Quarterly Newsletter

Roth FINANCIAL PARTNERS

Q2

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Instincts

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To say that 2020 has felt like a hard year could be deemed an understatement. Most of us have seen radical changes to our daily routines and plans due to the COVID-19 pandemic, and some of us have dealt with more pain and even loss in this season. It's been seemingly difficult to grasp onto the little joys that felt much more apparent and noticeable a mere six months ago. I will admit that in the first half of the year, there were (many) days where I felt overwhelmed with the happenings of the world and allowed worries, due to speculation of what was to come, to live rent-free in my thoughts for way too long. Outside of my faith and my family, sourcing positivity was a challenge.

Though it is not the "cure-all" (I'll always be the worrier in my family!), reading *Factfulness: Ten Reasons We're Wrong About the World – and Why Things Are Better Than You Think* by Hans Rosling over the past couple of weeks has snapped me back to a place where I can seek to see things with a more nuanced, thorough view. In the book, Rosling, a medical doctor and professor of international health, looks at ten ways our perspectives are distorted that unfortunately make aspects of life seem worse than they actually are, and provides a plethora of examples of the progress that is occurring globally. I'm particularly thankful that the book doesn't turn a blind eye to the difficulties of the world. Suffering is real. Fear is real. However, if we look at life through a lens that takes change into consideration (and not just static states of the world), we can allow that positivity to fuel additional change and not be inundated with negativity.

Below, I list three of the "instincts" Rosling discusses that I feel are especially relevant to 2020, both to the ride that we've gone through in capital markets this year as well as the volatility that could very well be in store for the remainder of the year as well as the long-term future.

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The Blame Instinct

I know I'm not alone in feeling some skepticism or mistrust as it relates to mass media and the sources of news that we receive. Every news outlet seems to have a slant or an agenda (yes, even the ones we agree with!) It's very easy to blame them for what seems to be a more dividend country/world than ever before.

However, it is too easy to blame a generic group ("the media," "liberals/conservatives," "Wall Street," etc.) for the ills of life. As Rosling writes, "the problem is that when we identify the bad guy, we are done thinking. And it's almost always more complicated than that."

Every four years (or two years, if you're a political junkie), we're transfixed on headlines that are filled to the brim with polls and soothsayers trying to garner attention about upcoming elections in November. Per commentators, this year is the "most consequential Presidential election of all-time" (reminds me of ABC's The Bachelor and the "most dramatic rose ceremony ever.") But wasn't that the case in 2016? And 2008? And 2000? It seems to me that what makes an election so consequential is that it's happening in the present.

The capital markets, in the long-term and to the surprise of many, do not care about which political party is in the White House and which parties control Congress. The S&P 500, over the past thirty years, has compounded at a little under 10% a year. Based on the predictions by media pontificators, you would think that years in which one political party was in legislative and/or executive control compounded at something like 30% a year and the dreaded "other" party only had losses. It's simply not true. There is no empirical evidence that political parties have an impact on market returns in the long-term (in fact, you may be surprised under which political party Presidency the US stock market has performed better under.) Even in the short-term, it is impossible to say what truly moves the market day-to-day and week-to-week due to the different needs and goals for each market participant (though the Wall Street Journal and other publications try their hardest to explain it!) Today's prices surely take into consideration probabilities of all different scenarios that will occur on November 3rd.

Similarly, maybe it's not the party itself that's to blame but instead the policies of said party. Let's take taxes for example. Is it the level of taxes that impacts the returns on the stock market? Per the Tax Policy Center, for most of the 1980s, the top corporate tax rate in the United States was 46% (decreasing to a top rate of 34% at the end of the decade.) Since those rates are higher than what we have now (currently a 21% corporate tax rate), wouldn't it make sense that the S&P 500 would perform poorly? Instead, the index compounded at over 17% for the decade (including the dreaded "Black Monday" crash in 1987.)

What about, instead of the general level of tax, an increase in the corporate tax rate (since strategists believe that corporate income taxes could increase to 28% in a Biden presidency)? In 1950, the corporate tax rate had a top rate of 42%. The next year, it increased to 51% and leveled out at 52% for the rest of the decade. An increase in the marginal tax rate by the largest US corporations would, on first thought, surely maim the returns of the stock market. However, the 1950s had even better returns, compounding over 19%.

