Amadeus Wealth Alternatives 14 Penn Plaza 9th Fl. 9th Fl., New York, NY 10122 www.amadeuswealth.com

212-697-3930

Edward Papier, CIMA®, CFF

ep@amadeuswealth.com

In this week's recap: A COVID-19 vaccine spurs a stock market rally, even as more cases are reported and some areas renew lockdowns.

Weekly Economic Update

Presented by Edward Papier, CIMA® CFF, November 16, 2020

THE WEEK ON WALL STREET

News of a COVID-19 vaccine ignited a rally in economically sensitive stocks and a broad retreat in technology companies last week, though enthusiasm was tempered by reports of rising new infections and fresh lockdowns.

The Dow Jones Industrial Average surged 4.08%, while the Standard & Poor's 500 rose 2.16%. The Nasdaq Composite index fell 0.55% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, jumped 4.01%.[1,2,3]

VACCINE HOPES

Reports of an effective COVID-19 vaccine sent stocks soaring on Monday as the end to economic uncertainty appeared to be in sight. Stocks that had been pummeled by economic lockdowns surged on the news, while the stay-at-home stocks suffered steep declines. Bond yields and oil prices both moved higher on expectations of increased economic activity.

Market enthusiasm evaporated in the days that followed, however, as higher COVID-19 infections, new lockdowns, and low expectations for a new fiscal stimulus package dampened the optimism brought on by the pending vaccine.

Stocks closed the week on a higher note, with cyclical stocks adding to their gains and technology companies shaving part of their losses.

CLOUDS OVER CHINESE CAPITALISM?

The market was caught by surprise last week when Chinese regulatory authorities issued draft guidelines to address concerns over abusive monopolistic practices. Shares in some of the biggest Chinese technology companies dropped on the news. This follows the prior week's suspension of a listing of a large initial public offering for one of the country's leading fintech companies.

It's difficult to say whether Chinese regulators are acting on concerns that western nations have with the dominance of Big Tech companies, or if they are attempting to rein in the power and influence of privately owned corporations. An answer may not be clear anytime soon, but investors will be watching.

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Retail Sales.

Wednesday: Housing Starts.

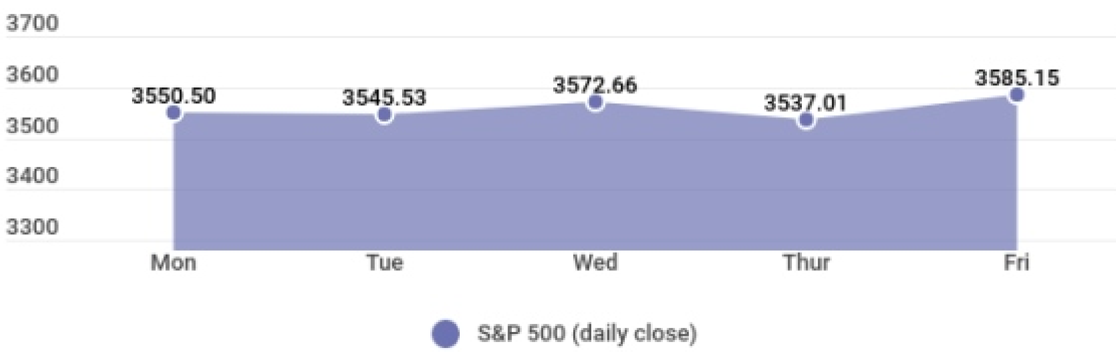
Thursday: Existing Home Sales, Jobless Claims, Index of Leading Economic Indicators.

QUOTE OF THE WEEK

"By three methods we may learn wisdom: First, by reflection, which is noblest; Second, by imitation, which is easiest; and Third by experience, which is the bitterest."

MARK TWAIN

Market Index	Close	Week	Y-T-D
DJIA	29,479.81	+4.08%	+3.30%
NASDAQ	11,829.29	-0.55%	+31.84%
MSCI-EAFE	2,001.32	+4.01%	-1.75%
S&P 500	3,585.15	+2.16%	+10.97%



	Treasury	Close	Week	Y-T-D
	10 Year Note	0.88%	+0.05%	-1.04%

10-Year Note	0.88%	+0.05%	-1.04%

Sources: The Wall Street Journal, November 13, 2020; Treasury.gov, November 13, 2020
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, November 6, to Friday, November 13, close. Weekly performance for the MSCI-EAFE is measured from Friday, November 6, open to the Thursday, November 12, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

In a recent *Thoughts from the Frontline* piece titled "Complexity Wins Again,", John Mauldin wrote briefly about the 5% withdrawal rule. This is really important if you are nearing or in retirement. From John's piece:

My friend Ed Easterling at Crestmont Research notes there have been numerous 20-year periods where stock market returns were below zero, especially when taking into account inflation. Ed's website has one of the best data treasure troves anywhere.

