Left Brain® WEALTH MANAGEMENT

NOLAND'S Notes

2019 RE-CAP / 2020 OUTLOOK

For those of you who are new clients or those who are reading this note for the first time, I should explain. Each year I sit and write you a note. In it, I try to analyze the prior year in my own words so that you have an idea of what environment your accounts were active in. I also try to give you an idea of how we see the investment landscape as we enter the New Year. In our brief discussions throughout the year time does not permit us to share all of our thoughts and analysis with you. My hope is that in the 20 minutes or so it takes you to read it, my note helps you gain a better feel for how we at Left Brain Wealth Management view the current investment climate and how we think about investment markets, in general. ***Welcome aboard (or welcome back)! I welcome your feedback!!!!***

(Before I forget, feel free to send our note to your inner circle of family, relatives, or friends, should you think it appropriate. Though we write this note for you, should you think of introducing us to your circle this will be a good way for them to get a "feel" for our work).

Let's Get Started!

Here are the official returns from 2019

INDEX	CLOSE PRICE	RETURN (%)
DOW JONES IND. AVERAGE (U.S. STOCKS)	$28,538.44	25.34%
S&P 500® (US. STOCKS)	$3,230.78	31.49%
RUSSELL 2000 (SMALL COMPANIES)	$1,668.47	25.52%
NASDAQ	$8,972.60	35.23%
MSCI EAFE® (INTL STOCKS)	$2,036.94	22.01%
MSCI EMERGING MARKETS	$1,114.66	18.42%
MSCI REIT (REAL ESTATE)	$1,278.68	25.84%
AGGREGATE U.S. BOND INDEX	$208.03	7.4%
GOLD	$797.66	18.03%
OIL	$516.42	34.09%

(Source: S&P Dow Jones Indices, FTSE Russell, Nasdaq, MSCI, S&P U.S. Aggregate Bond Index, S&P GSCI Gold, S&P GSCI Crude Oil)

(For those of you wishing for the abridged version of this note, feel free to jump straight to the summary which starts on page 6. For everyone else, we have lots to discuss! So, let's jump right in!!!)

WHAT HAPPENED???!!!

What a year it was! The investment markets turned in impressive results for 2019. They showed a lot of resilience into year-end in contrast to 2018's limp into the finish. There were many record setting stock market closes along the way. For the first time ever, we have four companies with $1 trillion dollar market caps (Apple, Microsoft, Google, Amazon). However, there were times during the year when it certainly didn't feel like a year of great performance. This could be because the media spent a good portion of the year obsessing over the phantom possibility of a recession. It could be because we were ping-ponged all year long with the latest on again, off again trade war negotiations. Or the lack of appreciation for 2019's returns could have been masked by one of the myriad headlines: impeachment hearings, Trump's criticism of the Fed, Brexit, etc.

In a way, 2019's market action felt a little like an old-fashioned matchup in the NFC's 'Black and Blue division': one where the ending score was 13-12 and all of the scoring plays were either field goals or defensive scores. During the game, the action is physical and gritty. It isn't pretty. The outcome isn't guaranteed. But you look up at the scoreboard at the end of the game and notice your team is the one with 13! This is a great analogy for the market's journey in 2019 and we were the "team" that ended with the 13!

It's no surprise that the strength of 2019's returns caught many investors off-guard. The economy is just buoyant enough to keep chugging along, but not yet powerful enough to create inflation. The news media continues to lead with headlines designed to create concern and panic. It's clearly working as investors withdrew $173 billion from stocks last year, adding hundreds of billions to bonds and cash. Obviously, there are still many investors who still haven't invested, or haven't invested enough. Our hearts go out to those on the sidelines! It must feel like Waiting for Godot as they wait for the all-clear.

We think conditions look attractive for 2020. Here's what we'll be watching……….

