Dixon, Hubard, Feinour & Brown, Inc. investment counsel

Third Quarter 2019 Review & Outlook

by Whitney Brown

Also in This Issue

INVESTMENT OUTLOOK

- Stocks stall in third quarter.
- Mixed signals on trade and interest rates.
- Long-term and intermediate market trends intact.
- Looking for bottom in global market slowdown.

Caught between the crosscurrents of growing fears and hopeful waiting, equity markets in the U.S. and abroad grappled to get back to even for the third quarter. After adding a solid second quarter to a strong first quarter rebound, equities stalled as doubts rose. An inversion of the yield curve where the 10-year U.S Treasury yield falls below the 2-year yield raised the specter of recession. Also, the Federal Reserve has sent mixed signals on how willing they may be to cut rates further, raising concerns that they may be falling behind in protecting the U.S. economy from the global slowdown. On the hopeful side, investors have remained optimistic, despite the setbacks and false starts, that pragmatism will prevail and the U.S. and China will come to some substantive agreement on fairer trade and reduction of tariffs. Meanwhile, investors grow hopeful that each bit of weakening economic data will strengthen the Fed's resolve to step up and cut more aggressively to reinvigorate growth.

Market Measures	3rd QTR	YTD 2019
S & P 500 (price)	1.2%	18.7%
Dow Jones Industrial Average	1.2%	15.4%
NASDAQ Composite	-0.1%	20.6%
Russell 2000	-2.8%	13.0%
MSCI EAFE	-1.7%	9.9%
Barclays Capital Inter Gov't/Credit Bond Index	1.4%	6.4%
	9/30/19	9/30/18
10-Year U.S. Treasury Bond Yield	1.68%	3.07%
Three-month U.S. Treasury Bill Yield	1.86%	2.21%

Recognizing that much of what has been feeding recent market volatility is speculation around the latest news of the day, it is helpful to look for an objective perspective. Whether it is the implications of a hard Brexit, U.S.-China trade, Saudi-Iran conflict, impeachment inquiries, or whatever makes people worry, it is critical to observe what the markets are actually doing versus what we think they should be doing. Stepping back and analyzing the market trends both long-term and near-term, we can note several important facts. First, the secular or very long-term equity bull market that began in 2009 is still intact. Along the way there have been three counter-cyclical bear markets ending in 2011, 2016 and late last year in 2018. After each cyclical bear, major equity indexes have gone on to new highs.

Next, the market low last December was a significant bottom that brought new life to the bull market. At that time indicators of negative market momentum and stocks hitting news lows reached extreme levels only seen at major market lows. The surging demand for stocks following that bottom is consistent with a market capable of taking another leg up to new highs. Finally, since the December low, there have been two noteworthy pullbacks in the major indexes, in May and August, each of which held well above the December low and each of which held at successively higher lows. This indicates the willingness of investors to hold stocks while waiting for a positive catalyst to move the market higher.

As we move into the more seasonally favorable period of the year for equites, we should remember that the underlying market foundation appears sound with a healthy demand for stocks and, so far, only limited selling pressure. Another plus is the recent resurgence of strength in small cap and value stocks. The U.S. should avoid recession, and the global economy may at last be showing some signs of bottoming. Strength in emerging market equites would be an early indicator of an economic turn for the better. Bond yields that retreated as safe haven money piled in should recover as growth fears subside.

Roanoke Roots

We are excited to welcome **Bob Martin** as a **Managing Director at Dixon, Hubard, Feinour & Brown, Inc.** After serving for almost seven years with Middleburg Financial (formerly Union Wealth Management) in Richmond, Virginia, Bob returns home to his roots in Roanoke. He is an Accredited Wealth Management Advisor℠ and a Financial Paraplanner Qualified Professional™.

"I am excited to return to the Roanoke community and renew my passion for helping clients achieve their financial goals."

– Bob Martin, AWMA®, FPQP™

Contact Bob at 540.343.9903 or martin@dhfb.com

Dixon, Hubard, Feinour & Brown, Inc. investment counsel

www.dhfb.com

How to Make Your Wealth Last Longer by Robert P. Martin, AWMA®, FPQP™

It is easy to get fixated on investment returns, investment timing, and stock selection. Most people don't realize, however, that focusing on the types of accounts in which you accumulate investments and the timing and sequencing of withdrawals from those accounts can have a significant impact on your taxable income. It matters where you keep your money; it matters from which accounts you begin to draw your money and in what order. Part of retirement planning, before and during retirement, is income tax planning.

Generally, people have the ability to hold investments and build wealth in tax deferred, tax free, and/or taxable accounts. Each of these accounts have different tax attributes which should be considered while you are saving and investing. While investing, it is important to optimize your types of investments in various accounts based on their tax attributes. For the best after-tax returns, investments with the biggest tax consequences should be sheltered in tax-deferred accounts such as a 401(k) or IRA. Among those are corporate bonds, bond mutual funds, and REITs. Meanwhile, taxable accounts should hold the most tax efficient investments, such as tax-exempt municipal bonds, stocks held for the long-term, and mutual funds with low turnover rates. Investment managers will be able to harvest tax losses to offset gains in order to minimize taxes. Effective asset location has a compounding effect over the long-term.

The order in which you receive distributions from these different investment accounts also has tax implications. Many retirees will have a 401(k) and/or IRAs, taxable account(s), a Roth IRA, a pension, and social security. Once you have answered the important question of how much income you need in retirement after taxes (net spendable income), you can then begin to determine from which accounts/ sources you will receive income. The order and sequencing of income from those sources is critical to evaluate. The goal is to achieve that income target while minimizing taxes.

