THE GORTON
WEALTH MANAGEMENT GROUP
of Wells Fargo Advisors

2019 Annual Review

January 2020

An update of performance, trends, research, and topics for the long-term investor

Relevant rates of return a/o 12/31/2019 vs.		**2018**
Russell 1000® Growth Index: Stocks within this index include: Amazon, Facebook, Google (Alphabet) Home Depot, Visa	+36.39	(-1.51%)
Russell 1000® Value Index: Stocks within this index include: Berkshire Hathaway B, Exxon Johnson & Johnson, JP Morgan	+26.54	(-8.27%)
Barclays US Agg Total Return Index:	+8.72	+0.01%
S&P 500 Index:	+28.88	(-6.24%)
Russell 2000® Value Index:	+22.39	(-12.86%)
MSCI ACWI® Index:	+27.30	(-8.93%)
CBOE S&P 500 BuyWrite Index (BXM):	+15.68	(-4.80%)
DJ Real Estate Price Index:	+24.13	(-8.00%)

Long Term Historic Returns, compounded annually (1970-2018)[1]

- Small Value +13.7%
- Large Value +10.3%
- Small Growth +9.0%
- Large Growth +8.5%

Growth and value stocks in this example are represented by the Ibbotson Associates Growth and Value Indexes for 1970–1997 and the Morningstar Style Indexes thereafter. Ibbotson Associates Growth and Value Indexes calculated based on data from CRSP US Stock Database and CRSP US Indices Database, Center for Research in Security Prices (CRSP®). The data assumes reinvestment of income and does not account for transaction costs or taxes.

Description of Indexes

An index is unmanaged and not available for direct investment.

S&P 500 Index - consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

Russell 1000 Growth Index - offers investors access to the large-cap growth segment of the US equity universe. The index is constructed to provide a comprehensive and unbiased barometer of the large-cap growth market. Based on ongoing empirical research of investment manager behavior, the methodology used to determine growth probability approximates the aggregate large-cap growth manager's opportunity set.

Russell 1000 Value Index - measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. These stocks are selected from the 1000 largest companies in the Russell 3000 Index.

DJ Real Estate Price Index - a capitalization-weighted, real-time index that provides a broad measure of the US real estate securities market.

CBOE S&P 500 BuyWrite Index (BXM) - a benchmark index designed to track the performance of a hypothetical buy-write strategy on the S&P 500 Index.

MSCI ACWI Index - based on the MSCI Global Investable Market Indexes Methodology, a comprehensive and consistent approach to index construction that allows for meaningful global views and cross regional comparisons across all market capitalization size, sector and style segments and combinations.

Russell 2000 Value Index - measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

Barclays US Agg Total Return Index - covers the USD-denominated, investment-grade, fixed rate, taxable bond market of SEC-registered securities. The index is composed of government and corporate securities, mortgage pass-through securities, and asset-backed securities.

"True Wealth is the ability to underwrite a meaningful life." —Brian Portnoy[2]

Putting it all in perspective

Michael Gorton, Managing Director - Investment Officer

First, I would like to count some of our blessings: I was recently doing some research and came upon the following data:

- Life expectancy
  - 1860: 35 years in Americas and Europe, 30 years for the world.[3]
    - This was so low due to the 25% rate of infant mortality.[3]
    - If you lived until age 10, then the life expectancy in Europe rose to 55 years.[3]
  - Life expectancy is now in the mid-70s with infant mortality at virtually 0.[3]
- Smog in the Los Angeles Basin (where I grew up)
  - Remember the 70s? The air particulates have dropped 70% since then and the number of days above the national air standard dropped from a high of 365 days to 5.[4]
- Education
  - World literacy and basic education have increased from 30% to 80% in the last 100 years.[5]
  - This is why the UK and US are no longer the dominant economies as the rest of the world catches up.
- Poverty
  - GDP per capita in the world has quadrupled since 1950.[6]
  - In 1965, approximately 60% of the world lived in poverty. No running water, no electricity, most not knowing where their next meal would come from. While the world population doubled, that same number dropped to 10%.[7]

We have made progress. Is it perfect? No. Can we do better? Yes. True, some folks fall through the cracks, but when you look at the long-term perspective, it is amazing how far we have come.

The year in review—Unlike last year, U.S. stocks advanced in December, closing out their best annual performance since 2013, due to easing trade tensions and clarity from the Federal Reserve. Technology was the only sector to meaningfully beat the S&P 500. Most markets were strong last year, it is just how strong they were...(see table on page 1). There were no bad places to be, just less better.... Again, Growth beat Value.... The markets are starting to feel a lot like the late 90s with the Index funds outperforming as they get more and more concentrated in the top 5 biggest/most popular companies. That said, they have come nowhere close to the earnings multiple bubble of that time period.

However, recall that the strong 2019 was preceded by the sharp drop at the end of last year and a weak year for returns in 2018. In 2018, the broad market, as measured by the total world index (MSCI ACWI®), was down 8.93%. So if you combine 2018 and 2019, that same index (up 27.3% in 2019) is up an average of 9.2% per year over the last two years. I am not sure that catapults us into bubble territory...

