Investments Group

January 22, 2025 at 1:30PM

Ron Reedy and Mike Flannery Co-chairs

In-person and Zoom Meeting This Month

Agenda

- ❖ Markets review
- ❖ Investment competition
- ❖ Valuation methods for stocks
- ❖ Role of dividends in retirement portfolio
- ❖ Review of recent interesting investments articles

Market Update – U.S. Equities

Index/Market/Stock	2024	2023	2022	2021
Total US Stock Market	23.8%	26.0%	-19.5%	25.7%
S&P 500	25.0%	26.3%	-18.2%	28.7%
S&P 500 Equal Weight	13.0%	13.8%	-11.5%	29.6%
NASDAQ 100	25.9%	54.4%	-32.4%	26.9%
Russell 2000	11.5%	15.1%	-21.5%	13.6%
S&P 500 Value Index	11.5%	22.2%	-5.2%	24.9%
S&P 500 Growth Index	35.8%	30.0%	-29.4%	32.0%

Note: returns/data from outside sources presumed to be reliable

Market Update – International Equities

Index/Market/Stock	2024	2023	2022	2021
Total International Stock Mkt (MSCI ACWI ex-USA)	5.5%	15.6%	-16.0%	7.8%
China (CSI 300)	14.5%	-12.3%	-25.7%	-3.3%
India (Nifty 50)	13.5%	17.4%	1.9%	22.4%
Europe (STOXX 600)	8.8%	11.3%	-11.8%	22.3%
Japan (NIKKEI 225)	21.3%	28.0%	-9.4%	22.6%

Note: returns/data from outside sources presumed to be reliable

Market Update – Topical/Commodities

Index/Market/Stock	2024	2023	2022	2021
Magnificent Seven (equal weighted)	64.0%	111.0%	-45.0%	
Nvidia	171.2%	239.0%	-50.0%	125.0%
Bitcoin	124.8%	164.3%	-64.9%	63.3%
Gold (COMEX)	26.0%	13.3%	0.6%	
PCE (at end of period)	2.8%	4.9%	5.3%	
Oil (WTI)	-3.0%	0.0%	0.0%	53.0%
Natural Gas (NYMEX near-month futures)	19%	-60%	22%	90%

Note: returns/data from outside sources presumed to be reliable

Market Update - Fixed Income

Index/Market/Stock	2024	2023	2022	2021
US T Bond 10-year return	1.2%	3.9%	-17.8%	
Bond Agg Index return	1.2%	5.7%	-13.0%	-1.8%
Intermediate Term Tax-Exempt (Bloomberg Muni 1-15)	0.9%			
Cash (3 mos T-bill) return	4.7%	5.1%	2.2%	
10 yr T yield (at end of period)	4.6%	3.9%	3.9%	1.5%
2 yr T yield (at end of period)	4.3%	4.2%	4.4%	0.73%
Fed Funds (at end of period)	4.3%	5.3%	4.3%	0.07%

Note: returns/data from outside sources presumed to be reliable

Friendly Investments Competition

How would each of you allocate a total of $100,000 to these asset classes to maximize overall return for 2025:

- Cash (Vanguard Federal Money Market Fund)
- Bonds (Bloomberg Float Adj Agg Index)
- International Stocks (MSCI ACWI ex-US)
- U.S. Stocks (S&P 500). Can also divide between S&P 500 Growth and S&P 500 Value and S&P 500 Equal Weight

Rules:

- $ investment by asset class due to Ron by 1/31
- Return period: full year 2025
- Will announce who is leading competition at each quarterly meeting
- Full year winner will be announced at January 2026 meeting

Note: Average returns by asset class (approx.):

- Last 20 years: Cash: 1.5%, Bonds: 3%, International Stocks: 5%, U.S. Stocks: 10%
- Last 10 years: Growth Stocks: 17%, Value Stocks 11%

Valuation Methods

- Fed Model (Ed Yardeni): Compares Earnings Yield (EPS divided by price) with bond yields
- CAPE (Yale's Robert Shiller): long-term Cyclically Adjusted Price Earnings measure
- Buffet Indicator

Valuation Methods

Fed Stock Valuation Model (FSVM)

Basis – Compares Stock Market Forward Earnings Yield (IBES*) to nominal yield on 10-year government bond.

