GREENE WEALTH MANAGEMENT LLC

"Success is not final, failure is not fatal: it is the courage to continue that counts"
- Winston Churchill -

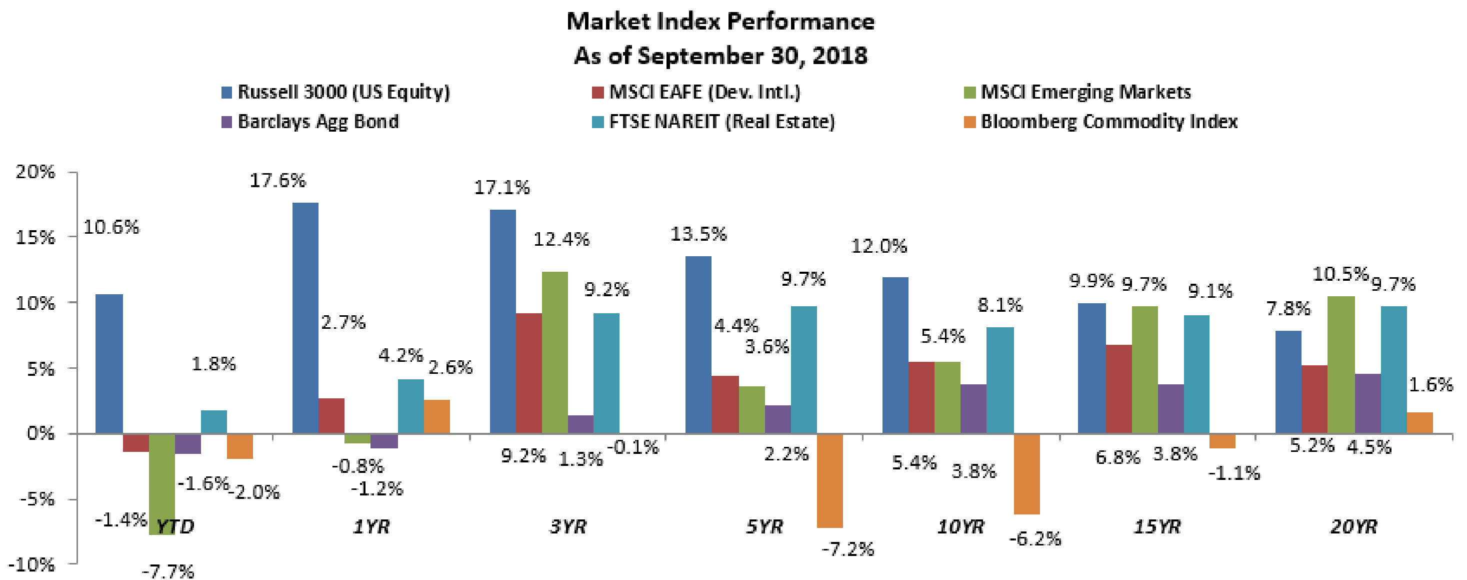
October 11, 2018

Churchhill went on to say "let our advance worrying become advance thinking and planning". Despite plenty of good news, it seems there are plenty of things to worry about too. The US economy is strong, unemployment is remarkably low, wages are rising, and both stock and real estate markets have been strong. However, trade wars, rising interest rates, natural disasters, downright nasty politics, and perhaps things being "too good" provide more than enough to worry about—and big stock market declines like we've seen the past two days always get our attention. We think it's important to remember that corrections and bear markets both happen often. From 1980-2017, there were 12 market corrections and 7 bear markets. This means we had one "attention grabbing" downturn every two years on average. The best and worst days often happen close to one another with market-timing attempts simply resulting in selling low and buying high—suggesting the value of keeping a long-term perspective. So, let us think and plan together.

Let's begin with a look back. Last month marked the 10th anniversary of the unofficial start of the financial meltdown when Lehman Brothers filed for bankruptcy. Remarkably few saw it coming despite signs of excessive risk-taking that now seem clear with the benefit of 20/20 hindsight. Home buyers and lenders got caught with outsized mortgages and plunging property values—and defaults no one imagined possible threatened to take down the banking system. Many investors never imagined losing 50% or more in the stock market and their first response was to head for the exits. We worked incredibly hard to advise clients to ride out these scary times with the well-diversified portfolios we had built—as history clearly showed that those who sell into fear usually regret the decision while those who stay invested are usually rewarded. Such has again since markets bottomed early in 2009 and the benchmark S&P 500 more than tripled, climbing up a "wall-of-worry" along the way. We have enjoyed what is arguably the longest bull market in history—but this wasn't so obvious in the middle of the meltdown or even along the way. "Staying the course" was not easy advice to give….or to take—but it turned out to be prudent.

