly in never-ending turmoil. Africa and Latin America also have their share of problems and are causing the migration of people to countries with more opportunities exasperating an already serious income inequality problem.   None of us quite know what to do about these things except disagree stridently with each other as to what is to be done. President Trump and Brexit are lightning rods to our news media and our political parties. We also seem to be living in a world of "I'm right, and you're wrong."

If perception is reality, and we are constantly being told that we live in difficult times, this uncertainty may bode ill for our investments. But is that really true? In the past year we have had fewer wars and more prosperity than almost any time before.

Stock prices are ultimately driven by earnings. Increased earnings give us higher stock prices and higher dividend yields relative to interest rates. These are what really count.

Our country has been divided by extremists on both sides—President Trump was impeached with no support by the Republican Party; and twenty years ago President Clinton was impeached with little support of the Democratic Party. None of that seems to matter to our economy or the stock market.

The principles of our investment philosophy—investing in stocks for the long run, being diversified, being tax efficient, keeping costs low, communicating regularly and customizing your investments to be consistent with your personal goals regarding growth, income and preservation of capital are what really matter.

In keeping with this philosophy, we become aware of opportunities where it might make sense to make changes to your investments. An example of this was that at the end of 2018 we believed that the market correction that occurred in the fourth quarter was not justified based on the prevailing economic conditions generally and your stocks in particular. Consequently in reviewing your accounts during the year we looked carefully at changes that might be or needed to be made. Again we always keep in mind tax consequences and the risk of having an inordinate amount in one position or sector.

Because of the tremendous performance during 2019 we find ourselves in the opposite position. We are now reviewing whether we want to sell all or some positions that have moved up substantially. A specific example is Apple. As far as we know almost everyone who owns Apple is pleased with its 2019 performance. However, do we really think a stock with a total market value of $1.4 Trillion is going to have the same kind of year again? (It doubled in the last year.) We believe that although it may continue to be a good investment, selling some and re-deploying the proceeds may make a lot of sense for more growth and diversification in individual portfolios.

Consequently, as much as we like Robert Earl Keen, we think investing with Aesop and choosing the tortoise is a pretty good idea as we don't believe the party goes on forever and slow and steady always wins in the long run.

Tax Note

There were very few changes to the federal tax law during 2019; however, some general observations are in order.

It is highly likely that individual tax rates will increase in the future. When that will happen is more difficult to predict. If the Republicans prevail in the November elections, taxes may be decreased for the "middle class" and that may be paid for by increases on higher income individuals. If the Democrats regain power we can all expect to see higher taxes. Longer term, both parties will need to increase taxes to pay for the new programs they want to implement.

Usually, changes in the tax law are prospective only. That changed last year. In December 2019, Congress passed, and President Trump signed, the SECURE Act to provide additional retirement protection. To "pay for" these new benefits, Congress altered the tax on some inherited IRA's. Prior to 2020, distributions from a decedent's IRA could be "stretched" over the beneficiary's projected lifetime. After 2019, a beneficiary must distribute the entire IRA balance within ten years.

This is a significant change to IRA taxation. More concerning is the fact that Congress has changed the taxation of existing IRA's. No "grandfather" rules here.

This raises the question to what extent can we rely on current tax law for our planning. Consequently you may want to consider changes in your IRA beneficiaries. Also, in some cases converting some or all of your regular IRAs to a Roth IRA may make sense. We expect to discuss these topics more in-depth in the future.

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