KEEN ON
RETIREMENT

Forecast 2020: Silence the Noise
Part 2: Matt Wilson

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Bill Keen: Hey everybody, Bill here. I wanted to take a moment to introduce my good friend and colleague, Matt Wilson's presentation from our recent holiday breakfast that we held in Overland Park, Kansas in mid-December. Matt is a Managing Director and Chief Investment Officer at Keen Wealth Advisors, and I've had the good fortune of working with him for nearly 18 years now. Matt does a great job each year at this event, sharing our thinking on the upcoming year and provides an array of supporting materials and data that folks can understand and follow. You are listening to the podcast now, which is one way to consume his work, but a better method would be to go to keenonretirement.com and watch the full high-quality video of Matt's presentation that includes his slides as well. It's much easier to reference slides when you hear him talking about data than just listening to the audio. Either way, I'm certain that you will find his presentation very informative and a resource for your thinking and planning for the remainder of 2020.

Bill Keen: Matt's a guest on the podcast at least every other episode. He's been with me 17 years. He's one of my very best friends. If something happens to me, I know 100% that you all are taken care of with him driving the ship and my own family personally with him handling our assets. So super grateful to have him at the firm and he is my friend and I'm looking forward to hearing your presentation buddy.

Matt Wilson: All right.

Bill Keen: Thank you.

Matt Wilson: All right, thank you. Thank you all. So I would say it wouldn't be hard to take over for Bill because I do a lot of the work at the office already. Alrighty, so Lindsay shared the poll result results and it looks like the answer is to keep the beard. I had a lot of comments of people who liked the beard, so I guess I'll keep it even though my wife doesn't like it. I was at a family event recently and a lot of people were there, people I hadn't seen in a very long time and someone went up to my mother and said, "Hey, is your oldest son here?" And she pointed me out and the girl whispered to my mother and said, "He looks like a movie star." So I at least have that going for me.

Matt Wilson: But I have our presentation, forecast 2020, and I'm going to share with you what happened during 2019 and what we expect going into 2020. Now I have a couple of clips from last year's presentation that I want to cover, and if we can have a little bit of a forecast as to what's going to happen with the economy, we can look out and see how much volatility should we expect. I don't expect a significant amount of volatility going into 2019 because of the quality of the economic fundamentals that exist today. Earnings are great, so I said volatility wouldn't be that bad going into 2019, and it actually wasn't that bad. So I'll take credit for that even though my hair is a lot longer and I have a beard now, so I don't really recognize that person anymore.

Matt Wilson: But the other thing I shared too was just expected returns for 2019 and I have them highlighted here. This was the graphic that I showed and I mentioned we should expect mid double digits in the 15% range for 2019. We've got a little video clip of that as well. Double digits. We're talking anywhere from 15% to 20% the farther we go out. And I don't expect next year to be much different considering the backdrop that we have in the economic data. So I'll take credit for that. Most years, it won't be exactly like that, but in 2019, so our presentation last year, December 8th in 2018, the Dow was just over 24,000. 24,388, and we closed yesterday at 28,135. That is a 15% return from a year ago. Now, for 2019, the Dow was actually up 22%. So one thing I forgot to say was that the market was going to drop for the next two weeks before it started going back up again.

Matt Wilson: A lot of reasons for that to happen. The Fed is committed to keeping this expansion going. We've had a record expansion here in the United States. Now this is going back to 2010. The Dow back then was just over 10,000 and now we're at over 28,000, and that's just without dividends reinvested as well. It's been a good decade. And the theme of the decade has really been the consumer, and I'm going to talk about the consumer, but there has been periods of what I would say sideways or consolidated returns. That's what these red bars represent. The market doesn't just go straight up. From 10,000 to 28,000, we had periods where it didn't do a whole lot. It chopped around, had some volatility, and then we had periods in between those where we had some nice market moves higher. And that's how the market works. We talked about average returns a lot, but returns don't come on an average basis. They come all over the place. They're volatile. And that's what this graphic represents.

Matt Wilson: And now we just got through a period of another sideways consolidation. So should we expect another leg higher or are we at a market peak possibly headed into a recession? So where are we today? Well, stock prices are a function of earnings. Earnings for 2019 are flat. Expectations when we get the earnings reports in January for the end of Q4 are 0.2% growth for 2019. 2020, analysts are projecting almost 10% earnings growth. So a pickup in earnings next year. Now revenue has been good. Revenue is up 3.8%. It's not a phenomenal growth rate, but revenue is up 3.8% in 2019. Earnings are flat. So what that tells us is that costs have gone up and it hasn't been taxes. Taxes have come down. We're seeing higher labor costs, higher capital expenditures, which is eating up a little bit of the profit margin. So that's give me one of the themes going into 2020, will earnings pick back up because, again, stock prices are a function of earnings?