We think there are some key takeaways from this history lesson. First, it is important to have a strategy in place that is truly consistent with your goals, time horizons, and risk tolerance—ahead of time. Loading-up on risk when times are good may feel great while markets rise—but can leave you quite vulnerable when corrections come. As Warren Buffett says, "only when the tide goes out do you discover who's been swimming naked". Another important lesson is to try and actually take advantage of market downturns by loss-harvesting that can save taxes later-on—and by rebalancing portfolios. We advise clients to do both—being proactive beats being reactive on both counts. And let's not forget about the risks of making any big "single-stock bet". No one from the Northwest will forget about the failure of Washington Mutual Bank—a century old bank with a long history of conservative management that got caught up in the sub-prime lending debacle and went bankrupt. Even fabled General Electric, which was one of the very few non-financial companies to hold a coveted AAA rating, now faces downgrades to BBB following a series of problems including troubles in its financial services business—with its stock price falling over 75% from an October 2000 high. Even Amazon, which has soared in value, dropped over 10% in just 5 days. One need only think back to the tech-bubble to be reminded of the risks that come with making any sector "big bets". Bottom line: holding a big position in a single stock or sector can be fun while things are good, but change can occur quickly without much warning, and translates into risk that may not be consistent with your goals.

The record bull market has left US stocks arguably expensive by many measures (certainly less expensive after the current two-day drop). Vanguard thinks that valuations are high, but not in "bubble territory". While US equity market momentum has continued to reward investors, high valuations and other indicators suggest some caution as we look forward. Russell notes "the hurdle for US earnings to surprise on the upside is very high as the impact of tax cuts will soon disappear and both borrowing costs and wages headed higher. A slowdown in earnings growth will take away one of the main supports for US outperformance relative to other markets". By comparison, valuations for developed non-US equities look more attractive—and many believe emerging markets are oversold with attractive longer term potential. We do not believe in trying to "over-steer the boat" with short-term tactical changes—but we do believe these factors support our view for long-term investors to remain globally diversified. Here is a look back at market returns through 3rd quarter-end:



We understand it can be hard to keep exposures to developed and emerging market equities when looking in the rear-view mirror like with this chart. Doing so clearly reduced returns compared to an all US equity portfolio. But we've long talked about how market leadership changes over time—and we think pricey US equities vs. more favorably valued developed non-US equities and downright cheap emerging market stocks argue for keeping a global perspective. It just may take time to prove out. Here are more ideas to consider as we think and plan for the future.

- While few economists are predicting a recession over the next 12 months, many note increasing odds of an economic downturn as they look into 2020. Having said that, anything can happen.

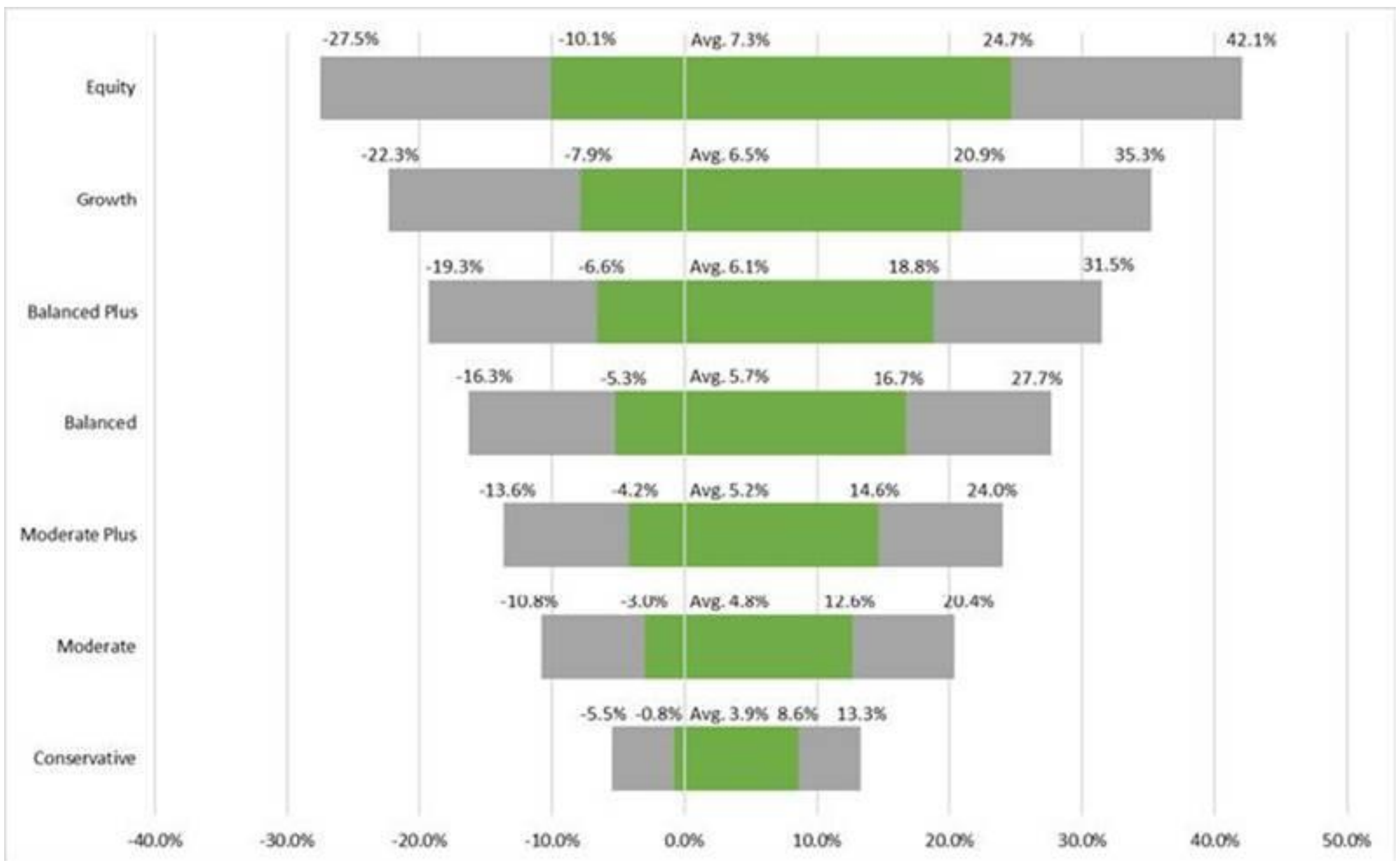
- High valuations for US stocks and low (but rising) interest rates suggest a modest outlook for future returns for both stocks and bonds. This view is shared by firms we respect including Vanguard, Russell, Northern Trust, Schwab, and many more. The longer term outlook for developed and emerging non-US equities is more favorable—but as we've seen so far this year, market leadership changes can take more time than expected, so patience may be important.