The point of the above is not to say that one party is better than another or that taxes are awesome (I'm not that deranged!) but instead to belabor the fact that a political party or a single hot-button issue cannot be blamed for the performance of the capital markets.

The Negativity Instinct

One of my main take-aways from *Factfulness* is how hard it is to hold two competing ideas in your head: that "things can be both better and bad." We constantly receive bad news from media outlets since it attracts more eyeballs and a stronger reaction from viewers/readers than reports of gradual improvement. This year has obviously been no exception.

One of the main questions we've received from clients relates to how this most recent stock market rally from the lows in March can be possible when things are still so bad, both from an economic and virus-containment perspective. The Bureau of Labor Statistics recently released their official June unemployment numbers and the number is staggering: 11.1% of people available to take a job and are actively seeking work, are currently jobless (roughly 17.8 million Americans.) At the end of 2019, that rate was 3.5% (a historic low). The current rate is higher than the unemployment rate was ever recorded in the "Great Financial Crisis" of 2008 (an October 2009 reading of 10.1%)

It is an understatement that an 11.1% unemployment rate is bad. However, today's information and statistics are already priced into stock and bond prices. It's the expected change in unemployment rates that matters to financial markets (and is only a sliver of the data points that go into valuing bonds or shares of a stock.) Currently, in the long-term, market participants are expecting unemployment rates to be lower than they are today. They expect the economy to be better than it is today, even if it takes a little bit of time (potentially years) to reach levels that were reached previously before this momentous event occurred.

Because of the forward-looking mechanism that is the capital markets, we feel that it is nearly impossible to time the markets, especially from an "all-in or all-out" perspective. By the time official statistics look strong enough to "jump back in", the market has most likely already begun its upswing. Especially with today's technology, it's very easy (maybe too easy?) to turn most of your investments to cash. During market turbulence, it may even feel cathartic to have that feeling of momentary relief from volatility. However, that cathartic feeling can turn insidious if the fear of losing that relief keeps you sitting in cash and thereby decreasing your chances of accomplishing the long-term goals that your investments are meant to fund.

Things may still look bad from a static level, but it's the underreported gradual improvements that are fueling the returns created by stocks and fixed income.

The Straight-Line Instinct

One of my biggest annoyances in following the capital markets this year has been the commentary about what letter shape the (hopefully) inevitable economic and market recovery post-crisis would follow. Would it be a "V-shaped" recovery (meaning straight back up at the same furious pace as the fall in February/March), "U-shaped" (instead of straight up, it would begin as a slower pace of growth before rocketing upward) or "W-shaped" (meaning going back up for a bit but then rushing down before the longer-term upswing)? I've even seen non-letters, such as the Nike "swish" or a square root. Everyone has an opinion and it will more than likely change over time.

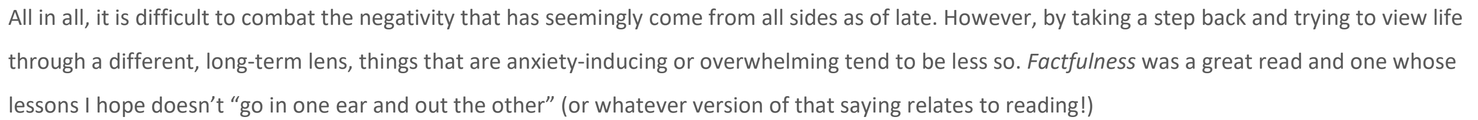
What all of shapes above have in common is that they are fairly straight in nature, which hides the "S-bends, slides, humps, or doubling lines" that Rosling states are common in data series. It's difficult for us to visualize the true eccentric shapes that life throws our way. Similarly, we tend to extrapolate expectations on a straight line as well. Rosling uses the example of a child's size as a reason not to extrapolate. My son Abe just turned five months old and weighs 17 pounds. He was born weighing just under eight pounds and has gained roughly nine pounds since then. At this rate, he will weigh over 600 pounds by the time he's my age! I think I can assume with a fair amount of certainty that this will not be the case (especially with my wife's love of vegetables.)

