StraightTalk

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ALFRED L. STRATFORD, III
Chartered Retirement Planning Counselor (CRPC®)
Senior Vice President, Investments

A Renewed Focus on Earnings and Dividends

If 2019 can be summed up as the year the market went up despite the public's confidence in it, then 2020 is shaping up to be the year of TMITH, otherwise known as *The Market Is Too High*. This periodic phenomenon is not new - over the course of my 27 year career, there have been some numbers that have seemed more insurmountable than others in the eyes of most investors. The first time the Dow Jones Industrial Average crossed 10,000 for example, was a seminal event for those who were invested, and a major milestone even for those not in the market. The year in which that occurred, 1999, happened to be a near term market top, just ahead of a three year decline in prices. The fact that the market broached a psychologically important but statistically insignificant number (Dow 9,999 is no different than 10,001) and the following three years were unpleasant for investors may have cemented the recent negative thought pattern around milestone numbers.

This trend has reared its head on a number of occasions, more recently when the Dow recovered the previous market high set prior to the Great Recession, and again at Dow 20,000. The next major numerical level to be surpassed, likely later this year, is 30,000 – and the possibility of this being a market top has already manifested itself in phone calls and emails wondering if now is a good time to jump out. *Which, of course, we will not do*. Bull markets don't recoil just because an index hits a magic new number, nor do they "die of old age." Cyclical (short term) bull markets typically end in one of two ways: the economic cycle rolls over from expansion to contraction, or the Federal Reserve acts to try and prevent runaway inflation by raising interest rates, which tends to choke off economic growth, thus causing that contraction.

Rather than spend time watching for the next milestone number, a better course of action is to keep an eye on the Fed, corporate earnings, unemployment, and how the economy looks and feels on your local level. Currently, the Fed is accommodative, unemployment is at lifetime lows, earnings are growing, and the local economy appears rather robust to my casual eye. Of course, this can and will change at some point, and business leaders across the country all have an eye on the looming election in November. But for now, the economic trend remains upward.

The 2020 Presidential election will be a topic for a newsletter later this year, but for those that think this will be the nastiest, most contentious election ever, I would suggest you are correct. For those that lament the "politics of personal destruction" and would like a return to a more civil process, I have a podcast for you called *American Elections: Wicked Game.* This podcast covers every election from George Washington in the first ever Presidential election in 1789, through our most recent one in 2016. Each podcast focuses on one election, and is a fascinating forty minute dive into the backdrop, the candidates, and the players around them. Even as our country was just beginning, Alexander Hamilton, most famous for being our nation's first Secretary of Treasury, influenced and outright manipulated the first two elections, tilting them toward our founding father. In another example seemingly ripped right from today's headlines, the 1824 election between John Quincy Adams and Andrew Jackson ended in a tie, to then be decided in the House of Representatives. The powerful Speaker of the House, Henry Clay, swung the vote in favor of John Adams in order to be named Secretary of State by him afterward.

This quid pro quo was famously known at that time as "the corrupt bargain." Of course, as we know from history, Jackson went on to beat Adams in 1828, by riding to the White House on a populist wave, vowing to end corruption in Washington and remove the permanent political class. It seems that it has always been this way!

Setting aside further discussion of the election for the moment, our focus must remain on our portfolio of investments as it relates to *our plan,* rather than the market. Standard & Poor's research shows that the U.S. stock market declines on average 14% each year. Some years it is less, like 2019, which saw only a 7% price drop inside the month of May, and some years it is more, like in 2018 when the market dropped a decimal point shy of 20% in the fourth quarter. Typically, if the decline occurs early in the year the recovery carries the market to a positive finish, but in some years, that routine price correction leads to a minus sign for that year. However, knowing this normal volatility to be an indisputable fact does not stop the indigestion and stomach churn when these regular events occur. And clearly you are not alone, because Lipper Research reports that last year was the largest for stock fund/ETF net liquidations since 2008. In plain English, a routine price drop of 7% caused as much flight from the stock market as 2008 did, even as the market hummed on to large gains for the rest of 2019. And that's not all. Those same money flow statistics show that this money did not come back after May...in other words*, those people missed it, and are still missing it.*

I would suggest, as I have in the past, that we focus on either earnings, or dividends, (or both) rather than prices. I have a table in my office of the market value in the year you were born, what the cash dividend was, and the level of inflation. I can quickly inform you how much beyond inflation those dividends grew starting in any year you choose. Here's a hint, the dividends always grew faster than inflation, providing the basis for a rising real income in retirement. The bonus is the magnificent appreciation in prices over that same time period – which came in addition to a rising income.

In analyzing the history of earnings, the same pattern becomes clear. The consensus S&P 500 earnings for the current year is $181 per share, which, if it proves accurate, will be a long way up from the $83.77 reported in 2010, and almost five times more than 1995's earnings number of $37.70. Here's another hint, inflation was not up five fold since 1995 - the earnings grew faster! That story is consistent for S&P 500 dividends, which grew from $13.79 in 1995 to more than $58 last year, again, far outpacing inflation over that 25 years. The mortality tables from the IRS illustrate that the average two-person retirement in America today is 25 years and growing due to increasing longevity.

Indeed, the reason to favor owning the great companies of America over savings instruments becomes even more critical in the face of that increasing longevity. While it is true that the average American life expectancy has turned down slightly over the last two years, this is a function of one specific issue. The recent trend of opioid abuse among teens and young adults is bending the curve down, and we all hope that trend changes soon for America's average life expectancy. However, nothing about anyone reading this newsletter is average. You are more educated, have greater access to medicine, exercise, and a better diet than the "average American." You are less likely to work in a dangerous occupation, and more likely to get regular health checkups and heed the medical advice of your physicians. Therefore, statistically, your life expectancy and your concomitant years in retirement could and should be longer than the average American.

So if you accept that your retirement "golden years" could be longer than average, the earnings and dividend growth numbers should skew even greater in your favor. Which begs the question, why would you give that historic pattern up, just to feel a bit better during a period of short-term volatility?

804.225.1143 | straightlinefinancial.com | 951 E. Byrd Street, Suite 930 | Richmond, VA 23219

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