Matt Wilson: This is a graph that displays that concept. So this is earnings for the S&P 500, the 500 largest companies here in the United States. So that's what that red line is. It's the earnings chart. We've got 2019 on there and then the projections for 2020 and 2021 and then overlaid on top of that, this black line is actual value of the S&P 500. You can see it follows earnings very closely. There are periods where the S&P gets a little ahead of itself, like we saw in the late '90s, prices got much appreciated much faster than earnings did and then the market had to recorrect after that to get back in line, but you can see though where stock prices are today relative to earnings.

Matt Wilson: Now, what drives earnings? So we have stock prices are a function of earnings. Earnings are driven by GDP. So this is nominal GDP here in the US and I've overlaid sales or revenue for the S&P 500. You can see it's correlated, not exact, but GDP is the value of all the goods and services that we produce on an annual basis, which materializes in sales or revenue for the most part for corporations. So if earnings are driven by GDP, well, what drives GDP? Well, GDP here in the United States, we're at $21 trillion and we've been on this expansion for a record 125 months, longest expansion in history. So what this graph shows is we've got time at the bottom. Those gray bars are recessions. We have not had a recession since the last one ended in 2009

Matt Wilson: This decade of the 2010s will be the first decade ever without a recession in the United States. I'll go on a limb and say that we have two weeks left. I don't think one's going to start in the next two weeks. The problem with the definition of a recession though is we don't know we're in a recession until six months after it started. It's two quarters of negative GDP growth to officially be in a recession. So I guess one could be starting right now and then they'll tell us six months from now, but based on the data I'm going to show you, I don't believe that's the case. So GDP, that $21.5 trillion, this is what makes that up. That very large red bar, that's personal consumption. It's almost 70% of that $21.5 trillion.

Matt Wilson: Consumer spending drives this economy and that's us all just what we spend our money on. The next highest category is business investment at 18%, so it's businesses spending on capital expenditures, inventory, what have you. After that is government spending, 17%, and then that last component, that's our trade balance. That is exports minus imports. So we import more than we export, so that takes away from our GDP minus 5.1%. And that, by the way, when we talk about the tariffs, that's where the tariffs are shown up in that negative 5.1 primarily. So if GDP drives sales, which drives earnings, which drives stock prices, and then consumers are driven by GDP or consumers drive GDP, well, what's the health of the consumer because that can give us an insight on our expectation for higher stock prices going into 2020?

Matt Wilson: Well, one way we look at the consumer is through the balance sheet. So the big red mountain graph there, those are assets. We're at a record high. Next to that is debt. Balance sheets are continuing to approve over $129 trillion in assets, $16 trillion in debt. So balance sheets are in good shape, right on trend line too by the way. That's what that black line is. Consumers too aren't racking up more debt and actually their debt, if they have some, is cheaper to service than ever. So this financial obligations ratio, this looks at the percentage of their disposable income that they have towards fixed debt costs, which could include mortgages, rent payments, auto expenses, 15%. It's hardly ever been lower. It'll ratchet up as consumers begin to overleverage, which is one of the warning signs. But right now, financial obligations, that ratio very strong.

Matt Wilson: Now, what about the jobs market? So what's the outlook for consumers too because consumers need to have jobs to be able to afford their expenses? You see, the unemployment rate here in the US, 3.5% is what came out in the number for November that was just announced early December. Longterm average, 6.2%. But you'll notice in this chart, we're never at the average. It's always either well above it or well below it. And is that sustainable? Well, yes and no. Now this is a broader measure of unemployment because people say, "Well, that only counts, that first chart I showed, it only counts people that are actively looking for work." So if someone took a lower paying job because they couldn't find the job they wanted or if they dropped out of the workforce, they're not counted in that first number.

Matt Wilson: This counts them. This is the U-6 unemployment rate. It's the broadest measure of the employment markets that we have, 6.9%, longterm average, 10.7%. And what you'll notice, what I like to focus on is the trend. It's what direction is it going? It's not about the actual percentage specifically. Are we seeing changes in the trend? You'll notice those last two charts, it's starting to slow down a little bit. It looks like it might be hitting a bottom, partly because it's hard to get much lower than that. You can't have a negative unemployment rate. Zero is the baseline.

