

# Money Manager Newsletter

March 31, 2019

## Investment Consulting Group, Inc.

**"The Most Important Lesson In Investing Is Humility"**

**Sir John Templeton**

### Welcome To The New Cold War In Tech

Cisco Systems, an early Silicon Valley success story, has become one of the nation's top tech exporters. Today, roughly half of the networking giant's sales come from outside the U.S. As foreign countries sought to catch up with U.S. connectivity, Cisco helped plug them in. But a wave of nationalist thinking has put Cisco (ticker:CSCO) and most of its peers, in an uncomfortable position. Earlier this month, Cisco CEO Chuck Robbins described the current climate as "one of the more complex macro, geopolitical environments that I think we've seen in quite a while with all the different moving parts." It's likely to get worse. As the White House was negotiating on trade with Beijing, it was also contemplating a U.S. ban of telecommunications equipment from Chinese companies like Huawei Technologies, essentially China's version of Cisco. President Donald Trump was tweeting about the importance of 5G, as Secretary of State Mike Pompeo was pushing U.S. allies to ditch Huawei. At the same time, China is no longer content to be the world's factory for low-cost goods, pushing its own homegrown companies to challenge the global positions of established tech leaders. For China, technology is central to its ambitions to be a global power, a topic that goes well beyond trade agreements. In December, at the request of the U.S., Canada arrested Huawei Chief Financial Officer Meng Wanzhou on charges of bank and wire fraud. China's investments in the U.S. fell to less than \$5 billion last year from \$46 billion in 2016, according to Rhodium Group. Wall Street's tech analysts can't model for an end to innovation. But that doesn't mean investors should dismiss the risk. Huawei, if the company is hit with an export ban similar, research says the company would be likely to survive. While a collapse might be seen by U.S. officials as a cold war victory, it would reverberate throughout the global economy. Huawei has six times the sales of ZTE, and its gear is used in 170 countries. The companies are still grappling with their own challenges, China's economic slowdown is denting Alibaba's sales, increased investment and marketing are pressuring Baidu's margins, and regulations around gaming loom over Tencent's stock. Those challenges are now reflected in the stocks. The three companies lost a total of \$229 billion in market value last year, and each trades below its five year price/earnings ratio.

Reshma Kapadia—Barron's

Although President Donald Trump started the trade war, pretty much all sides in America agree that China's steroidal state capitalism makes it a bad actor in the global trading system and poses a threat to security. Many countries in Europe and Asia agree. At the heart of these complaints is the role of China's government, which funnels cheap capital towards state firms, bullies private companies, and breaches the rights of foreign ones. As a result, China grossly distorts markets at home and abroad. Mr. Xi took power in 2013, China has in some ways gone backwards. Two decades ago it was possible, even sensible, to imagine that China would gradually free markets and entrepreneurs to play a bigger role. Instead, since 2013, the state has tightened its grip. *The Economist*

If banking or institutions are protected by the taxpayer and they are given free reign to speculate, I may not live long enough to see the crisis, but my soul is going to come back and haunt you.

Paul Volcker—Fed Chair 1979-1987

3/31/2019	Growth Median P/E	Historical Growth Avg.	Value Median P/E	Historical Value Avg.
Royal Blues	33.1x	25.0x	12.9x	11.6x
Large Cap	23.1x	20.1x	10.7x	10.9x
Mid Cap	30.2x	23.7x	11.1x	12.1x
Sm Cap	31.5x	27.7x	11.0x	12.1x

### 5 Pieces of Advice From John Bogle

To honor John C. Bogle, who recently died, and is widely seen as having changed how ordinary people invest their money.

#### 1.) Stay The Course

"Wise investors won't try to outsmart the market. They'll buy index funds for the long term, and they'll diversify."

#### 2.) Beware The Experts

Money managers missed all the warning signs before the 2008 financial crisis.

#### 3.) Keep Costs Down

Vanguard's fund shareholders own it collectively. "In investing, you get what you don't pay for. Costs matter."

#### 4.) Don't Get Emotional

Invest in a diverse selection of stocks and bonds, trust in the arithmetic and stick to it. "Impulse is your enemy."