- We believe it prudent to look for ways to help cushion portfolios against potential stock market corrections. Accordingly, we have decided to increase the quality of our US bond allocations. While there are no guarantees, history has shown that high-quality bonds, particularly US Treasuries, have provided good protection against equity risk. For example, the S&P 500 fell 37% in 2008 while intermediate term government bonds rose almost 5%. We will be updating our model strategies for taxable portfolios with fund changes that increase our exposure to AAA bonds from about 40% to approximately 65%. This will leave the bond portion of portfolios intermediate in duration, higher in quality, and lower in fund costs with a very small reduction in current yield. We think this modestly defensive move is prudent as we look forward.

From a planning perspective, we continue to advise using what we believe are realistic assumptions about future returns. Research suggests using return expectations of 4-7% over the next 20 years depending on asset-allocation—with higher potential returns coming with higher risk. Standard deviation measures expected volatility around average return expectations within a particular confidence range. The expectations are based on a normal distribution of projected results. Risk/return forecasts are not estimates or guarantees of future results - actual future returns will almost certainly be different than these estimates used for planning purposes. Here is a look at the assumptions we use in stress-testing financial plans using Monte Carlo simulations.

1-Standard Deviation: 68% of projections fall within this range.

2-Standard Deviations: 95% of projections fall within this range



"Equity" Represents 100% stock portfolio and "Conservative" represents 20% stock and 80% bond, others fall between the two extremes.

Note we do not believe there is a "free lunch" when investing. Seeking higher potential returns involves accepting higher risk—and it is important to note that taking more risk does not necessarily assure higher returns. These same realities are faced by big pension plans, where actuaries have systematically been reducing assumed returns to more realistic levels. Lower forecasted returns, along with rising lifespans, have left many pensions woefully underfunded—requiring sponsors (government and private) to substantially increase contributions, cut benefits, or risk default. The lesson to be learned from this is that it takes more (sometimes a lot more) money to provide any given level of retirement income if returns are lower and life expectancy is longer. We have continued to advise clients to use realistic assumptions in planning for retirement, to review/update plans regularly, and to determine what (if any) mid-course corrections are prudent to meet long-term financial goals. We are reminded that clients cannot control life expectancy or market returns—but do have some control over how much they save and spend.

We are indeed fortunate to work with successful people who for the most part are well-positioned to meet long-term financial goals. This is not a matter of luck, but rather the result of living within their means, a strong commitment to saving, prudent investing, and thoughtful ongoing planning. But life has a rather amazing way of throwing us surprises (both good and bad) that can require planning changes—which is why we stress the importance of regular reviews. Much like with medicine where early detection can be so important, so too is it with financial planning. Early detection can allow for modest changes applied over long time periods—while waiting too long can makes fixes remarkably difficult. A combination of fairly small adjustments can go a long way in improving results. A modest increase in savings and working a little longer can improve results when changes are made well in advance of retirement—but waiting until just before retirement requires more dramatic and unappealing changes.

Studies suggest that Americans continue to worry about running out of money when they are old—so take Winston's advice and "let our advance worrying become advance thinking and planning". We remain committed to helping each and every one of our clients on this lifelong journey. Indeed, success is not final, failure is not fatal: it is the courage to continue that counts. As we move toward year-end, this might be a good time for us to talk. Please let us know if you have any questions, concerns, and if you'd like to meet soon. As always, we are here for you. Thank you for your continued trust and business.

Kirk P. Greene, CLU, ChFC, President
Greene Wealth Management, LLC
1301-5th Avenue, Suite 3410
Seattle, WA 98101
www.greenewealthmgmt.com
Phone 206.623.2200
Fax 206.623.2202

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