Matt Wilson: Now what about the younger generation? There's always a lot of chatter about them. Millennials are working and continuing to work, but also people over age 65 are continuing to work longer. That's actually one of the fastest growing segments in the jobs market is age 65 and over. So this is the labor force for individuals we've got on here, 15 to 74. Again, that's continued improvement too. So more people are continuing to work as a percentage of just all of the population. And as I mentioned, the younger generation, this is from 25 to 34, they're working highest number ever of millennials working. Those are the children or the baby boomers and there's more millennials than there are baby boomers. That cohort will be going through the economy and you spending a lot of money.

Matt Wilson: This is the number of job openings compared to the number of people looking for work. Last year, this started for the first time. We had more job openings than people actually looking for work and it's still that way. That's a good and bad problem. It's a bad problem if you're looking to hire somebody and you can't find somebody to do the work. It's a good problem if you're an employee because if you're looking for a job or looking to switch jobs, they'll probably offer you higher compensation, better benefits, what have you, to fill that gap. 7 million job openings, 5.8 million people considered unemployed, and there's still a slack in the labor market too.

Matt Wilson: So this is basically what's available because those percentages, I said that 3.5%, that's a low number, but it doesn't count people that aren't looking for jobs. So these folks, these actually aren't counted. These are people who would like a full time job, but they're not actively looking. So they don't get counted in any of the unemployment statistics. There's less and less of those out there, but that number, that trend is still continuing to improve. It tells us there's still more availability out there.

Matt Wilson: This is, I say this every year, it's my favorite graph. I think this is one of the most important indicators of the future health of the economy. This is the initial jobless claims here in the US, so this is when people first get laid off and file for unemployment. This gets released every week Thursday mornings. You have to go back to the 1960s to find a number that's lower. That trend continues to improve. And it can only go so low, and what we look for, our trend changes. Do we see spikes in this number that are headed in the other direction because that'll tell us that corporations aren't confident about the outlook and they're starting to lay people off? When they begin to lay people off, those people don't have money to spend, which again reduces GDP, reduces sales, reduces earnings, reduces stock prices. So it all starts here in the jobs market. Market pays very close attention to this number.

Matt Wilson: This is real disposable income. So real, whenever you hear that, what that means, that's after inflation. So they net inflation out of it. So we can compare this to historical numbers without inflation impacting it, and disposable is after taxes. So this is what you actually have available to spend. Highest number ever. And it's been improving since the recession of o9. This gives us insight too on the ability for consumers to continue spending. Some of those spikes in there, you'll notice one of them in 2013 was actually a change in the tax system, increased taxes, and that's why it dropped down. The 1 No.4, interestingly enough, Microsoft declared a special dividend and there were so many share owners of Microsoft stock that it raised personal income in the US when they paid that out.

Matt Wilson: Continuing to improve, and people have more money to spend, which is great. That's what we want to see happening in the economy. So currently, we're in a situation, we still have more jobs, people are earning more, wages are actually going up, inflation is rising, but the Fed, they've come out and said, "We're not going to do anything until we see inflation show up." So they left rates the same. It's about 1.5% on the fed funds rate. So instead of them trying to be ahead of inflation, which is historically what they've done, they've tried to raise rates in anticipation of future inflation. Now they said, we're just going to wait for it to show up first because we tried to get ahead of it last year and that was basically what happened in Q4. Fed kept raising rates and were committed to raising rates and the market didn't like it. The market sold off and then the fed changed course in January and the market's just been off to the races ever since.

Matt Wilson: But that strong consumer will lead to more revenue, higher earnings, and higher stock prices. So what's the expectation into 2020? So I mentioned we've had a record expansion since the 2009 low end recession ended. There's been someone predicting a recession every single year since then, mainly because it gets a lot of attention if they get on TV and start talking about the end is coming. So the TV stations put up those people on TV, but the reality is we have to look at the data. Now, the reason I talk about recessions a lot is because recessions are where we see significant market drops that can last for a long time. There's always volatility even in the bull markets. So when markets are going straight up for the last 10 years, as I showed, there's periods of sideways markets, there's volatility, but there isn't the sustained pullbacks like we see during the recessions. So these are recessions and bear markets since the great depression. The average decline, so when the market peaks where it finally stops going down, is -42%, and the time it takes from the peak to the trough is 22 months.

Matt Wilson: Most people don't want to live through something like that again. And so if we can get some insight into the odds of a recession coming up, we can attempt to avoid this as much as possible. That's why I share those indicators to let you know, here's what leads the economy to tell us if something like this is on the horizon, because I mentioned that four week moving average of initial jobless claims, very good indicator. Every single time before recession, so those gray bars, you'll notice the little red arrows that I have pointing up, we've always seen people being laid off ahead of time and it's because our economy is driven by the consumer. So if they don't have jobs, they're not spending. And if they're not spending, corporate earnings go down, which reduces stock prices.

