Mike Mills
Managing Partner
CFP, CLU, CFS

Happy Halloween! As the weather cools off, the political climate continues to heat up. With recession fears running high, trade war concerns, and high market volatility, investors appear jittery. The million-dollar question clients are asking, as markets begin to flirt with the previous highs, is will markets catch a cold and what should investors do today? Please enjoy the following resources where we look at the previous quarter and attempt to address this important question mentioned before.

I. MWA Quarterly Market Review
II. MWA Commentary
III. A review of 4 Core Beliefs Embedded in our portfolios
IV. Blog Article (Timing Isn't everything)

Please don't hesitate to give us a call if you have any questions, concerns.

Best Wishes,

Mike Mills, CFP, CLU, CFS

Section I: Market Review

Below is a graph that shows the returns from the major asset classes across the world. To dig deeper into these returns and other details around the markets across the world, click here for our PowerPoint that shows graphs and pictures describing what is going on in markets across the world.

MILLS WEALTH ADVISORS

Quarterly Market Summary

Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
3Q 2019	STOCKS				BONDS	
	1.16%	-0.93%	-4.25%	5.72%	2.27%	2.83%
Since Jan. 2001						
Avg. Quarterly Return	2.0%	1.4%	2.8%	2.6%	1.2%	1.2%
Best Quarter	16.8%	25.9%	34.7%	32.3%	4.6%	4.6%
	2009 Q2	2009 Q2	2009 Q2	2009 Q3	2001 Q3	2008 Q4
Worst Quarter	-22.8%	-21.1%	-27.6%	-36.1%	-3.0%	-2.7%
	2008 Q4	2008 Q4	2008 Q4	2008 Q4	2016 Q4	2015 Q2

Section II: MWA's Quarterly Market Commentary

Where you draw the line manipulates the investment rate of returns picture. For most investors your year to date returns look attractive compared to most portfolio goals, but in reality, most investors are just getting back to where they were a year ago due to the 4th quarter market decline that occurred last year. Here are our thoughts on the current market environment and the impact of recent events. Below are the major things I want to cover:

1. 50-point drop in Interest rates a month ago
2. Markets are pricing in a 25% chance of recession (Money has moved to quality)
3. Brexit / Trade War / Overall Instability

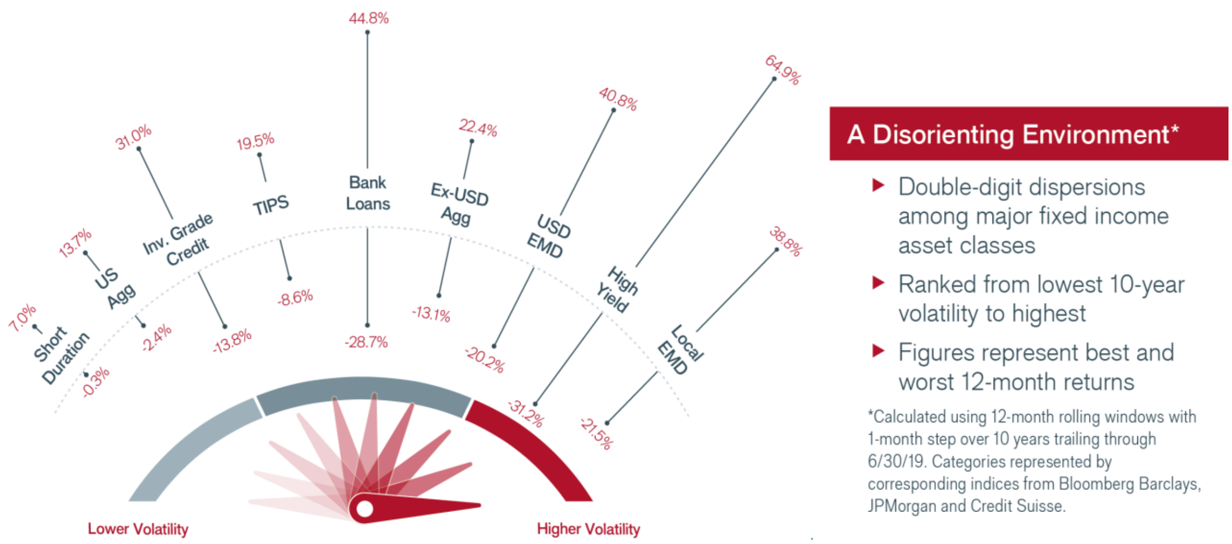
Interest Rates Drop

1. Interest rates in the United States decreased during the third quarter. The yield on the 5-year Treasury note declined by 21 basis points (bps), ending at 1.55%. A few months ago, yields were over 2% in the US, so the recent drop has been significant. The current yield on the 10-year Treasury note (one of the big drivers in the mortgage market) decreased by 32 bps to 1.68%. The 30-year Treasury bond yield fell by 40 bps to 2.12% pushing long-term yields close to where they were coming out of the financial crisis. Low global yields have pushed up returns for bond market investors, made borrowing less expensive, and have made stocks appear cheap (relative to bonds). Recent 30-year home loans are back down to 3.65% (normal) - 3.9% (Jumbo loan) which should continue to incentivize long-term borrowing and may continue to extend the real estate rally, even though tariffs could raise new construction cost.