#### 5.) Own The Entire Stock Market

Mr. Bogle was the leading proponent of structuring an investment portfolio to mirror the performance of a market.

John Bogle—Founder of Vanguard

Paraphrasing Martin Luther King Jr., Bogle to Barron's earlier this year that "the arc of fiduciary duty is long, but moving in the right direction." And he intended to see that it kept doing so. "I have no corporate power," he added. "But I believe I still have more ethical and intellectual power. And that is good enough for me."

Beverly Goodman—Barron's

### The 4% Rule

The 4% rule was originally developed by William Bengen, a financial planner from MIT. Through research, Mr. Bengen found retirees can take 4% of their initial retirement assets and increase that amount every year to account for inflation, assuming a 50% to 75% portfolio allocation to stocks. In Mr. Bengen's study, applying the 4% rule led to a worst-case scenario of an investor's money lasting 35 years. Thus, the 4% rule was born. My work recreated the study with retirement withdrawals beginning every year from 1929 to 2009—82 separate retirement starting points. We used actual market data until 2017 and ran multiple simulations with historically conservative average return estimates thereafter: 5% for stocks, 2% for bonds and 3% for inflation. What I found was that 70% of the time (58 of the 82 scenarios), retirement funds lasted 50 years or more. The remaining 30% of the time, the money "ran out," with the worst-case scenario in our study being 29 years. So, yes, the 4% rule can still work.

Wes Moss: Atlanta's Capital Investment Advisors

### The Proposal

Impose tests on corporations before they engage in stock buybacks is just one of a series of bad ideas emanating from Washington. Others include a wealth tax and a 70% top income-tax rate. Barron's asked Berkshire CEO Warren Buffett for his views on a wealth tax since he would be one of the biggest payers, given his \$81 billion stake in Berkshire Hathaway. Buffett, who would owe about \$2.5 billion annually, did not respond. To pay such a tax, he might have to sell stock and cut his charitable giving. Still, Jeff Bezos, not Buffet would likely be the biggest payer. He has a \$125 billion stake in Amazon.com, or at least will until his divorce settlement. Sen. Warren ought to call it the Buffet and Bezos tax. Nearly all of Buffett's wealth is being given away, with most going to the Bill and Melinda Gates Foundation. Buffett's philanthropic footprint is enormous and laudable. But it will be hard for future generations of entrepreneurs to accumulate Buffett-sized fortunes to give away if onerous taxes are imposed.

Andrew Bary—Barron's

In investing, the return you want should depend on whether you want to eat well or sleep well.

J. Kenfield Morley

DJ IA	Nasdaq	S & P 500	Russell 2000	MSCI EAFE	Crude Oil	Euro	10 yr Treas.	Fed.Fund Rate	Prime Rate
25928.68	7729.32	2834.40	1539.74	7761.73	42.53	0.8077	2.41	2.25-2.50	5.50

As opposed to a rising tide of worries swirling in the media and market-place commentary, we build our continuing case for US and global economic growth predicated on several basic conditions:

- 1.) employment growth leads to income growth leads to decision-making leads to activity leads to economic growth;
- 2.) economic growth based on income growth, and not accelerating debt growth, creates momentum but not speed;
- 3.) demographics, particularly the rise of US millennials, provide an emerging source of demand built on 1) and 2).

M. Randolph Westlund, CFA—Quad City Bank and Trust

There is no one who can replace America. Without American leadership there is no leadership. That puts a tremendous burden on the American people to do something positive. You can't be tempted by the usual nationalism. Lee Hong-Koo—S. Korean Prime Minister

### Degrees of Success

For every 100 students who enroll full-time in college or university, 42 percent will graduate within four years and 18 percent more will graduate within six. This means that two out of every five college students get all the benefits of crippling debt with none of the gains of an actual degree. Of the 60 students out of every hundred who graduate, 42 will leave with student loans and five will default on those loans by the age of 33. For the 40 who don't graduate, 10 will default on those loans. Even more, 10 years down the line, 32 percent of the college grads end up in careers that didn't require a college degree in the first place. Douglas Belkin and Dylan Moriarty—The Wall Street Journal

A paper by academics at Chinese University of Hong Kong argues that Chinese annual growth was overstated by 2 percentage points from 2008-16. The economists argue that local governments over-report growth and the central government under adjusts it. There is certainly anecdotal evidence in the fact the adjustment always results in a growth rate equal to the target selected by the Premier at the start of the year. Does anyone doubt that this year's growth will be in a 6-6.5% range? Of course it will be. But the paper's reliance on tax data is dubious, as China has a vibrant grey economy. China's rich are estimated to hide over a trillion in income from the tax collectors annually.

