TILIA NEWS

INVESTMENT MANAGEMENT | FIDUCIARY ADVICE | RETIREMENT PLANNING

Tilia Welcomes a New Advisory Board Member

Tilia is extremely proud to announce that we've added Caroline Montgomery to our Advisory Board. Caroline is an experienced CPA as well as Partner and Tax Manager at Adam Shay CPA, PLLC.

Caroline has an impressive background. She earned both her undergraduate and master's degrees in Accounting from East Carolina University. Though she is younger than her experience implies, Caroline has well over a decade of experience in public accounting. After joining her current firm in 2015, she quickly rose to a leadership position and eventually became the first non-founder partner at the firm in less than 4 years.

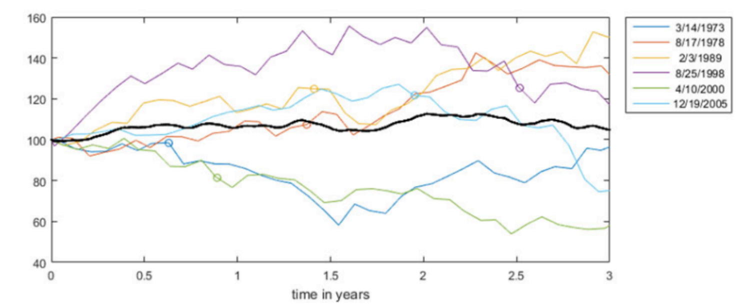
More than her background, what has impressed us about Caroline is her ability to see the bigger picture where taxes & investments collide. Caroline recognizes the need for a coordinated approach to tax & investment planning as well as the hurdles involved. She has a great work ethic, and has demonstrated that she truly understands how to provide high level client service. She also serves as the Treasurer of one of our favorite local non-profits - NourishNC.

Caroline understands what we are trying to achieve with our clients and the growth of Tilia. Her leadership experience with a fast-growing firm, her broad knowledge base of accounting & her grasp of client service all make her an excellent addition to the board!

Recession Risks Are Rising - Why It Still Makes Sense to Own Stocks

Financial markets have faced renewed uneasiness over the last few weeks. Headlines have focused on the "yield-curve inversion" that occured recently in the U.S. government bond market. Yield curve inversion means that investors are willing to accept a lower interest rate on safe bond investments in order to lock that rate in for longer. In this case, 2-year U.S. Treasury bonds are paying 1.75% while 10-year U.S. Treasury bonds are only paying 1.6%. A reasonable person may ask "what's the big deal?" It matters because every recession over the past 50 years has been preceded by a yield-curve inversion and that "signal" has been correct 7 out of 8 times over that time period. In the cases where a recession did occur, it took 6 months to 2.5 years for it to start, with the average being around 18 months.

This time could very well be different & become the 2nd false signal over the last 5 decades. But let's assume that this time is not different. Should investors sell stocks and avoid the inevitable downturn? Historically, the answer to that question has generally been "no." Here is a look at the performance of the U.S. stock market following the last 6 yield curve inversions:



Relative level of the MSCI USA index each month after a 1-year/5-year CMT inversion, scaled so that the value at the start of the inversion is 100. The initial inversion dates are shown in the legend. The mean path is shown in black. The start of every recession is marked with a circle.

On average, U.S. stocks have exhibited positive total performance over the 3 years following the inversion. Recency bias clouds our brains with the market downturns of 2000-2002 & 2008-2009. It is important to remember that both were accompanied by historic excess - 2000 was the tail-end of the Tech Bubble and was exacerbated by 9/11. 2008 was a major financial crisis caused by a housing bubble, years of easy credit, and over-exposed banks. While we have some issues in 2019 (large student debt load, rising consumer debt, trade barriers), there is nothing that currently stands out as potentially catastrophic to the economy or the financial markets.

Social Security

At Tilia we're often asked, "how do I maximize my social security benefits?" The answer is particular to your specific life circumstances.