   Dividend yields on a moderate global portfolio are just under 3% per year and our all equity portfolio boasts a 2.5% dividend yield. This may not sound like a lot; however, when looking historically, most of the times that equities have yielded 50% more than 10-year bonds, equities have been a good relative long-term bet. Today volatility is high and given the climate I would expect it to stay that way.

   For investors that can stomach the roller coaster type ride that stock market investing demands, history suggests that investors will eventually be rewarded for accepting this risk. Remember the analogy, "investing is like watching a yoyo while riding an escalator." When utilizing a **Global Stock and Bond Factor-Tilted strategy** spread across 12,000 securities, the downs are temporary, no matter how painful, and the ups are permanent. However, I know it is not easy.

Fixed Income Best & Worst Returns by category:



I thought this was interesting picture because it shows some of the best and worst returns for different types of bonds. If you look at your portfolio, you will notice that the majority of the defense we hold is generally in high quality bonds (the two on the far-left side). Please notice the largest loss on record for each type. The majority of our defensive assets were selected to protect the equities we own.

I don't believe it is productive to try and get out of markets before a decline (again, you must be right twice, and once is hard enough). Instead, I would prefer that we set aside enough defense to cushion a decline, while providing enough liquidity and reserves that can be redeployed when equity prices decline. Making these simple moves will shorten the time it takes for portfolios to recover, provide a more tolerable investment journey, and make attaining your goals probable.

Recession Fears are High

2. A recession is not a certainty, but there are plenty of potential pitfalls that could slow global growth and hurt consumer confidence. As we have said before, we are encouraging clients to make sure they are comfortable with the amount of defense they have in place. If you are unsure, please shoot us an email and we can schedule time to review your future cash flow expenditures versus your emergency fund, and the amount of defense set aside to protect your equities. There is no doubt in my mind that for long-term investors maintaining exposure or adding to underperforming, less expensive, often higher-yielding areas of the market that are perceived as riskier will produce larger future gains than safer assets. The million-dollar question is, will markets get cheaper before a rotation occurs? In the last quarter we have seen a flight to safety rotations in equities; however, if risk and return are still related, eventually defensive lower-volatility sections of the market should produce lower returns over the next decade compared to more risky areas of the markets that are currently much cheaper and offer better yields. There is no free lunch. ***I think the formula***

for success is to make sure your portfolio matches your risk capacity and the portfolio is set to produce the long-term returns you need to meet or exceed your goals.

Dollar Strengthens on Brexit Fears & Trade War Worries

3. The US still has some of the highest interest rates in the developed world, we are perceived as one of the safer markets, and capital has been flowing to defensive areas like utilities and staples. The dollar has gotten stronger, international markets have mostly lagged the US and growth (while expensive) has still been an asset to own. With much of the developed world experiencing negative interest rates, we think it is likely that global Central Banks remain in a cautionary stance with accommodative monetary policies, which should continue to favor higher returning assets like stocks over bonds, except in a large sell off. Tensions from the trade war could continue muddy the water and weigh on global growth as could Brexit fears. While these are negative headlines, for long term investors we continue to believe the large discrepancies in valuations favor accepting the risk and trusting that the markets have priced in these two risks.

   We continue to under own high-flying stocks that have little to no profit and high valuations and expect to continue to add funds to Factor-Based strategies globally. This includes low-volatility stocks or high-profit stocks in income-oriented accounts. In growth accounts we expect to rebalance or maintain current exposure with the exception of realizing any possible tax losses that can be used to offset future gains. Before the end of 2019 we will look to realize any possible tax losses that can be exchanged to roll forward, so we can maintain exposure, but improve the tax efficiency of portfolios. We will continue to maintain broad diversification in *core holdings* meaning more than 50% of our funds will continue to be allocated to the United States with tilts remaining focused on smaller, undervalued or higher-profit type companies.

Market recommendation:
Hold current positions and collect the higher dividend yield with a large amount of high-quality fixed income to protect against declines.

Add Defense? If worried or need more liquidity, sell winners and build a little more defense (10%ish) that can be redeployed in the future. For anyone with $5 million in assets add to Volatility Arbitrage Strategy from fixed income and/or equity-based on risk.

Mortgage Refi: If your mortgage cost is above 4%-4.25% a refinance could quote could be worth looking into, especially if rates retest the 3.25% low. If you would like us to look into debt restructure or make a mortgage referral, please let us know.

Each Quarter going forward, I am going to spend a few paragraphs reviewing a few of the financial principals, core beliefs, and financial research that is embedded how we solve financial problems, invest client resources, and or design various strategies to attain/fund financial goals with the greatest chance of long term success. Below we look at 4 of the 50+ Core Beliefs we use at MWA.