Bloomberg News' Christopher Condon offers a terrific roundup of Fed thinking on low inflation. Fed Chairman and other policy makers make no mention of the global economy, which would be downright bizarre if it were not so predictable. "It's almost surely true that inflation is less tightly linked to what's going on in the real economy than it used to be, and that matters a lot." said Jeffrey Fuhrer, director of research at the Boston Fed. Got that? The Fed would rather believe inflation has disconnected from reality than try and understand the complexities of the global real economy. There is more labor slack than you think. Plenty of people out of the labor force are actually looking for work, the BLS definition of looking is outdated. Or, there's international labor slack. Secular disinflation caused by a host of factors like older people saving more and spending less. Expectations are the most important driver of inflation, according to Jay Powell in his monetary policy testimony to congress. Problems with inflation expectations, for instance, last year expectations rose sharply in the first half of the year, following an ugly CPI report in January, but inflation fell back in the second half of the year. That is exactly what happens with expectations and inflation according to several prominent studies by Fed economists. Chris Low, Chief Economist -- FTN Financial

Capitalism without Bankruptcy is like Christianity without Hell. Frank Borman—NASA Astronaut Gemini 7, CDR Apollo

### How Do Banks Make Money?

The fallacies of fee income is simple. The old rule was regarded as 3-6-3. Bankers pay 3% interest rate on deposits, charge 6% rate of interest on loans, and head to the golf course at 3 o'clock. Remarkably, interest income now accounts for nearly half of all operating income generated by U.S. commercial banks. Fee income has more than doubled as a share of commercial bank operating income.

Donald Stanforth, President—Investment Consulting Group, Inc.

### It's Polling Question Time

Over the last 30 years, steady engagement between the governments, companies and people of the U.S. and China has:

- A.) generated significant benefits for both Americans and Chinese
- B.) benefitted China more than the U.S.
- C.) failed to deliver significant benefits to either side

In the coming years, the best way for the U.S. to achieve its economic and political objectives with China is by:

- A.) close engagement to cooperate where possible, and to push the Chinese government to change its view/practices where necessary
- B.) pursuing policies designed to slow China's economic rise, which represents a threat to America
- C.) focus on achieving change in china's political system rather than on economic and commercial opportunities

Andy Rothman, Investment Strategist—Matthews Asia

One last comment from last quarter regarding Target Date Funds. The investment industry needs to explain more clearly what a Target Date Fund is to retirees, and how it helps them retire.

Donald Stanforth, President—Investment Consulting Group, Inc.

### How Do Target Date Funds Work?

- The "target date" (customarily part of the fund's name, e.g., "Vanguard 2020 Target Retirement Fund") corresponds to the year in which a typical investor in the fund expects to retire. Then the participant at retirement date keeps this fund "through" retirement.
- The "end date" is the year when the fund stops changing its allocation between growth and safety. (Subcategories may continue to change.)

"People start being interested in something because it's going up, not because they understand it or anything else. But the guy next door, who they know is dumber than they are, is getting rich and they aren't... It is so contagious. So that's a permanent part of the system."

Warren Buffet

Treasury Market Yields	3/31/2019	12/31/2018	12/31/2017
2 Year	2.27%	2.48%	1.89%
5 Year	2.23%	2.51%	2.20%
10 Year	2.41%	2.69%	2.40%
30 Year	2.81%	3.02%	2.74%
SP 500	1.96%	2.15%	1.89%
Commodities			
Oil (\$/bar)	\$42.53	\$45.41	\$60.42
Gold (\$/oz.)	\$1176.20	\$1278.30	\$1306.30
CRB Index	\$168.36	\$169.80	\$193.86