Matt Wilson: It's not that complicated. The media, whether they know this or not, they don't want to just talk about this because that gets pretty old pretty quick, but if I had only one thing I ever would look at, it would be this. And right now we're not seeing a trend change in the market. Now that is one of the issues though. If earnings don't start to pick back up in 2020, that could be something that happens. Corporations may start to lay people off because earnings aren't growing as fast. Now the expectation is earnings will grow, but we watch that very closely, but the market watches it too. The stock market follows the job market. So what I have here, the blue line, US stock market, and then the red line is the unemployment level.

Matt Wilson: So as the unemployment level goes down, you'll see the stock market goes up. But I inverted the unemployment level in this next chart, so it makes it easier to see that correlation. The stock market and the jobs market, they are highly correlated. And you'll notice the red line, it tends to go down first before the stock market does. So this can give us a very good indication for the future of stock prices. Slower growth in corporate profits and corporate earnings is going to be one of the themes in 2020 seeing that pickup and now the concerns are what's causing it. Again, as I mentioned, higher labor costs, which is an okay thing, in additional capital expenditures to replace property, plant equipment, inventory, what have you, and those are okay.

Matt Wilson: It's going to bring down profit margins a little bit, but if revenue grows high enough, that will offset it and we'll see positive corporate earnings. The other issue is the tariffs. Any time the word tariffs are mentioned, the market either goes way up or way down almost instantaneously. And we also have the election coming up in 2020. Be no shortage of commentary on the markets and the economy and the candidates. It's already been going on. There's way too many people out there now. They need to start narrowing it down, which they will, but it'll be the theme in 2020. Now the tariffs. I get a lot of questions on the tariffs. So I mentioned our trade balance, it's negative 5% of our GDP, and only China, our trade with China is only a portion of that.

Matt Wilson: So it's not a very big component when it comes to our GDP, but the fed has put out some estimates that said if the tariffs were fully implemented, we would expect households to spend an extra almost $900, $831, on goods because of the tariffs. So all that is is attacks. It doesn't go to anyone's bottom line besides the governments. And the market is saying, well, that's $831, that disposable income, that's not going to a corporation or somewhere else or even just into their savings, which would boost the economy. The tariff isn't going to boost the economy at all and that's why the market's reacting to them. Now we have supposedly a phase one deal. So the tariffs that's supposed to be instituted tomorrow won't happen, but there's still future tariffs on the board. But that's why the tariffs are getting so much attention.

Matt Wilson: Now the other issue, especially around the election, is what are the candidates' policies around business environment, So more regulation or less regulation, and also taxes? We've got a short video and I think it describes most people's feelings around taxes.

Speaker 3: Oh my gosh.

Speaker 4: Where's all your money going buddy?

Speaker 3: Taxes. 9, 10, 11. Let me fix my houses.

Speaker 4: But it's okay. It's part of the game.

Speaker 3: No, it's not.

Speaker 4: It is.

Speaker 3: It's not fun.

Speaker 4: It's not fun to wait?

Speaker 3: It's the worst part of the game.

Speaker 4: Is what?

Speaker 3: Taxes.

Matt Wilson: So and that's not... That wasn't my son, my family. I found that online, but I actually found that earlier this year. I'm like, "I have to save that. That's..." But that is. That's the issue that the market cares about the most is tax policy primarily. Now this graphic, this is electionbettingodds.com. So anyone can go there, but the reason I like this is because people are placing wagers with money on what they think is going to happen. So it's not what you want to happen, you're putting money down what you think will happen. And it actually can be a little bit more realistic, more accurate than some of the polls are. Now right now, Trump is the favorite. You can see Biden and then Sanders in that middle component there for winning the election. Now this will change a lot between now and November just as the candidates get shored up and we actually know who's running, but the tax policy is the big factor.

Matt Wilson: Now I will say this, it doesn't matter who gets elected if their tax policy is significantly worse than what we have currently and what we've had historically, the odds of something like that getting passed through Congress is pretty low. So as much as Congress gets hard time for not doing a whole lot, that can help too because presidents can't just do what they want. They have to get the things passed through Congress. We even saw that with president Trump the first two years. He had a Republican Congress and he wanted to do a whole lot of things. And he got tax reform pushed through towards the second year, got a lot of things done, but he wanted to redo healthcare and there wasn't much support for that. So it works both ways too depending on who gets elected. But that'll be one of the themes that we're watching in 2020 is as this gets closer, how does that look?

