nVEST nSIGHTS

March 31, 2019

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10268 Sawmill Parkway
Powell, Ohio 43065
614.389.4646

WWW.NVESTWEALTH.COM
Email: info@nvestwealth.com

REFLECTIONS ON A BULL MARKET

Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

As investors recall, the January-February start to 2019 was one strongest starts since 1991 because the Fed announced a pause to its process of raising interest rates. This helped stocks recoup much of the losses from last year-end. March added another +2% total return and boosted the S&P500 return for 1Q2019 to +13.6%. Since 1926, the Index delivered double-digit returns in the first quarter 14 times. Only 4 years did the market fail to post +20% for the full year (1930, 1986, 1987 and 2012). Very often a pause in the upward path occurred in the subsequent 2Q. A 2Q pause could develop this year because... either a delay in a trade deal with China develops that is longer than expected, and/or first quarter company earnings announcements are soft relative to current market valuations. Interesting, the 1Q bounce back created a "V" shaped chart pattern following the challenging drawdown of the 4Q2018, and December in particular. "V" shaped chart patterns are unusual, with a "W" shaped chart pattern more common. A pause for the reasons cited above could cause the stock market charts to create a more normal "W" pattern. In essence, a strong 1Q stock market performance often leads to slower but continued gains.

Did you know? The current Bull Market celebrated its 10th birthday on March 9th, gaining over +400% in that time period.

- The 2 <u>best</u> years (out of the 10 years) were the 1st (up +72.3%) and the 5th (up +23.7%).
- The 2 <u>worst</u> years were the 7th year (down -2.2%) and the just concluded 10th year (at 3/8/2019 rising a small +0.4%).

The 10-year annualized return amounts to +17.5% per year (total return of price change + dividends). While this is perhaps the least loved or admired bull market, and many investors are most skeptical of its prospects, it would be easy to miss the 20 best days (of the total 2,517 trading days). If one missed the 20 best trading days (not 20 days per year), the annualized gain is cut in half to +8.6%. Not shabby; yet affirming that timing the market is not profitable (not worth the psychological worry effort).

Did you know? Since 1950, there are 60 different 10-year periods (the years 1950-1959; 1951-60; 1952-61; through 2009-2018). These 10-year return stats for the S&P500 are compelling:

- The index produced an average annual <u>total</u> return (dividends + price change) of less than +7% during 15 of the 60 decade-long periods, or 25% of the time.
- 19 of the 60 periods (or 32% of the time), resulted in an average total return of at least +14%
- The S&P500 produced a positive total return result in 58 of the 60 decade-long periods. That's 97% of the time!!

Again, these historical stats strongly advocate the merits of being a long term, in-the-market investor.

AGE IS JUST A NUMBER

Later this 2nd quarter, the current economic expansion will reign as the longest of all time. Earlier on March 9th, the bull market celebrated its 10th anniversary. No one would describe either as young as far as time. Former Fed Chairman Ben Bernanke offered at the start of the year that "economic expansions don't die of old age, they get murdered." Mixed economic data in the US and weak data abroad suggest that the Fed should not be too quick to raise interest rates further or tighten monetary policy. The Fed learned that there are limits to how quickly it can normalize interest rates and monetary policy in a global environment that is still attempting to escape the hold of financial repression (low or zero interest rate policy to boost economic growth). Thus, the Fed is unlikely to be charged with the crime of killing the economy and current Bull market any time soon.

The Administration blunted the full positive impact of the tax cuts (of December 2017) with a continuation of trade/tariff negotiations with China, and the recent government shutdown (over funding the southern border wall, which would be an economic boost) to start 2019. The cumulative effect of these slowdown issues produced a tough 1Q for businesses globally (creating uncertainty in executing future plans and soft 1Q earnings reports), but offers hope about the future as policy resolution develops. At the same time, China is pursuing efforts to stimulate its own economy. Thus, several global policy stimulation actions, including prospective tariff and Brexit resolution, should lead to a stronger global second half. The current economic cycle and Bull market will likely celebrate another anniversary event that suggests neither needs to die of old age; or "age is just a number," at least at this time. Both die when policy mistakes – either fiscal or monetary policy – are made.