SIZING UP THE INVESTMENT CLIMATE

I am often asked "What do you think of the markets". We think it is important for you to understand how we process the investment landscape at any given time. We view the investment environment through a lens that never changes, but the picture we are seeing often does. Here is our view for 2020:

1 – INTEREST RATES

By any measure interest rates are historically low. The Federal Reserve cut interest rates three times last year. Ten-year treasury bonds yielded **1.9%** at the end of 2019. This is one of the reasons that housing (and the home builder stocks) had such a strong year. Low interest rates, a strong job market, and stable economic conditions are just the right prescription to bring housing back to life. Interest rates are low, but what everyone is trying to determine is where rates are headed and how soon they'll get there. Here at Left Brain, we have no special insight as to the direction of interest rates, so we spend our energy in other areas where we believe outcome is more predictable. As is always the case, the US economy faces issues, both foreign (trade war, Middle East, Brexit) and domestic (upcoming election, fragile economic recovery). Understanding that context, we do think it's likely that the Fed will respond to any economic weakness with accommodative monetary policy (think interest rate cuts). In the 90s, when Alan Greenspan was Fed Chair, this was referred to as the Greenspan Put: *if the markets fell enough Greenspan would cut interest rates, to* *keep the economy chugging along).* As long as Trump remains in office and Powell remains Fed chair, we expect a Powell Put. **We're calling the interest rate environment Favorable.**

2 – INFLATION

One explanation the Fed has given for maintaining low interest rates is that inflation is still below target. It's true that inflation is currently low, with the most recent Consumer Price Index (CPI) growing at a rate of 2.3% ; however, the trend is in the wrong direction. Five years ago (2015) CPI was just 0.7%. Also, the inflation rate has jumped from 1.9% in 2018 to its current reading of 2.3% (the highest since 2011)! We'll be watching the inflation trends vigilantly. With the trade war truce, Brexit clarity, and low interest rates worldwide, we wouldn't be surprised to see the inflation trend to continue higher. A bit more inflation would be welcome, but a large move higher in prices would be worrisome. **We're calling Inflation Neutral.**

3 – EARNINGS

Analyst estimates call for S&P 500 earnings of [$176 per share] for 2020, which would be a record. Last year's market gains, at the index level, were driven by multiple expansion (investors paid more for the same level of earnings), rather than earnings growth. This year, our view is that it will take an actual increase in earnings to get stock prices moving higher. At the index level, market participants expect 10% earnings growth for 2020. That sounds good now, analyst estimates early in the year are written in pencil: those same analysts tend to bring out their erasers as the year rolls on! What we do watch very closely, here at Left Brain, is business momentum. In our view, there are enough companies posting strong revenue growth with profitable business models to offset the stagnant slow growers. We expect the outstanding companies to produce sufficient earnings growth to move things at the index level. **We're calling the Earnings outlook mildly Favorable.**

4 – VALUATIONS

Valuations increased in 2019, but earnings: not so much. The S&P forward price to earnings (P/E) ratio is 19. This is a bit higher than normal, but not outrageously so, given where interest rates and inflation are. The S&P500 currently sports an earnings yield of **5.25%** (100/19-PE ratio), which we find much more attractive compared to the alternatives (Real Estate, "safe" bonds, Gold, cash) at today's prices. Stocks and their current earnings yields certainly look attractive, especially when compared to the current 1.8% yields being offered from 10-year Treasury bonds. **We're calling Valuations mildly Favorable.**

Our View of the Macroeconomic Landscape

In our view, the economic conditions support a positive investment environment. A vocal segment of investors (of which we are not a part) and news media have become obsessed with fears of "the next recession". Here at Left Brain, we focus on the aspects of the market that we know well and avoid this type of prognostication. We avoid spending time on things that we know we cannot forecast accurately: we do not know when a recession will occur, how long it will last, or how deep it will be. What we **do** know about potential recessions, however:

1. There will be a recession, eventually.
2. There will be tremendous opportunities to make money during said recession.
3. There will be an eventual recovery from said recession.

During selloffs, recessions, market crashes, and pullbacks, you need not worry about us having a plan to address the related opportunities and/or challenges. Our primary mission is always the same: identify and evaluate attractive securities. However, our job as investment advisors certainly gets more interesting during selloffs. We tend to be busier too. We could either spend our time reassuring you, our investors, that the latest headline risk will pass. Or, we could spend that time identifying securities (at possibly bargain prices) with superior profit potential. The former action will make you feel better temporarily. The latter has the possibility of increasing your net worth permanently!

