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Resolute Connections

In this month's newsletter, *Market Lessons Since 2000* reviews each of the most recent bull and bear market, how each is different, and whether what worked in the past will work in the future; something to consider as we enter the 11th year of the current bull market.

The Truth About Recessions takes a look at the past 65 years of economic expansions, and recessions to find the U.S. has experienced an official recession for around 15% of all months, while at the same time we can reasonably expect that the subsequent recovery will be longer and steeper than the downturn. Which raises the question - can one effectively navigate the natural economic boom and bust?

Beware of Forecasters examines the core of the financial press, the prognosticators and pundits that fill the airwaves and printed media with their forecast. What it finds is that we are better off ignoring those claiming to have a crystal ball, and to view the financial press with the skeptical eye it deserves.

Debt Reduction Options concerns a topic that doesn't seem to be part of the political discourse these days: the U.S. national debt which is exploding. And it offers up a few solutions that one might want to factor into future plans – higher taxes which could put a crimp in retirement plans.

If you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

Market Lessons Since 2000

Remember the "lost decade" of the aughts (total return of -2% for US stocks)? It was followed by the longest bull market in history (247% total return in stocks). The century began with a belief that we were in a new era where cash flow no longer mattered, where internet companies with little revenue had valuations in the tens of billions of dollars. Critics were scolded for their old-school thinking. The result: U.S. stocks peaked on March 24, 2000 and quickly plunged by 50%. High-quality bonds, REITs and precious metals did well during this bear market.

After that, stocks soared to new heights, this time driven by real estate. The mistaken assumption this time was that if people defaulted on their mortgages, the paper was secured by real assets, and real estate always goes up in value. Between October 2002 and March 2007, U.S. stocks gained 133% and international stocks gained 240%. The subsequent decline—U.S. stocks falling 55% and internationals falling 60%—was about the same as before, but the burst was about twice as fast as the previous bubble. Meanwhile, REITs and precious metals also failed miserably as diversifiers in this plunge. High-quality bonds gained 81% as rates dropped.

On March 9, 2009, the longest bull market in U.S. history began. U.S. stocks gained 491.6%, international stocks gained 199.8% and investment-grade U.S. bonds gained 51.9% over the course of the decade.

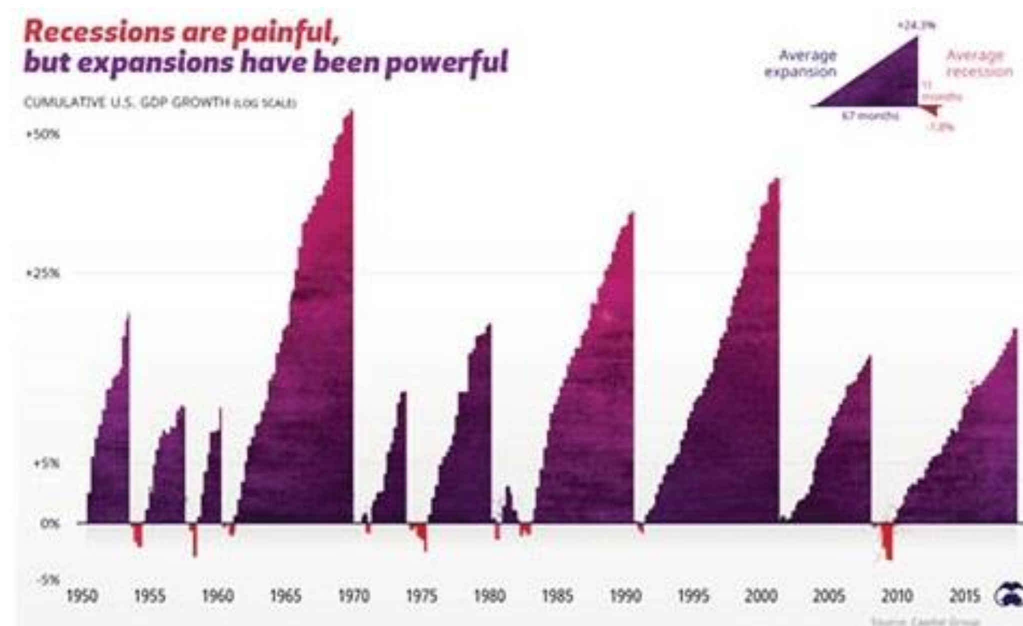
The key lessons here were drawn out in a perceptive article by advisor Allan Roth: Every bull and bear market is different; what worked in the past may not work in the future. Bubbles are easy to spot in hindsight, but not so much at the time (Are we in one now?) The next two decades will be just as emotional as the last two; there will be turbulence, so hold on tight.

The Truth About Recessions

You know that a recession is coming, though the day and the hour is unknown even to the savviest and information-infused economists. So, it makes sense to get out of the way now, before it hits—right?

If that's how you think, then you may be in danger of missing out on far more upside than the downside you'd be avoiding. A recent study by the Capital Group fund complex examined the size and duration of U.S. GDP expansions vs. contractions since 1950, and found (see graph) that, on average, expansions added 24.3% growth to the economy over (again on average) 67-month periods. The contractions were painful, but they only resulted in a loss of 1.8% of GDP, and lasted, on average, just 11 months. In other words, if we believe in past experience, the economy has tended to expand much longer and steeper than it has contracted.

You can see from the graph that not all recessions and expansions were the same. The contraction that began in 2008 (the read dip toward the right of the graph) was especially painful compared with the eight other recessions that Americans have experienced in the past 65 years. And recessions tend to cause a lot of pain while they last: they reduce income, industrial production and retail sales, and cause rising unemployment. The stock market is especially averse to recessions; you often find bear markets associated with recessions.