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"[An inverted yield curve] means the Fed made a policy mistake - raising interest rates too fast too much. At this juncture, a few weeks of inversion should not be the 'red alert' for definite future recessionary event."

"For now, this Bull market is without an expiration date, but we know that managing risk is very important at this stage of the cycle."

ANNOUNCEMENTS:

- Early April - 2Q 2019 fees collected. 1Q'19 performance reporting delivered
- April 15 - Deadline to file personal income taxes; Traditional and Roth IRA contributions for 2018 tax year not accepted after this date.
- April 19 - Good Friday; stock & bond markets are closed.
- May 27—Memorial Day; financial markets and banks closed.
- June 30 - Last Day of 2Q
- Our ADV Part 2A & B as required by the SEC & Ohio (and other states) is available to you anytime upon request.

NO BEAUTY CONTEST

The Treasury yield curve inverted in late March due to worries about slowing economic growth. [Worth mentioning that slower economic growth often occurs during the 1Q of most years, but rebounds thereafter.] Many times through US economic history, the yield curve inversion signaled a recession somewhere in the upcoming future – maybe within a year or two at most. An inverted yield curve means that short rates are higher than long rates. Normally, the shape of the yield curve is upward-sloping, and can be interpreted that rates will gradually be higher in 2, 3, or … 10 years in the future than current short maturity rates. An inverted curve with short rates higher than long rates could be interpreted to mean rates in 10 years will be lower than current short rates, because there is low or anticipated low inflation and/or slow economic growth. Further, it means the Fed made a policy mistake – raising interest rates too fast too much. At this juncture, a few weeks of inversion should not be the "red alert" for a definite future recessionary event. The yield curve would need to remain inverted for a continuing period of time.

Inversions are unnatural events that signal a policy mistake. It's not unusual for the US yield curve to invert every cycle, because the Fed makes a policy mistake at least once every cycle. Over the last 40 years, recessions occur because the Fed kept tightening even after the yield curve inverted. The key for the Fed is to not invert the curve. But, once it's inverted, the Fed should stop raising rates or tightening, hoping that their pause is early enough to allow the economy to regain its growth path. It may be too early to know if their pause is timely or not. Let's hope the inverted curve was the "stop sign" for the Fed to pause and watch economic developments, and thereby avoid a recession.

One side effect of the yield curve inversion and recent Fed pause is that the whole curve shifted itself lower than at the start of 2019. Meaning, consumers are finding interest rates lower at the end of March than at the start of the year. Auto and home sales are increasing again as consumers take advantage of lower rates. This too supports the notion that economic growth should advance again in the 2nd half of 2019 and support stock market prices.

In any case, the current yield curve inversion will not win any beauty contests with investors.

STYLE DIFFERENCES EXIST

Amazing! The S&P500 provided a "full year" size return in the 1Q2019 alone. This fast pace is unlikely to continue for the balance of the year. While the market offered attractive valuations at year-end, following the 1Q rise investors should once again be aware of higher prices. It is important to monitor economic developments and other policy actions to verify this Bull market can advance its historical run.

Our portfolio management process is employing a "dial-down risk" strategy. We know "Age is Just a Number." We know the Bull market can run longer than 10 years, IF economic fundamentals provide continuing support. As portfolios incorporate a dialed-down risk in both bond and stock exposures, it is interesting to observe fund style performance differences. Both US domestic and foreign (EAFE) growth style stock funds are continuing to perform better than value style funds (see "Growth v Value" on page 3 below "Benchmarking"). Valuations of growth style funds are rich or stretched compared to value. That means risk is elevated for growth versus value. Diversifying a portfolio still requires owning both growth and value style stock funds. Dialing-back risk advocates capturing some profits from more expensive growth style stock funds to reduce their portfolio exposure. Then, redeploying the proceeds first, to retain the stock/bond allocation target per objective, and second owning value style stock funds where the risk/reward appears better. For now, this Bull market is without an expiration date, but we know that managing risk is very important at this stage in the cycle.