Social Security benefits, paid monthly in retirement, are calculated based on your (or your spouse's) 35 highest-earning years. With at least 10 years of work history, you may file for benefits as early as age 62 and late as 70, with the "full" retirement benefit generally paid at age 67.

While many factors influence your benefit - life expectancy, outside income, lifetime earnings, cost of living adjustments, etc - we believe the most important (and controllable) factor is deciding when to claim it. Typically, this occurs when you have stopped full-time work and require retirement income.

If a retiree elects to receive benefits as early as possible, age 62, the payment is reduced by approximately 28% for life vs. full retirement. If the retiree instead waits until age 70, payments are 28% higher than full retirement age and 76% higher than the age 62 benefit. However, the increased payment per benefit check must be weighed against fewer total lifetime benefit checks.

A retiree who lives beyond 78 years receives higher lifetime payments by waiting until full retirement age versus 62. If the retiree lives beyond age 82, claiming social security at age 70 will result in higher lifetime payments relative to claiming at full retirement. We rarely recommend waiting past full retirement age. 9 out of 10 times, we'd recommend starting social security at full retirement age, and investing the benefit if you are still working. By electing to take the benefit and investing it, you mitigate your own mortality risk and in most cases you'll more than make up for the increased monthly payment that comes from waiting longer.

When the time comes to make the decision, Tilia can help you figure out what makes the most sense for you and your family.

The list of reasons we continue to hold a favorable view of stocks is long:

1) Interest rates are already ultra-low & trending lower - this makes the alternative (bonds & cash) an unattractive option for investors. In 2000 & 2008, nervous investors could move money into bonds & earn 5 - 7%. Now that number is closer to 2 - 2.5%. This also makes it cheaper for consumers to buy houses & other long-term assets, and lowers borrowing costs for the government & corporations.

2) The dividend-yield from large U.S. stocks is higher than a 10-year government bond rate, which is extremely rare. While the 10 year bond promises to pay investors 1.6% per year, the S&P 500 has a dividend yield of 1.82%. The bond pays a fixed level of interest for 10 years, while the dividend is likely to rise considerably over that time. S&P 500 corporations pay out ~ 35% of earnings as dividends, leaving plenty of room for increases, even if earnings growth stagnates.

3) Overall valuations are not excessive relative to the last 2 decades. Compared to the average 12 month trailing Price/Earnings ratio on January 1st of each calendar year, current valuations are ~13% lower.

4) Market catastrophies tend to occur after greed has taken over & investors are euphoric. The churn in the broad market over the last 18 months, the depressed valuation of emerging market stocks & the relentless bidding-up of conservative bonds shows plenty of market pessimism.

5) Stocks are one of the few assets that have historically protected investors against inflation. With global interest rates approaching zero, inflation is a long-term risk that no one seems to be anticipating, despite the fact that it has persisted throughout modern history.

6) Corporate earnings growth has been steady. Consensus projections for 2020 are for 11.5% year-over-year growth. While that may prove to be too optimistic, a 50% cut to that estimate would still represent meaningful improvement over 2019 & would support rising stock prices.

7) Consumer spending remains strong, as shown by recent quarterly results from Wal-Mart, Target, Lowe's & Home Depot, among others.

We are currently in the annual process of updating our "core portfolio" that guides our individual stock holdings for investor accounts. Along with the other metrics we look for in potential investments, we've increased our focus on how well these stocks held up during the last recession. While the next recession will be different from the last, we feel the global financial crisis serves as a good "stress-test" for our investments.

While the current environment warrants caution, there is a good chance that the headlines of the day will fade & optimism will return to financial markets. Investors that get scared out of stocks face a high probability of watching the market rise from the sidelines. Stocks will continue to rise & fall in ways that surprise even the most astute market observers. Sticking to a reasonable allocation of stocks, bonds & cash while keeping your personal balance sheet in a strong position is the surest path we know to weathering market storms and growing wealth over time.

Sources:
ssa.gov
https://www.msci.com/www/blog-posts/what-yield-curve-inversions/01309865880
https://www.multpl.com/s-p-500-pe-ratio/table/by-year