As it relates to investments, we cannot extrapolate downward and upward movements in the short-term. The Dow Jones Industrial Average fell almost 1,000 points on March 23rd. In the previous five weeks, it had fallen 37%. Per the headlines, stocks had failed to respond as investors had hoped to policy measures by the Federal Reserve. People were just tired of seeing so much red on their screens. As it turns out, that day was the current low for the year and the index rose almost 39% through the end of the second quarter. (This is a good reminder that even though the percentage increase was higher on the upswing than the downdraft, the Dow Jones was still down almost 13% from its highs as of 6/30/2020. When you're using percentages, it takes more of a percentage increase to offset a percentage decrease.)

We also cannot extrapolate upward returns in the short-to-medium term. To become one of the largest companies by market-capitalization, you must be doing something right as a company. As of 6/30/2020, Amazon (AMZN) was the third largest public company in the world. From 2010 through 2019, Amazon's stock compounded at a smidge under 30% a year. Of course, you had to have held on through five separate declines over 25% throughout that period. If you had the intestinal fortitude to make it through those rallies and declines, then you were especially rewarded (even this year, Amazon was up almost 50% through 6/30/2020!)

Can you expect similar returns in the years ahead? History says that it's a low probability event. Per Research Affiliates, on average, only three stocks in the global top ten list (when ranked by market capitalization), remain on the top ten list ten years later. The top company (which today would be Microsoft) is almost always somewhere on the list ten years later as one of those three holdovers – however, never still as the top company and almost never returning better than the MSCI All-Country World Index of global stocks. As previously noted, expectations for the performance of a company are baked into the price of the stock, so if the largest companies are to continue to stay on top, they have to continue to innovate and hold market share more than currently expected.

Amazon, Microsoft, and other giant companies may continue to reap great returns for their investors, but based on history, it will most likely not be in a straight line nor at the same fervent pace as the recent past.



All in all, it is difficult to combat the negativity that has seemingly come from all sides as of late. However, by taking a step back and trying to view life through a different, long-term lens, things that are anxiety-inducing or overwhelming tend to be less so. *Factfulness* was a great read and one whose lessons I hope doesn't "go in one ear and out the other" (or whatever version of that saying relates to reading!)

Our goal is to provide that perspective as it relates to your finances, and therefore your lives, in as material of a way as possible. If there's anything else we can be doing to provide the comfort and understanding you desire as it relates to your financial plan, please let us know.

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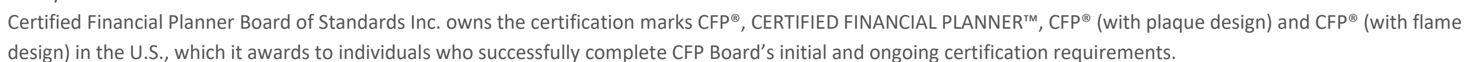

Around The Office Updates

Operations update:

We are back! As you more than likely know, our entire team is working full-time from the office again (all while practicing social distancing). However, as a measure of safety for our clients and ourselves, we are continuing to conduct meetings by way of phone or virtual conferencing (i.e. Zoom) until further notice. We will continue to keep in touch with updates if and when the circumstances change. The best way to contact us remains the same – by email or phone (281-973-8816). We hope and pray you are continuing to stay healthy and safe during this time.

Sister, Sister

It's hard to believe we're over halfway through the year! Jimmy and Sandi's daughters are growing *fast.* Kaylee is a little over two and a half years old and Maggie just turned 5 months. While mom and dad look forward to the day where they can confidently leave the two girls in a room alone together, there is still some work to be done. (Kaylee recently approached mom and dad claiming that baby Maggie was asking for more Disney princess tattoos). They have their work cut out for them.

Man's Best Friend

Eric and Ellie's son, Abe, just turned 5 months and has one of the most infectious smiles of any baby on the planet. He loves jamming to music with mom and dad and has quickly become best friends with the family dog, Sprout. It's only a matter of time before they team up to steal snacks from the pantry!

Looking Into Q3

Copies of Tax Returns

If we haven't already received a copy of your 2019 tax return, we would like to get a copy from you at your convenience.

This allows us to maintain updated information as it relates to your financial plan.