Pursuing less risk may result in slightly slower advancing portfolio values during a rising market environment. Yet, if style performance shifts to favor value, those exposures will provide a nice boost to portfolio appreciation. Or, if/when the market does pull back the lesser-risk, value-style stock funds should provide better downside protection in portfolios. Nvest tries to be dynamic and disciplined with our investment process.

Benchmarking as of March 31, 2019

Summary of index portfolio returns compiled by Nvest Wealth Strategies, Inc.

Index Portfolio	Stock/Bond Allocation		Total Return Through 3/31/2019			
			1st Qtr	12 Mths	3 Years	5 Years
Capital Preservation	0% / 100%	*Cumulative*	1.6%	2.9%	5.5%	7.1%
		Annualized		2.9%	1.8%	1.4%
Income	20% / 80%	*Cumulative*	3.9%	2.9%	11.1%	12.9%
		Annualized		2.9%	3.6%	2.5%
Balanced Conservative	35% / 65%	*Cumulative*	5.1%	3.0%	14.2%	16.1%
		Annualized		3.0%	4.5%	3.0%
Balanced	50% / 50%	*Cumulative*	6.8%	3.2%	18.8%	21.2%
		Annualized		3.2%	5.9%	3.9%
Balanced Growth	65% / 35%	*Cumulative*	8.5%	3.1%	23.2%	25.4%
		Annualized		3.1%	7.2%	4.6%
Growth	80% / 20%	*Cumulative*	10.2%	3.4%	28.3%	31.0%
		Annualized		3.4%	8.7%	5.5%
Aggressive Growth	95% / 5%	*Cumulative*	11.4%	3.2%	31.3%	33.8%
		Annualized		3.2%	9.5%	6.0%

The index returns reflect returns of various mutual fund averages compiled by Morningstar and allocated as follows: Capital Preservation: 90% Bond Average, 10% Treasury Bill Index; Income: 80% Bond, 10% Large Cap, 3% Mid Cap, 2% Small Cap, 5% International; Balanced Conservative: 65% Bond, 15% Large Cap, 5% Mid Cap, 3% Small Cap, 7% International; Balanced: 50% Bond, 24% Large Cap, 7% Mid Cap, 4% Small Cap, 10% International; Balanced Growth: 35% Bond, 30% Large Cap, 9% Mid Cap, 6% Small Cap, 15% International; Growth: 20% Bond, 38% Large Cap, 12% Mid Cap, 8% Small Cap, 17% International; Aggressive Growth: 10% Bond, 40% Large Cap, 15% Mid Cap, 10% Small Cap, 20% International. You cannot invest in these indexes or averages and all above indexes/averages include a 5% allocation to the Treasury Bill Index, reflecting a nominal level of cash. The level of diversification represented by these benchmark averages may be materially different than actual client accounts; therefore, clients may experienced different levels of performance volatility. Past performance is no guarantee of future results.

GROWTH VS. VALUE: The charts to the right show how much stronger growth–styles are running relative to value. The strength is evident not just in the recent quarter, but especially so throughout the 10-year bull market. As a result of this persistent strength, growth styles appear more "expensive" and vulnerable than value-counterparts.

1Q 2019

	Value	Blend	Growth
Large	11.9%	13.6%	16.1%
Mid	14.4%	16.5%	19.6%
Small	11.9%	14.6%	17.1%

Since market low (March 2009)

	Value	Blend	Growth
Large	366.8%	417.3%	484.3%
Mid	458.8%	472.2%	499.3%
Small	369.5%	415.0%	460.4%