E/P = Y(10) – Market is fairly valued

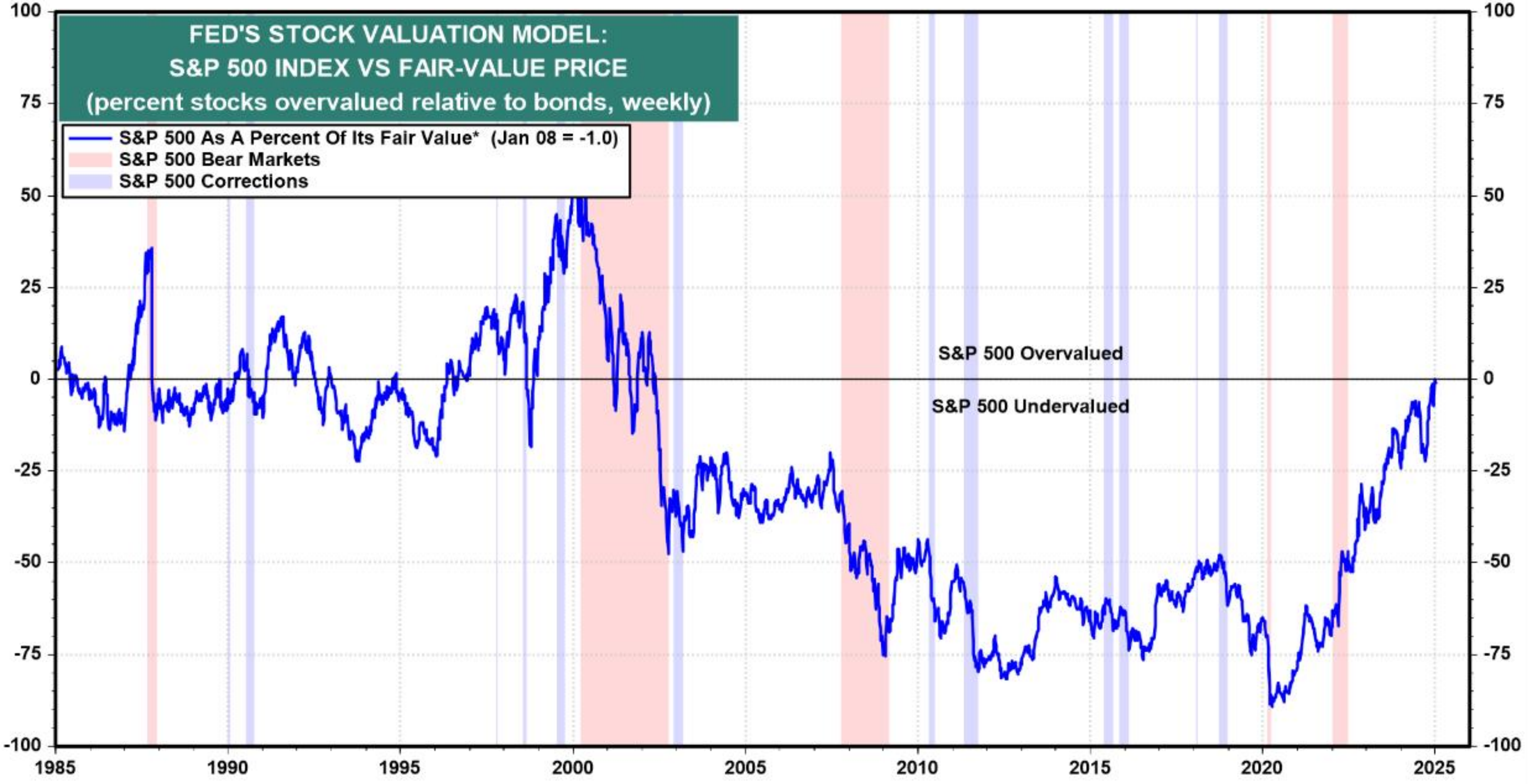
E/P < Y(10) – Market is over-valued

E/P > Y(10) – Market is undervalued

Used by Ed Yardeni; referenced by both Greenspan and Powell

Flaw: Generally, generates a positive bias toward equity markets

*IBES – Institutional Brokers Estimate System – owned by London Stock Exchange



Source: LSEG Datastream and © Yardeni Research.
* Year-ahead forward consensus expected earnings divided by 10-year US Treasury bond yield.

Valuation Methods

CAPE - Cyclically Adjusted Price Earnings Model (Shiller Model)

- Basis – First developed by Graham and Dodd (authors of “Security Analysis”, or “Buffet’s Bible”) and further developed by Yale economists, John Campbell and Robert Schiller, to smooth out earnings spikes in companies and market and adjust for inflation
- Current price of S&P 500 divided by Average of 10 years of inflation-adjusted earnings
  - Higher CAPE ratio suggests lower returns and vice versa
  - Recent CAPE ratio was 37.8. Historical levels: High: 44, Low: 5, Median: 16
- Flaws: generally pessimistic; doesn’t take into account accounting changes which produce wide swings in earnings; and does a poor job of dealing with stock buybacks which are now a significant factor in returns
- Note that Vanguard has a valuation model that starts with CAPE and adjusts for prevailing interest rates and inflation

Shiller PE Ratio

1Y 2Y 5Y 10Y 20Y 50Y **All**

Chart | Table | FAQ Share

Current: 37.79 +0.70 (1.88%)

4:00 PM EST, Wed Jan 15

Mean:	17.19	
Median:	16.01	
Min:	4.78	(Dec 1920)
Max:	44.19	(Dec 1999)

Shiller PE ratio for the S&P 500.

Valuation Methods

Buffet Indicator

- Basis: Compares stock market capitalization to GDP.
  - ➢ In 2001, Buffet said the ratio was a useful tool in gauging valuation of the stock market
  - ➢ Range of 75-90% is reasonable; over 200% suggests the stock market is overvalued
- Possible flaw: does not fully account for the growth in international operations of US companies since 2001