For example, Roth IRAs (invested with after-tax monies) have the unique tax status of both earnings and withdrawals being tax free. They also have no distribution requirements unlike regular IRAs. Given the favorable tax status, they are usually the best place to put high growth investments and last place to tap for retirement income.

Another example is looking for ways to lower your future IRA distributions if your balance is large enough where required minimum distributions (RMDs) will force you into a higher tax bracket. Many retirees find that they may not be in a lower tax bracket at retirement. Persons in lower tax brackets in their 60s

(Continued on page 3)

Don't Forget Estate Planning by Jim Hall

One of the most difficult topics to contemplate is our own mortality. Just the thought of having to discuss plans, intentions, and desires when we are no longer in the picture can be depressing and therefore easy to postpone.

However, just like your investing strategy and spending decisions, a workable Estate Plan is an equally important consideration. In fact, it may well be one of the best "gifts" you may give to your surviving family and beneficiaries.

As our office often experiences, one spouse will tend to take the lead in handling finances or investing while the other spouse may not be the least bit interested in those sorts of "details." Trouble may arise if the spouse that is most involved in handling finances is the first to pass away. The surviving spouse can face a steep learning curve and may find things even more difficult or complicated if there was reliance on an old will or worse, no will. Relying on an old will may not be sufficient to address any significant changes in circumstance that were not foreseen in years prior. Even worse, having no will creates extra steps and hurdles to navigate and often exposes the estate to unnecessary taxes that could have been avoided.

Besides reviewing current estate planning documents, an often forgotten but very valuable tool we have seen is to make a list of "go to" contacts to help the surviving spouse know exactly how to proceed. These lists would include the names of any important contacts the surviving spouse should know (investment manager, estate planning attorney, insurance agent, maybe a human resources/benefits contact if the deceased had been working or was recently retired). Even a list of any User IDs and corresponding passwords would be invaluable in allowing access to any online information. Also, making a list of accounts and how they are owned or titled would be very helpful. It is important to review the location of any safe deposit box AND where to find the key to access. Finally, if there are any hidden or unusual assets, these should be shared as well.

If you feel the need to visit or revisit your plan, we are all willing to help facilitate and guide any discussion.

How to Make Your Wealth Last Longer (continued)

(Continued from page 2)

may want to take distributions from their IRAs before the RMD age requirement at 70 ½. Some large account holders may also want to consider converting small portions of their IRA to a Roth IRA every year. Income taxes are owed on converted assets, but conversion allotments can be calibrated to manage the upfront tax hit. Persons with charitable inclinations will want to consider the benefit of diverting some of their RMD directly to charity, as the charitable donation would not be counted as taxable income.

Finally, we cannot overlook social security benefits. Contrary to popular belief, the social security trust fund is not going to become insolvent. For 84 years, Americans have been receiving social security—benefits funded by their life time of earnings. Retirees today are more dependent on social security in retirement than ever before—some 40% still claim social security at the earliest possible date. Most people don't understand their benefits. Developing a personalized claim strategy to optimize your income stream from the various iterations available can impact your life-time benefits by an appreciable amount. To wit, for those that can afford to do so, are healthy, and plan to work longer; delaying social security should be a consideration for the higher earning spouse but not necessarily for the lower/non-earning spouse. Social security optimization will be discussed more in a future article.

In summary, you can make your wealth last longer and reduce your tax burden significantly. The key is understanding the implications and start planning now.

Investing for Total Return by Watt Dixon

Given longer life expectancies and especially considering more years spent in retirement, it is important for investors who depend on their portfolios to meet their spending needs to have an investment strategy that can meet the dual needs for current income and long term growth. In most cases a total return approach will be an effective way to meet these goals.

Total return is a flexible strategy that relies on a portfolio of equity (stock) and fixed income (bond) investments to generate portfolio returns from bond interest, stock dividends, and capital appreciation of stocks (and at times bonds). The allocation to stocks, bonds, and cash may be influenced by each investor's income needs, age, risk tolerance, and time horizon.

Some investors feel that if they spend anything other than interest and dividends, they will invade their principal. A successful company that is generating profits can do three things with the money: reinvest in the business, buy back shares, or pay a dividend or bond interest. When a company decides to pay a dividend, it may forgo an opportunity to invest for growth. Also, the market adjusts the share price of the stock to reflect the dividend paid out. When a company repurchases shares, it supports the market value of its stock. Some of the most successful companies in the world pay relatively low dividends and some pay none at all, choosing instead to reinvest in their businesses which is usually reflected in a higher stock price.

The total return investing method provides flexibility for adapting to changing market conditions. In a prolonged low interest rate environment, like we have been experiencing, it may prove difficult to generate sufficient income from dividends and bond interest alone. Market conditions can often force a fixed income investor into longer, more volatile bonds and lower credit quality issues with higher default risk. During a bullish period for stocks, when interest rates are usually low, more of the total return investor's income can come from capital appreciation. In turn, relying exclusively on capital appreciation of stocks can be dangerous in a prolonged bear market. When stocks are in a flat to downward period, often rates will be rising, and the total return investor's income may be derived more from bond interest and less volatile dividend paying stocks.

A total return investment approach will make sense for most investors who have current income needs. A key element is having a spending plan and staying within a budget. Current income tax regulations favor long-term capital gains and qualified stock dividends over taxable bond interest and non-qualified dividends. Therefore, investors should not be afraid to include the return from long-term capital appreciation in meeting their income needs.