SELECTED MUTUAL FUNDS - TOTAL RETURN PERFORMANCE SUMMARY

As of March 31, 2019

BOND FUNDS - TAXABLE	STYLE	1ST QTR	12 MTHS	3 YEARS	5 YEARS
Taxable Short-Term Bond Average		*1.7%*	*3.0%*	*1.9%*	*1.5%*
Taxable Intermediate Bond Average		*3.1%*	*4.0%*	*2.4%*	*2.5%*
Wells Fargo Ultra Short	AS	1.3%	2.6%	1.6%	1.1%
AC Alternatives Market Neutral Value	AS	-2.3%	-3.0%	-0.8%	1.2%
Vanguard Short Federal	HS	1.3%	3.0%	1.1%	1.2%
American Century Short Duration	HS	1.5%	2.9%	1.8%	1.5%
Pioneer Short-Term Income	HS	1.4%	2.8%	1.9%	1.5%
PIMCO Low Duration	HS	1.5%	2.2%	1.8%	1.4%
Vanguard Short-Term Investment Grade	HS	2.2%	3.6%	2.0%	2.0%
American Century GNMA Income	HI	2.1%	3.8%	1.1%	1.8%
Diamond Hill Corporate Credit	LI	5.7%	5.6%	7.3%	5.3%
Miller Convertible	LI	5.3%	-1.5%	5.1%	2.8%
BOND FUNDS - TAX EXEMPT					
Tax-Free Intermediate Bond Average		*2.7%*	*4.5%*	*2.1%*	*3.0%*
Vanguard Muni Limited Term	HS	1.5%	3.3%	1.4%	1.5%
T. Rowe Price Tax Free S/I	HS	1.5%	3.0%	1.1%	1.3%
Vanguard Muni Intermediate Term	HI	2.6%	5.1%	2.3%	3.2%
Vanguard Ohio Long-Term	HL	3.0%	5.5%	3.1%	4.4%
STOCK FUNDS - DOMESTIC					
S&P 500 Index		*13.7%*	*9.5%*	*13.5%*	*10.9%*
Equity Fund Average (Morningstar Mgr Agg US Core EW)		*13.7%*	*3.5%*	*11.3%*	*7.5%*
Schwab Large Cap Growth	LG	15.5%	12.1%	16.1%	12.2%
Parnassus Endeavor	LG	18.4%	5.1%	13.9%	12.2%
T.Rowe Price Dividend Growth	LV	13.0%	12.6%	13.4%	11.0%
WisdomTree US Quality Dividend Growth	LV	12.9%	9.3%	13.7%	11.4%
American Century Equity Income	LV	10.5%	9.1%	10.5%	9.4%
Goldman Sachs US Equity Dividend & Premium	LV	11.6%	6.1%	9.4%	8.6%
Hennessy Focus	MG	13.9%	4.5%	8.5%	8.5%
John Hancock Multifactor Mid-Cap	MB	15.4%	4.1%	11.9%	N/A
John Hancock Disciplined Value Mid-Cap	MV	13.5%	-3.0%	8.6%	7.3%
SPDR S&P600 Small Cap Growth	SG	10.8%	3.7%	14.0%	9.6%
Neuberger & Berman Genesis	SB	15.0%	6.6%	13.0%	8.2%
Diamond Hill Small-Cap	SV	9.8%	-5.8%	5.4%	3.1%
SPDR S&P600 Small Cap Value	SV	12.4%	-0.5%	10.9%	7.1%
Wells Fargo Small-Cap Value	SV	12.3%	-7.0%	9.3%	3.3%
STOCK FUNDS - INTERNATIONAL					
Morgan Stanley EAFE Index (Foreign)		*10.0%*	*-3.7%*	*7.3%*	*2.3%*
Oakmark International	LV	9.0%	-14.1%	6.4%	1.1%
Schwab Fundamental International Index	LV	9.0%	-4.3%	8.0%	1.9%
John Hancock International Growth	LG	13.2%	-3.7%	9.6%	6.6%
Thornburg Developing World	LG	14.6%	-2.2%	9.3%	2.1%
Harding Loevner International Small Company	SG	13.5%	-7.7%	8.1%	3.7%
Hennessy Japan	LB	7.3%	-1.1%	13.5%	12.2%
STOCK FUNDS - SPECIALTY					
Salient-Forward Select Income (REIT)	MV	12.0%	9.3%	4.8%	4.8%
Neuberger Berman Real Estate Securities	MV	17.2%	17.5%	7.0%	8.8%