But what stands out in this graphical portrayal of economic growth vs. contraction is the much greater size of the expansions: the purple mounds greatly exceed in size and duration any of the contractions that we've experienced. In all, over the past six and a half decade, the U.S. has experienced an official recession for around 15% of all

months—and you know that it will again, sooner or later. But perhaps we can also reasonably expect that the subsequent recovery will be longer and steeper than the downturn. The economy and the markets can be thought of as a rollercoaster that tends to rise more often than it falls.

Beware of Forecasters

Every year, we hear from market prognosticators telling us where the market will be a year from now, the future direction of interest rates and when the economy will or won't enter into a recession. But does anybody ever keep track of the accuracy of these forecasts?

A recent article cites a March 2017 study covering 6,627 market forecasts on the S&P 500 index, made by 68 forecasters who employed technical, fundamental and sentiment indicators, for the period 1998 through 2012. They found that the overall accuracy rate was 48%, just below the accuracy of a coin flip. Two-thirds of the forecasters had accuracy scores below 50%. The highest accuracy score was 78%; the lowest was 17%, and, when graphed, the distribution of the forecasting accuracy looked very much like the common bell curve, which one would expect from random processes. Loosely translated, the conclusion of the article was that there was no evidence whatsoever of forecasting skill.

So why isn't the media looking back at how well its gurus forecast the future? The article suggests that if they did, the game would be over, and the papers and financial media would have to stop running these tantalizing visions of the future—and probably lose viewers and readers. So, they continue to play a very cynical game.

The article then focuses financial writer and market analyst John Mauldin, whose website states that he is privy to the smartest thinkers in the marketplace, screened and analyzed "by a team of ace analysts," which "gives you the equivalent of direct access... to some of the bright minds and most successful managers in the world today." Mauldin finished 36th in the aforementioned study, just behind CNBC's Jim Cramer, who was 37th. The article asks whether Mauldin's published five-year

forecasts, offered to his readers five years ago, would have given them an edge in their investment activities.

Mauldin predicted a major slide in the Japanese yen to the U.S. dollar, which he said was "almost certain," with a 90% probability. Actual result: the yen increased nine percentage points against the dollar. Mauldin predicted that Europe would experience a crisis at least as severe as the Grexit scare, with a run-up in interest rates and a sovereign debt scare in the peripheral countries—again a 90% probability. Actual result: the MSCI Europe Index returned about 5% a year over the past five years, and interest rates have stayed at historically low levels.

Mauldin also predicted that China would experience a "hard landing" or "recession"—a 70% probability—and then China would suffer a long period of Japanese-style stagnation—a 95% probability. Actual result: China's GDP growth did slow somewhat, but where was the hard landing or period of stagnation? Mauldin forecast a series of crises in emerging market countries, potentially setting off a Long-Term Capital Management-style global financial shock—an 80-90% probability. Actual result: no emerging market debt crisis.

Finally: Mauldin predicted a continuation of the secular bear market in U.S. stocks that began in 1999. Actual result - the S&P 500 index provided a compound return of 11.7% over the five-year period, with a total return of about 74%.

If you needed it, this article will help you be skeptical of any experts, with their teams of researchers, who claim that they also have a crystal ball.

Debt Reduction Options

You probably know that the U.S. national debt is exploding, but if you don't, try looking at the U.S. debt clock (https://usdebtclock.org/) which shows how high our national debt is every second (currently $23.2 trillion and counting). Our federal budget deficit will exceed $1 trillion this year. The clock says that the federal debt per individual taxpayer is $187,632—and rising. (The clock also calculates interest paid,

debt per citizen, debt per family, mortgage debt, gross domestic product and a lot of other interesting things.)

Sooner or later, our federal debt will have to be paid back—or, at least, we will have to reduce the annual deficit to more manageable numbers. The question is: how? A recent article looked at different options that politicians will eventually have to consider.

One is a new inheritance tax. You probably know that the first $11.58 million of a deceased person's wealth is now exempt from federal estate taxes, which means that very few people will pay any estate taxes at all—today. The article says that if we moved the exemption threshold down to $2.5 million, the government would raise an estimated $34 billion more a year. At a lower threshold of $1 million, taxes collected would go up by $92 billion.

The article considers the wealth tax, which is favored by Democratic presidential candidates Bernie Sanders and Elizabeth Warren. The Hamilton Project has proposed four types of wealth taxes, which would tax people with wealth ranging from a low of $8.25 million to taxes that would start at a net worth of $25 million. Each of the wealth tax options would raise approximately $300 billion a year.

Another possibility is a value-added tax—a tax levied at various levels of production for goods and services. This, of course, is popular in most developed nations, and it causes prices to rise for consumers. A 10% VAT would raise around $1 trillion a year—which might conceivably reduce our annual debt to $0.

A final possibility is a financial transaction tax, which would put a 0.1% fee on all trades of stocks, bonds and derivatives. This would raise costs for investors, but it might, if implemented, raise government revenues by $60 billion a year.

The article also talks about raising corporate taxes, but the problem there is that you would have to get tax havens like Ireland and Luxembourg to go along. Otherwise, companies would set up shop in those lower-tax countries (many have already) and avoid the higher U.S. rates. It might be possible to raise the highest corporate tax rate from 21% (today) to 25% or 28% and not cause corporations to create offshore tax

solutions. This would raise an additional $110 billion per year, and might also boost economic growth and stimulate investment.

The point of the article is that some form of additional taxation is coming. What the article doesn't say is that raising today's personal income tax rates (particularly on the higher end) will probably be the first thing our next President and Congress consider.

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