THE LEFT BRAIN WAY

We often get some version of the question *"Should I have less money in stocks since I'm getting older/close to retirement?"* This is a very common, and very interesting, question. There are popular myths regarding stock/bond portfolio mix like "take 100 minus your age". Or that maybe the standard 60%/40% stock/bond portfolio is appropriate. In reality, the answer is different for every investor and there is no "one size fits all" answer. Some clients need their portfolios to generate income to support their current expenses, while others might benefit from deferring withdrawals and taxes as long as possible, since they do not need current income. Most of you will be somewhere in the middle. Specific financial circumstances will dictate your investment mix based on your unique situation.

Two things that you should know about ownership of shares at Left Brain:

1. In general, your portfolio may contain more money in stocks than you might expect. This could be for a couple of reasons:
   - (a) **Stocks rise faster than bonds**: Imagine an account is invested 50% stocks/50% bonds on January 1. If stocks rise 20%, and the bonds post a flat return for the year, stocks will now make up **55%** of the account on New Year's Eve. This is the case even though we haven't purchased more stocks. *(Imagine the distortion in stock weighting after five years of positive stock returns).* There is a natural phenomenon where the faster growing investment increases its weight faster than the slower return holding.
   - (b) **We don't rebalance just because the stocks have gone up.**
2. We own more technology stocks than you might expect. There are a couple of explanations for this:
   - (a) The Technology sector made up 24% of the S&P500 as of year-end 2019. So, even index funds have a 24% weighting in tech shares. *Anything above 24% could be considered an overweight, or at least above market weight.*
   - (b) We think the most attractive companies are geared toward technology based on important "Left Brain" metrics like revenue growth and gross margins. Our research process continues to point us to businesses that "touch" technology. It's hard to overstate the critical role technology plays in our everyday lives, financial system and global economy today. With the dawn of 5G, artificial intelligence (AI), cybersecurity, and digital transformations, the power and vital nature of technology is becoming ever more critical. This isn't the future; this is the present. This was one of the sticking points in the US-China trade war.

This is nothing like the ".com bust" of 2000. Today's modern growth companies have profitable business models and provide essential services. In many cases, tech businesses are positioned to do better in tougher economic times because their revenues are subscription based and many provide critical services to the business world. Of course, we'll review our holdings regularly to make sure they're performing as expected, but we're very content holding wonderful companies regardless of what sector they occupy.

Note: Don't be afraid if you see a name in the portfolio you don't know. You can find LBWM research on the company in the Client login portal of our homepage.

WHILE WE STILL HAVE THEM (ROTH IRA)

Year-end 2019 brought a new law – the SECURE Act. This brought an end to an important technique we used to defer taxes on retirement accounts. The SECURE Act ended the ability to "stretch" an IRA. The playbook which had been in use previously, was to position a retirement account for growth after it had been inherited. This involved taking only the required annual "minimum" distribution, based on the beneficiaries' age. For example, if the account was growing at 6% annually and I only have to distribute 4% annually, then the account could grow very large over time. The new tax law has eliminated this strategy requiring non-spouse inheritors to distribute the entire account balance within 10 years. Down went another tax strategy!!

The Roth IRA is one of the few remaining strategies for the average investor to own a tax-free asset. Simply put, contributions are made to a Roth today using after-tax dollars. Qualified distributions are made TAX FREE, later! Another attractive feature of the Roth is that there are no Required Minimum Distribution requirements for account owners during their lifetime, unlike in most retirement vehicles. We first suggested going "all-in" on the Roth in the 2015 edition of Noland's notes. For those that followed our advice on publication date 2-20-15 and converted $100,000, the value would have grown to **$169,000!** *as of year-end 2019, even if invested in an index fund.

We hope that we don't sound like alarmists when we express our concern. At last count we have $22 trillion in outstanding national debt. This is up from $12 Billion, just 10 years ago. It's no surprise that the ability for the average investor to pay less tax has decreased as the debt levels have increased. Our concern is that the US Government will need more tax revenues in the future not only to service the interest on the current $23 trillion of debt, but also for the increase in spending that'll be needed to support future obligations like Social Security and Medicare. Raising taxes by decreasing deductions is certainly an oft-used play in the government's playbook. We think having money in a Roth account is a wonderful insurance policy, in case we're right and the future looks like the past. We think you'll be glad you did! 😉

Remember, there are currently no income limits on conversions to Roth IRAs either. So, if you have lots of money in traditional IRAs, 401(k) plans, and other retirement plans, you can consider converting portions to the Roth IRA (Monies converted are taxable in the year converted).

