EISNERAMPER
WEALTH MANAGEMENT
CORPORATE BENEFITS

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INVESTOR INSIGHTS – SECOND QUARTER 2022

Future Returns

Equities

The last two newsletters urged caution in asset allocation because of the overpriced nature of equities. What we warned was that future returns would be minimal because the price of equities relative to any measure was as high as it had ever been. Future equity returns following high prices are low. For example, equity valuations were high at the end of 1999, and the following decade saw an annualized return rate of -0.95%. What this meant was that by investing in the S&P 500 from 2000-2009, one had less money even after dividends than they did at the beginning of the decade. For every dollar invested at the beginning of the decade, 90 cents were left by the end of the decade. This meant no one achieved their investment objectives by investing in the S&P 500 during the 2000s.

Unfortunately, we find ourselves in a similar position today. Future returns for equity strategies dependent principally on price appreciation look dismal. Research Affiliates makes projections of many asset classes ten years out. Their current projection of the total return on U.S. Large Cap stocks is -0.70%, almost identical to the returns the index experienced in the decade of the 2000s. Now it is important to say that we should not take that exact projected return literally, it is not meant to be an absolute projection. We think of it as a warning. It is telling us what we have said in our last two newsletters; stock price valuations are high, future returns will be low and we need to be cautious.

Fortunately, we have some data on returns when we had similar valuations. At the end of 1999, domestic stock valuations were higher than we had ever seen them up to that point, and there was talk of one decision stocks, stocks you buy and hold but never sell. The following decade provided investors an environment of extreme volatility, twice the S&P 500 declined 37%, 2000-2002 and 2008. While all investors can accept some level of volatility, because they believe volatility is a necessary part of equity investing, the expectation of investors is they will achieve returns that are reasonable. A return of -0.95% was not what any investors had in mind when investing in 2000.

During the decade of the 2000s, our dividend strategy compounded at 7.7%. We began the decade with a 4% dividend yield and saw dividend increases during the decade of approximately 7%. This cash flow accounted for most of the return during the decade. Today the dividend yield on our portfolio is 3.5%. If we get similar dividend growth, we can expect a return of slightly less than the 7.7% of the 2000s. The key issue is our dividend strategy will meet the investment return needs of our clients, and even active strategies that are dependent primarily of price appreciation will struggle.

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Now some analysts will counter this argument by pointing to the returns of the last 3 years. An investment in domestic equities using the S&P 500 for 2019-2021 saw a double in total return. So, before tax, $1 invested on January 1, 2019 was worth $2 at the end 2021. By any standard, that is a fabulous return. In fact, it is so fabulous that it only occurred one other time since we have kept records on domestic returns. The other time was any sequential 3-year period from 1995-1999. It did not occur in the Roaring 20's, during the period when the Nifty Fifty was in its run or any other period. Now, we know critics of this caution and will say this time is different. They will say we have new technology and great companies that are changing our lives. We agree on the great companies that are changing our lives, but we disagree on the implication that price relative of these companies will remain high. Look at the great companies of the late 1990s, some of them are doing well as a business but still have a price at or below their peak over 20 years ago.

So, caution is our advice. We believe the cash flow from our dividend portfolios will be sufficient to meet the investment needs of our clients, but we also believe we will experience volatility. Commitment to this strategy will be tested, just as it was tested in 2008 when the general market declined 37% and our portfolios declined 22%. Is this what we expect to happen? We have no insights into the future, but we do have a good knowledge of history. You will see reports that the bear market is over, actually the Wall Street Journal had one on the last day of March. Do not believe it. Markets do not go straight up or straight down; they test our resolve. This market will, as well. Today we have inflation, a war in Ukraine and a global economy that looks perilous. These are not the investment conditions in which you would want to be aggressive with your portfolio; they are conditions in which we should we defensive. Be ready for the markets to test your resolve.

Bob Farrell's Investing Rules

Bob was the Chief Investment Strategist for Merrill Lynch, started his career in 1957 and worked on Wall Street for over 50 years. He is a legend on Wall Street and along the way he posted his top 10 rules for investing. They have been widely followed since they were first published. We think they offer a good reflection on how to think about investments as we move forward. They are as follows:

1. Markets tend to return to the mean over time.
2. Excesses in one direction will lead to an opposite excess in the other direction.
3. There are no new eras—excesses are never permanent.
4. Exponential rapidly rising or falling markets usually go farther than you think, but they do not correct by going sideways.
5. The public buys the most at the top and the least at the bottom.
6. Fear and greed are stronger than long-term resolve.

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7. Markets are strongest when they are broad and weakest when they narrow to a handful of blue-chip names.
8. Bear markets have three stages: sharp down, reflexive rebound, and a drawn-out fundamental downtrend.
9. When all the experts and forecasts agree, something else is going to happen.
10. Bull markets are more fun than bear markets.

Today, perhaps more than at any point in history other than 1999, these rules are important to understand and to review as we think about how we invest. Today, both the stock and bond markets are overpriced and project very low future returns. You can also expect higher volatility than normal if history is our guide. We think we are in the first phase described in Rule #8. Our advice is to think of everything you read through that filter.

Fixed Income

We have said this many times in many different ways: be cautious on bond market. You may not achieve the investment return needs by investing just in bonds. The current yield on the 10-Year U.S. Treasury is 2.35%. It is impossible to find any analyst who holds the position that interest will decline from here. Some analysts think we will have transitory inflation while others think it will be with us longer. It does not matter which camp you are in on this topic. If rates rise and then decline quickly, as some analysts are suggesting, then markets would be telling us to expect low growth in company earnings. Yes, it would also tell us to expect low inflation, but low growth results in low equity returns and low P/Es. If, however, we get inflation for a longer period, both bonds and stocks are very likely to see red ink. Inflationary times have not been great times for achieving good investment returns.

So, what do we do?

- *Stay focus on your investment game plan*
  When investors look at quarterly returns today, many may be concerned. It is important to stay focus on the investment objective and financial plan we built out through the Advocacy Process™ . While our portfolios are doing well on a relative basis, the equity and bond markets are down.
- *Make portfolios defensive*
  If your portfolios are not defensive, consider investing in our dividend strategies along with tactical management strategies.
- *Incorporate a small amount with Disruptive Technology strategy*
  Today, there is not a rush to add Disruptive Technology strategy to portfolios, but there will be down the road. If we are right and the stock market is down another 25% sometime this year, The disruptive technology portfolios will likely be down more. While we believe there may be a general re-evaluation of tech and disruptive stocks lower, the method the Disruptive Technology manager uses of looking out 5 years will result in high returns over that period and buying at a low point will be rewarding.

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- *Be cautious as we wait for other opportunities*
  It is natural for you to get anxious for new opportunities. We may experience low or even slightly negative returns for some time. This is an unfortunate reality of thoughtful investing. Patience is the virtue you will need to get through this period as it has been in other periods. While it is true that some corrections have come quickly like March of 2020, there have been long, slow slides like 2000-2002. Be prepared for the long slow slide and be ready to react if we get a quick decline. No one can help you find the bottom, but we can help with patience and finding a reasonable valuation level.

April 2022

As always, information provided should be considered based on your personal needs to accomplish your goals. At EisnerAmper, we will be happy to discuss with you any questions and how these principals can be applied to meeting your financial plan. Feel free to contact Marc Scudillo, Managing Partner of EisnerAmper Wealth Management & Corporate Benefits, LLC; 908-429-0025 or email at mscudillo@eawmcb.com.

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