Section III: MWA Core+ Principals & Beliefs

- **Diversification is the only free lunch - more is better:** The following article Larry Swedroe discusses recent research that compares returns from investors that hold individual stocks vs broadly diversified asset class funds. You may have heard me say a common Millism, "Diversification is the only free lunch when investing". I think the following article does a great job of communicating using research why most stock investors eventually lag more diversified low-cost portfolios.

  Individual Stock Investing Increases Risk, by Larry Swedroe, 9/17/19
  https://www.advisorperspectives.com/articles/2019/09/17/individual-stock-investing-increases-risk

- **Markets work –** They are the best pricing mechanism in use – today's market prices (stocks, bonds, real estate etc.) contain every market participant's best guess of what the future price will be (current prices look forward).

  What this really means to us as investors:

  - **Market prices are usually pretty right -** Prices incorporate all known information and while not perfect, generally do not stay incorrect for very long. If prices were incorrect for long speculators or investors would figure out the mispricing and would trade in the security until prices fall back into balance as they capitalized on the mispricing.

  - This means that theoretically, for prices to change, new information must come along or be interpreted differently. If the market expects something to happen, and everything happens exactly as forecasted, there would not be much movement in prices. In reality, markets are complex systems. Prices will always oscillate because there are millions of participants, changing opinions, a constant flow of new information on securities, and the inter-relation of the system.

    MWA's take away: The bulk of a portfolio should not attempt to predict returns, but instead should be designed to capture the returns markets offer by maintaining exposure to the risk clients are willing to tolerate as inevitable bumps come and go.

- **The Asset type ("asset class") decision has a large impact on investment returns: The Asset Allocation Policy** will account for a large portion of the return in the long run. The security we select or when we buy tend to account for much less of the total long-term returns than the allocation

Figure 1. Role of asset allocation policy in return variation of balanced funds

Selected periods, January 1962 through December 2011

	United States	Canada	U.K.	Australia	Brinson et al. (1986)
Number of balanced funds in each market sample	518	245	294	336	91 U.S. pension funds
Median percentage of actual-return variation explained by policy return	91.4%	88.3%	80.0%	89.9%	93.6%

Notes: For each fund in our sample, a calculated adjusted R^2 represented the percentage of actual-return variation explained by policy-return variation. Percentages stated in the figure—91.4%, 88.3%, 80.0%, and 89.9%, for the United States, Canada, the U.K., and Australia, respectively—represent the median observation from the distribution of percentage of return variation explained by asset allocation for balanced funds. For the United States, the sample included 518 balanced funds for the period January 1962–December 2011; for Canada, 245 balanced funds for January 1990–December 2011; for the U.K., 294 balanced funds for January 1990–December 2011; and for Australia, 336 balanced funds for January 1990–December 2011. Calculations were based on monthly net returns, and policy allocations were derived from a fund's actual performance compared to a benchmark using returns-based style analysis (as developed by William F. Sharpe) on a 36-month rolling basis. Funds were selected from Morningstar's Multi-Sector Balanced category. Only funds with at least 48 months of return history were considered in the analysis, and each fund had to have a greater-than-20% long-run equity exposure, both domestic and international (based on the average of all the 36-month rolling periods), and a greater-than-20% bond allocation (domestic and international) over its lifetime. The policy portfolio was assumed to have a U.S. expense ratio of 1.5 basis points per month (18 bps annually, or 0.18%) and a non-U.S. expense ratio of 2.0 bps per month (24 bps annually, or 0.24%).

Sources: Vanguard calculations, using data from Morningstar, Inc.

https://static.vgcontent.info/crp/intl/auw/docs/literature/research/The-global-case-for-strategic-asset-allocation.pdf

- **Taxes are punitive and must be minimized – Capital Gains tax rates can range from 0 - 23.8% & Ordinary Income Tax Rates can range from 10 - 40.8% (more when state income taxes are included)** Successful investment strategies will minimize turnover and movement over time so as to attempt to make sure investors are not paying taxes on money that we are not spending. Additionally, if savings are positive and as the non-IRA portion of the portfolio grows, it can often be less expensive to utilize short-term borrowings over selling assets with gains and then repurchasing similar assets after the assets arrive from savings and dividends.

Section IV: Timing Isn't Everything

We have been getting a lot of questions about is now the time to sell out? Please read the recent blog article we posted on market timing (and remember the hard part about timing markets is you must be right, twice). Over my 20+ year career we have seen many more people lose money missing the unlimited ups, rather than by avoiding short term market declines.

If you have any questions or want to talk about your portfolio or planning please don't hesitate to call.

--Mike

Michael Mills, CFP, CLU, CFS
Managing Principal

Sources Not Identified Above:

Q4 Investment Outlook: No Rest for the Weary
by Team of American Century Investments, 10/14/19
https://corporate.americancentury.com/content/dam/ac/pdfs/corporate/booklet/investment-outlook-retail.pdf