Consensus is somewhere between usually and always wrong, so the question is: will it be better or worse than consensus?

- Consensus is for 1.8% GDP Growth[8] and earnings +4.7% (range of negative to +10%).[9]
- So, will we be a lot worse, a little worse, a little better, or a lot better?
  - Stock Mutual Fund flow through the 3rd quarter was negative at -$18 billion.[10]
  - Money market funds which were steady at about $3 trillion rose to $4 trillion last year through the 3rd quarter.[10]
- China trade more settled. Matthews Inv. Management (a fund company that invests solely in Asia with a China/Asia perspective) believes conditions could bump our GDP to 3.5% as we move through next year. This may drive a higher earnings number and could lead to a strong market in 2020.
- Trying to filter out the noise is the toughest part of investing. But, when the noise is negative, it is usually a good time to invest. So, although I don't predict markets, I can make a case for a double digit return next year (much better than consensus). Of course many things could derail this prognosis, i.e. election, world economic downturn, China trade deal unraveling, etc...

Don't Sabotage your portfolio:

- Trying to guess market cycles is futile. Many people attempt, but few, if any, are successful in the long term.
- Don't listen to the news.
  - When markets are going through a rough patch, the media will typically sensationalize to get your attention and sell advertising. This is designed to make you feel bad and raise your emotional barometer. When the markets are going through a good spell, the opposite will happen.
  - This will influence your "gut" to Buy High and Sell Low, obviously not good for long-term returns.
- Don't look at your account every minute, every hour, or even every day. It magnifies your emotion to do the wrong thing at the wrong time. A study confirmed that most people get less pleasure from a positive market than the pain they experience from a down market. Every year, the market is roughly up ½ of the days and down ½ of the days +/- 20.[11] So, if you look at the market every day, there is a greater chance you will feel more pain than pleasure. In contrast, if you look at it every decade (I suggest you look more often), and we experience 7 or 8 up years and 2 down years, you will feel more pleasure than pain. This is the long-term outlook for investing....
- Typically there are one or two corrections every decade, coupled with 7 or 8 good years that have historically outweighed the bad ones. Invest to take advantage of the good years, don't be frightful of the bad ones. Take them like medicine.
  - Have an asset allocation that is right for you in both up and down markets, as we will experience both.
  - Be realistic about your emotional barometer in down markets and have a long-term allocation to compensate for that barometer. If necessary, accept lower long-term returns.
- Think of investing like a hitter in baseball. A good hitter bats .333—meaning he hits the ball safely 1/3 of the time and strikes out a few times along the way.
  - Goal of a mythical portfolio of 10 stocks: $10k in each stock = $100k total invested
    - 2 drop 50%, 5 stay the same (but we collect dividends), and 3 double during a market cycle.
    - 5k+5k+10k+10k+10k+10k+10k+20k+20k+20k = $120k or +20% plus dividends of 2.5% = an average annual return of 7-8% per year over a 3-5 year period.
      (Of course, this is a hypothetical portfolio not intended to reflect any particular investment and your results may differ).

- Too many people obsess over those two that are down and miss the big picture of what we are trying to accomplish, which is reasonable returns over time by taking reasonable risk.

- What we don't know and cannot predict: events/disasters cause market downturns. Here are some stats on how long it took the market (as measured by the S&P 500 Index) to recover after the event:
  - World Trade Center Bombing—2 days[12]
  - Oklahoma State Bombing—1 day[12]
  - World Trade Center Destroyed—17 days[12]
- So, try to own good quality companies that pay dividends and raise those dividends on a regular basis, coupled with good quality growth companies at a reasonable price that may not yet pay dividends. The more you own, the better chance of higher long-term returns.

This year the focus should be your goals, not only defining them, but prioritizing them. What is more important: i.e. a new car or retiring a year early? Paying for your grandchild's education or going on vacation?

What We Cannot Control

- The annual market returns
- The volatility of market returns
- The sequence of market returns
- The timing of unexpected cash flows
- The inflation rate
- Tax law changes
- Unexpected life events
- Health changes
- How long you live
- Social Security and Medicare changes

What We Can Control

- The age when you retire
- The amount you save annually
- Your retirement income
- Your annual vacation fund
- The amount you leave in your estate
- The risk in your portfolio
- What you donate to charity
- What you gift to your children
- Funding education

Please call to set up a time for your annual review. Our Job is to Provide a purpose-driven process using Probability Analysis. Are you still on Track? Have your Goals Changed? How are you doing vs. your "Plan?"

Our Envision planning process factors in and illustrates both the up and the down markets. We then try to provide guidance and adjustment through uncertainty helping you to accomplish your goals. We can do this in person or over the phone. Topics:

- *Envision® Plan (goals and objectives, what has changed?)*
- *Asset Allocation—stocks vs. bonds vs. cash and equivalents; is your allocation where you want it to be?*

I wish you all a Happy and prosperous New Year!

Michael Gorton

Managing Director – Investment Officer

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