USA Ratio of Total Market Cap over GDP: 202.2 (As of 2025-01-08)

Jan 10, 2025 Powered by gurufocus

Role of Dividends in Retirement Portfolio

- Dividends accounted for **40%** of the return of the S&P 500 over the last 87 years
- There are two schools of thought with regard to funding retirement needs:
  - **Total Return Investing**: Invest with an idea of selling assets periodically to fund expenses
  - **Income Investing**: Invest in a portfolio of high-yielding assets that generate income to fund forecasted expenses

Role of Dividends in Retirement Portfolio

There is no single right investing approach, depends on circumstances and goals

Flaws:

- Total Return Investing approach may force the sale of assets at inopportune times in a market cycle
- Income Investing approach may restrict potential asset growth, may be a poor hedge to future inflation impacts, and may make a portfolio less diversified

If one does see a role for dividend-paying stocks, one should look for the following:

- High quality issuers
- History of growing the dividend
- An allocation to companies outside the US, as they tend have a bias toward dividend vs. buybacks, when compared to US issuers

Presently, there are positive tax implications with dividends on stocks held greater than one year (subject to change especially when there is an executive branch change)

Structured investments like REIT’s and Limited Partnerships have their own set of tax considerations, especially in retirement accounts – CONSULT YOUR OWN ADVISOR

Role of Dividends in Retirement Portfolio

Dividend Aristocrats Index versus S&P 500 Index

	ARISTOCRATS	S&P 500
1990–1994	11.13%	8.69%
1995–1999	19.48%	28.54%
2000–2004	9.74%	-2.29%
2005–2009	3.32%	0.41%
2010–2014	18.27%	15.44%
2015-2019	11.32%	11.67%
1990-2020	11.97%	10.21%

Reflects reinvestment of dividends. Data through December 31, 2020, annualized.
Past performance does not guarantee future results.