**Excluding the taxes due upon conversion.*

HAPPENINGS

Things continue to evolve here at Left Brain. If you'd like to consider yourself up on things, here are a few things you should know:

Investment Reports:

We do our investment research internally. Good research was always in short supply even in the best of times. The increasing spread of the indexing religion has driven money flows from actively managed funds, shrinking one large source of research coverage. The number of traditional Wall Street "Sell-Side"analysts have also decreased dramatically since the Great Recession. Those are the reports used to attract investment banking business (IPO's, Mergers, etc.) from the big financial brands (mostly New York based) you're familiar with.

We employ analysts who produce research based on the Left Brain investment philosophy. We use this research for selecting securities for your portfolio. When reviewing your portfolio, you may come across a new holding or company that is unfamiliar. This is a good opportunity to head to the client login button on the LBWM site and log in to your account to view the research report for that security.

Summer Fridays:

From Memorial Day to Labor Day we allow eligible employees to work from home on Fridays.

Christmas/New Year's:

As a founding principle at Left Brain, we value the importance of time away from the office to spend with our love ones, especially during the holidays, as well as to "re-energize" for the upcoming year. As such, it is our practice to close the office from Christmas until the New Year. Please plan accordingly.

Miami office

Should you find yourself in South Florida, feel free to stop by. Our office is in the downtown financial district "Brickell", we'd love to meet with you there. Though we've maintained a presence in Miami for a few years, our key team members will now be working from that office throughout the year. We bring this to your attention just so you'll understand when you call and are transferred to the Miami office, they really will be "working!"

SUMMARY - OUR 2020 PLAYBOOK

The new year has started off where last year left off. Analysts are projecting a 8.0% rise in 2020 earnings for the S&P 500. Stocks are priced at 19 times forward earnings, which we find somewhat pricy, but not outrageous, given the current low levels of interest rates and inflation.

Unlike last year, when there was little actual earnings growth and stocks rose by simply becoming more expensive (multiple expansion), even modest growth this year will be a welcome sight. In general, we still like stocks at this stage of the expansion and at today's prices. Especially compared to "safe" bonds, real estate, cash, and gold.

There are some who find fault with today's valuations and prices. They're referring to valuations of the indices (Dow Jones Industrials, S&P 500, etc.). Here at Left Brain we build portfolios made of individual securities (not indices or ETFs). We're always on the lookout for best-of-breed businesses. Valuations for superior businesses should trade at a premium. Not only do they produce higher returns for their owners, but the pool of them is shrinking. 20 years ago there were 6,917 publicly traded companies here in the US. In 2018, there were only 4,397. This is no small issue. There has been no better way to increase one's wealth passively than participation in the equity markets. Fewer opportunities to invest in publicly traded companies creates a limited supply of stocks, causing a natural bid to the asset class that is a tailwind to your portfolio! In a world of 2% interest rates and 2.3% inflation (CPI), the markets still look good to us. We're forever finding new world-class businesses, whose revenues should hold up fairly well even in a recession. As this is an election year and the trade war seems to have de-escalated, this could be a year of relative calm. A year of calm leading to positive returns would almost surely shock a lot of investors. We take pity on all those sidelined investors, still waiting for the "all-clear."

The markets haven't sold off in a very long time. When they do, it won't feel good. Trust me. Even a modest 10% correction will feel uncomfortable. It'll be at that moment that your initial reaction will be to send an e-mail, or to call in and ask…" What should we do?" I can tell you in advance what we'll say. If and when we get the next recession, we'll be using the occasion to High grade portfolios (in other words: buying high quality securities at a discount). We'll be taking advantage of any market panic to add exposure to the very best opportunities. We know that the markets are prone to bouts of indiscriminate selling, especially during times of rough economic conditions or scary headlines. As the saying goes, there's no better time to buy beach front houses than right after a hurricane.

We're not on recession watch here at Left Brain. Economic conditions look healthy to us. There are three things we know concerning recessions:

1. **We will have a recession, eventually.**
2. **There will be tremendous opportunities to make money during said recession.**
3. **There will be a recovery from said recession.**

Dance like no one's watching. Sing like no one's listening. Love like you've never been hurt. We'd add: invest like you've never lost money.

As always, I will be looking for opportunities to help you profit this year and in the years ahead.