Matt Wilson: Now markets also give us a little bit of insight too. So historically, when the incumbent is running again and the economy and stock market are performing well, they have very high likelihood of winning the election. And the fourth year of a presidential term is also historically a decent year. Third year, very good. That was the data I shared last year. Fourth year not quite as good as the third year when we look at those historical averages, but still good. So what I have highlighted is returns that we've seen going back to the great depression, average returns, 7.9% and median return, 8.7%. And you have to go all the way back to Truman to have a negative return in the stock market, and then prior to that was Hoover, that was in the midst of the great depression.

Matt Wilson: And I wouldn't expect this to be different based on what I shared around the consumer and the outlook for the consumer, what the jobs market is currently. If things are pretty good right now, and the trends have been good as well. So to summarize everything, we've got good jobs, good wages. Earnings, they're decent. They aren't negative for 2019, but they're flat. Now that's coming off of 2018. Earnings in 2018 were up over 20%. Now revenue growth was half of that and tax policy changes were half of that. So it wasn't all just because of lower taxes. So 2019 having flat earnings isn't a huge surprise, but this is the theme. This has been the theme for the last decade, consumers and jobs. This is what drives the economy and that correlates to higher stock prices.

Matt Wilson: There is no signs of recession. Now if the data changes, of course we'll change our opinion. I say they're strong opinions loosely held. We'll change them. Not married to anything as long as the data supports it, and maybe we see signs show up next year and a recession in 2021. It's hard to say until we actually start to see signs of it first. So you won't see us necessarily predicting or coming and pounding the table until we actually have data to confirm it. And I always like to remind folks, volatility is just a feature of the markets, so we will always have volatility, and the numbers are large, 28,000 Dow. Well, 1,000 point drop doesn't have the same impact today as it did 10 years ago, but when you see 1,000 point drop, that's nerve wracking.

Matt Wilson: And the media will hype it up. They'll have all the graphics, markets in turmoil, breaking news, but I always warn this. If you ever see a point drop, you have to convert it to a percentage because it's always about the percentage that gives us that historical comparison. So Lee Iacocca, he passed away this year in 2019, worked at Ford, then went to Chrysler, turn it around. Lot of great quotes, but I thought this one defines the system that we have here in the US. We are continually faced by great opportunities brilliantly disguised as insoluble problems. And we incense. We have a system in place that incense people to solve these problems. And we don't necessarily know what the answers are today to some of them. We don't necessarily need to know the answers today, but we do figure them out and we've continued to figure them out.

Matt Wilson: But I think the outlook for 2020 looks good. We've got, again, all that data looks very solid, strong markets going into it. We just came through a period where the market didn't do much. A darn year hit 27,000 in January of 2018. I think it hit like 26/6 on the Dow, and it didn't break through that 27,000 barrier until October of this year, so 22 months. Market didn't do a whole lot and now we're breaking out to the upside. Maybe the catalyst is getting some of the tariff discussions off the board going into the election. Fed is on the same page now. They were a little out of tune last year. They're committed to doing everything they can to continue the expansion. Now, the fed will be overconfident. The current chairman has said that they feel they have the tools and policy in place to continue the expansion indefinitely. So they think they can prevent a recession from ever happening ever again in the future.

Matt Wilson: Now I guess they say that for job security reasons, because if they said, "You know what? We're okay at it, but we can't prevent all the recessions," people probably would be more adamant on firing the fed, but they feel that way. Now the reality is they can't prevent it from happening. They can stimulate and they can do everything they want, but they can't put... Unless they're putting money in people's pockets, which just grows the size of the government, not necessarily the size of our system, but they have the tools in place. But they are being very accommodative right now, which is very good going forward.

Matt Wilson: Now before I bring up our entertainment, as Bill mentioned, at Keen Wealth, as we continue to grow, we're in this new space this year, which we are very happy with. A lot more space than we had next door at the Sheridan, but we're committed to being the best advisers we could be in greatest service to our clients and that's why we're growing our organization and we have the individuals that we have and continue to add top talent because when we find somebody and we know that we need to have them on our team, we're going to hire them whether we actually need to or not. And it's to support that commitment, just serve you all in this room.

Matt Wilson: So I want to thank you all for coming. We appreciate the faith and trust that you've put in us and hopefully you've enjoyed the event today. We have, getting great entertainment here to close this out and I want to thank the team as well. I know Bill brought up our planning team and our operations team and also the back-office folks who didn't really want to come up, partly I think because they were up all night getting this together. I update the data up until the close of the market, so they have a lot of work to do. And without them, this event wouldn't be happening. They were here very early in the morning making sure this all comes off smoothly.