The Dividend Aristocrats Index outperformed in five of the seven five-year periods. It only underperformed during 1995–1999 (other than a slight underperformance during ‘15-’19), when investors were infatuated with high-growth stocks that fueled the internet bubble and led to the 2000–02 bear market. While the Dividend Aristocrats Index didn’t keep pace during this period of “irrational exuberance,” they produced an attractive total return of 19.48% and proved far more resilient when the bubble popped.

Interesting Articles – Annual Forecasts

Wall St. Is At It Again, Making Irrelevant Predictions- NYT 12/20/24

- Each year many brokerage firms publish their forecasts for S&P 500 performance for the upcoming year
- Starting with forecast for 12/31/2000, consensus predicted only gains, every single year, of about 8.8% on average
  - ➢ Average annual variance vs actual was 14.2%
  - ➢ S&P fell 7 of these 25 years
  - ➢ 2023 forecast: 6.2%, actual 26.3%
  - ➢ 2024 prediction: 3%, actual 25.0%
  - ➢ 2025 guess: 9.6% (some other polls show 12-13% predictions)

Interesting Articles – Investment Ideas

Where to Invest in 2025 – WSJ – Jan.3 2025 – Lawrence Strauss

10 investing and economic professionals' perspectives:

1. "Move beyond the Magnificent Seven" – David Kostin – Goldman Sachs –Still maintain allocation but look to mid-caps ($5-20B in market cap).
2. "Stick to Large Cap" - Ankur Crawford – Alger – All in on large cap growth – especially AI related
3. "Don't Expect Big Stock Mkt. Gains" – Saira Malik – Nuveen –After two big years in stock market– likes REITS, small caps and high-quality bonds
4. "Not So Fast on Large Caps" David Kelley – JP Morgan Asset Mgt. — Unrebalanced 60/40 portfolio of 2019 is now 79/21. Consider this risk and overriding concerns on inflation
5. "Prepare for Bumpy Weather" Chris Senyek – Wolfe Research — Market is presently very rosy for "Trumpeconomics" Stick with Mag 7, large tech and communications – when details on policy emerge – reassess

Interesting Articles – Investment Ideas

6. “It’s Time for Value” – John Rogers – Ariel Investments –Large cap is very expensive. Buy small cap and expect deal flow to pick up
7. “Buy Bonds over Stocks” – Mike Cudzil – PIMCO –Thinks Fed will cut rates – if not, coupon still gives a positive return – stay with high quality (AAA) asset backed securities
8. “Prepare for More Volatility” – Yung-Yu Ma – BMO Wealth Mgt. –Trump policies are likely to be more disruptive than one may think. Prepare for pullbacks. Still favorable on US Market – add some small caps
9. “Watch out for Inflation” – Jason De Senna Trennert – Strategas – “Market gains slow as earnings need to pick up to justify valuations. Stick to high quality corporate bonds < 5 years. Consider securities linked to AI infrastructure
10. “Interest Rate Uncertainty” – Aditya Bhave – BofA Global Research –Interest rates could stay higher due to tax cuts and larger deficits

Interesting Articles - Valuation

Is this Wildly Overvalued Stock Market Doomed? Yes, But Maybe Not Yet - WSJ 12/6/24

- US Stocks, driven by AI, rising earnings and American exceptionalism, are super expensive on just about every measure (US PE 23, ROW 14)
- Goldman Sachs thinks S&P 500 will make just 3% a year for the next 10 years
- BofA expects 0-1% a year for a decade
- Expensive stocks can always get more expensive, over periods of time
- Potential Attractiveness of Other Markets:
  - ➢ Japan leads in robotics, Denmark in anti-obesity drugs, Taiwan in microchip manufacturing
  - ➢ Bond yields may be attractive