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10268 Sawmill Parkway
Powell, Ohio 43065
Ph: 614.389.4646
Email: info@nvestwealth.com

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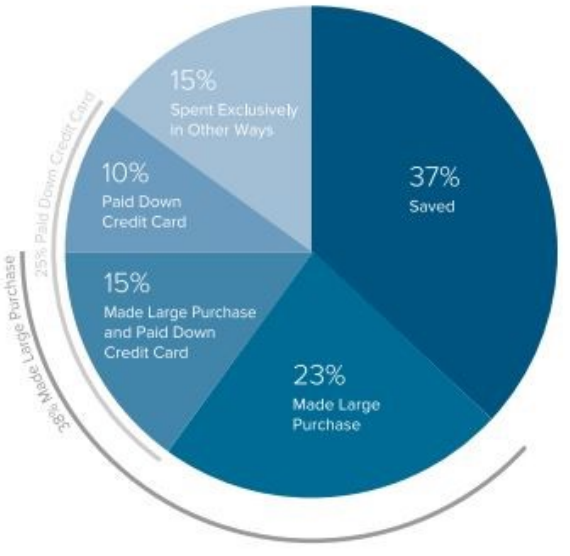
EXCITED ABOUT THAT TAX REFUND? THINK AGAIN!

Steve Henderly, CFA, Nvest Wealth Strategies, Inc.

Another tax filing season is quickly drawing to a close, and for many people that means the anticipation of a sizable refund headed their way. The IRS indicates that about 80% of taxpayers receive a refund, with the average being around $3,000. That's a nice chunk of cash! What's not to be excited about?

The reality is that a refund means you withheld more from paychecks or income sources than needed and provided our government with an interest free loan. The fact that so many people are accustomed to and count on a refund because it occurs year after year is where an opportunity to create better financial habits exists.

There are really 3 broad categories of how money from tax refunds can be used: it can be saved, spent, or used to pay down debt. According to a study by HelloWallet (link) – an application to help individuals track their household finances – only about one-third of taxpayers save their refunds. Instead, of those who received a tax refund, their average credit card bill spiked by $2,000 in the month after receipt of a tax refund. This implies that many people are viewing tax refunds as a "license to spend" more than they otherwise would, and/or view tax refunds as "free money".



Source: Author's analysis of HelloWallet data.

For those who view the refund as a method to payoff high interest debt (about 25% of users paid down credit card debt), that is a more financially prudent decision than frivolous spending. But, there is also strong evidence that the credit card balance would not have been accumulated in the first place if the taxpayer was withholding at a lesser rate resulting in a smaller refund. These people would be better to receive more of their paycheck and avoid accumulating high-interest debt throughout the year.

All things considered, a strong argument can be made that our current tax refund pattern/system (and the way many view it) is a hindrance to Americans' ability to achieve financial goals. The study's observation that refunds were rapidly spent instead of saved or used to pay down credit card debt, means that many households are worse off than if they were appropriately adjusting their tax withholding throughout the year.

When working with clients in our "Living Life" financial planning process, the topic of tax refunds will often arise. We advocate individuals who are accustomed to receiving a significant tax refund each year to revisit their withholding and manually adjust the amount to better reflect what is their typical full-year tax liability. For example, if one is receiving a refund each year of around $2,400, it means they could be withholding $200 less from each month's paycheck by specifying a dollar amount rather than using standard exemptions. This approach can be more challenging for those who receive a significant portion of their compensation through variable commissions, etc.

What should one do with the extra tax savings? Our most beneficial allocation ideas are to begin creating and enhancing your personal investment savings; increase your 401k withholding, or contribute to an HSA. Reducing the amount you are loaning to Uncle Sam each month can greatly enhance both your current and long-term financial health and flexibility.