Interesting Articles –Impact of Higher Rates

What if Fed Pivots Again on Rates? WSJ 1/16/25

- Fed cut short term rates in September
  - Rate cuts tend to be a tailwind for stock prices because they stimulate economic growth and reduce appeal of bonds
- Since then:
  - Yield on one-year Treasury has risen from 3.9% to 4.2%
  - Two-year Treasury yield jumped from 3.5% to 4.3%
- In past eight months, two-year has dropped from 5% to 3.5%, only to rise to 4.3%.
- Unlikely the Fed will start raising rates but if it did start talking about hiking, a strong market reaction would be likely to occur long before any actual Fed increase

Interesting Articles –Impact of Higher Rates

A Bond Selloff Is Rocking the World. You Might Want to Take the Other Side. WSJ 1/12/25

- A better-than-expected jobs report pushed yields on 10-year Treasurys to 4.8%, the highest level since 11/1/23, and up from 4.4% a month ago; yield on the 30-year paper rose to 5%
- Bonds with yields at these levels are seen by some equity investors as competition, especially for medium-term investment horizons

Interesting Articles – Trump Impact

How Trump's Plans Affect Your Money WSJ 1/16/25

- The S&P 500 is up 2.9% since Election Day
- Taxes – Vowed to extend 2017 tax cuts, which are scheduled to expire at end of 2025:
  - ➢ Keep top rate at 37% and retain $14MM wealth transfer threshold per person.
  - ➢ Might increase cap on SALT deduction
  - ➢ Eliminate taxes on Social Security payments.
  - ➢ Changes likely to take effect for 2026 tax year.
- Cryptocurrency – U.S. as "crypto capital of the planet"; Bitcoin price up 44% since Trump's election
- Mortgages – Potential return of Fannie and Freddie to the private sector which could lead to higher rates
- Article didn't touch on tariffs and immigration policies, executive orders and deregulation – all wild cards

Interesting Articles –Withdrawl Strategy

So What's the Best Way to Withdraw Your Savings? NYT 12/29/24

- After decades of building a nest egg, retirees must suddenly switch to making sure that money lasts 30 years or more
- It's all about cash flow
- When it comes time for a retirement paycheck, the challenge is to balance withdrawls from taxable and nontaxable money against when and how to collect Social Security, collect any pension, liquidate real estate, sell other assets and how much to leave to any heirs
- Just 22% of retirees take withdrawls from retirement accounts using a formal, sustainable strategy
- One strategy is to divide assets into four buckets:
  - ➢ Emergency cash (not greater than 10% of net worth)
  - ➢ Income: Social Security, pensions, annuities, withdrawls from 401ks to pay living expenses
  - ➢ Growth and Inflation Protection: long-term investments with a targeted return of at least 7%
  - ➢ Legacy : assets expecting to leave to heirs/charity

Interesting Articles – Withdrawl Strategy

So What's the Best Way to Withdraw Your Savings? NYT 12/29/24

- Social Security: Don't take while working. Up to 85% of Social Security benefits are taxed for people with a certain amount of additional income.
- IRAs, 401ks: In general, focus on prolonging tax-deferred and tax-free growth as long as possible. Best to leave assets in a Roth account for children.
- RMDs: Begins at 73 for those born between 1951-1959. 75 for those born after 1960. 25% penalty. Approximately 4% drawdown rate for a person 73 in 2025. Calculator at Investor.gov. Consider delaying Social Security and draw down 401k balances to minimize taxes and reduces future RMDs.
- Withdrawl Risk: Limit withdrawls in down years, especially at the beginning of retirement. Consider meeting with a financial planner to discuss these complex issues.

Q&A/General Discussion

- Open forum

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