A number of advocates and studies provide for 5% withdrawal rates: "I only want $50,000 from my million dollars" and have it last for 30 years. The calculated success rate for that rate of withdrawal is 73%. Pretty good odds...except when we consider the impact of valuation.

SWR Statistics By P/E Quartiles: 5% SWR

Quartiles	Starting P/E Range	Success Rate	Average Ending $s	Avg Yrs If Out Of $s
Top 25%	18.5 +	47%	$ (850,676)	21.8
Second 25%	13.9-18.4	70%	$ 1,607,294	21.5
Third 25%	11.2-13.8	80%	$ 6,326,247	26.5
Bottom 25%	below 11.2	95%	$ 7,661,850	30.0
All Periods	14.6 average	73%	$ 3,693,376	23.0

"SWR" stands for Safe Withdrawal Rate, and the safe amount varies considerably depending on market valuations when you start. The table shows that if you are in the top 25% of valuations and each year withdraw 5% of your $1 million retirement savings (to generate $50,000 for living expenses), you would run out of money 53% of the time (100 minus the Success Rate). On average you have less than 21 years of retirement then run out of money. With valuations in the top 10%, like they are today, it is even worse.

Many planners use a total return model which starts in the 1920s and shows that over time markets will give you an 8% to 9% return. They plug in that 8% to 9% number for each and every future year, assuming that time will take away the effects of a bear market and recession. And that is probably true if you have 80 to 90 years. If, however, you are retiring when the markets are at a very high valuation, like now, your model will likely give you bad advice.

Pension funds are going to get devastated in this decade. So are many retirees. And it all comes from bad models on top of more bad models. It's a big problem. Valuations matter, especially if you're heading into retirement and depending on your life savings to fund it.

Ned Davis Research (NDR) plots forward 10-year real returns based on price-to-earnings (P/E) ratios. It's clear to most of us that when you buy an asset at a good price, you get a better return on your money. When you look at data back to 1925 and sort P/E into five categories, or quintiles, ranging from "Cheapest 20%" to "Most Expensive 20%." It then shows the returns that followed ten years later. The data suggests the most probable outcome ranges today between +5% and -1% with average of 2.4%.

The bottom line is where we are in the cycle matters. JP Morgan came out this week predicting the S&P 500 Index will reach 4,500 by the end of next year. They may be right. But keep in mind, over the coming 10 years we may see 4,500 in the S&P 500, then a correction back to 2,200 (current median fair value based on median P/E), on our way back up to 4,500 ten years from now. That would be a painful ride to the low returns current out current high valuations are suggesting. Of course, nobody knows for sure. The system and the players (Fed officials, central bankers, legislators) within it are changing and the solutions to the debt problem are yet to be known.

But do remain optimistic. There are opportunities, depending on investment positioning. It's just not in the traditional 60/40 stock-bond mix. As GMO and others, below, have written, 60/40 is the wrong game plan today.

- At a recent Milken Global Institute Conference, asset management experts suggested "The 60/40 portfolio is largely a relic of the past, with alternatives likely to become a bigger portion of investors' portfolios over the next decade".
- Jeremy Grantham's GMO suggested they are advising all out clients to invest as differently as they can from the conventional 60% stock/40% bond mix, just as they did in 1999. They forecast US Large Cap Equities will return -5.8% on average over the next 7 years.
- David Rosenberg, former chief economist at Merrill Lynch, has recently suggested "What makes the most sense in this era of financial engineering and central bank manipulation is to shift the portfolio to real or tangible assets that spin off a reliable cash flow stream".
- Morgan Stanley Wealth Management predicts 60/40 will return 2.8% over the next 10 years.
- Research Affiliates forecasts 0.5% returns for US equities, coupled with -0.6% returns for US bonds.

Think differently about what's out there and look towards alternatives to hedge against the inevitable reversion and overshooting past the mean.[4]

Edward Papier, CIMA® CFF may be reached at 2126973930 or ep@amadeuswealth.com
www.amadeuswealth.com

Know someone who could use information like this?
Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.

U.S. Treasury Notes are guaranteed by the federal government as to the timely payment of principal and interest. However, if you sell a Treasury Note prior to maturity, it may be worth more or less than the original price paid. Fixed income investments are subject to various risks including changes in interest rates, credit quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications and other factors.

International investments carry additional risks, which include differences in financial reporting standards, currency exchange rates, political risks unique to a specific country, foreign taxes and regulations, and the potential for illiquid markets. These factors may result in greater share price volatility.

Please consult your financial professional for additional information.

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CITATIONS:
1. The Wall Street Journal, November 13, 2020
2. The Wall Street Journal, November 13, 2020
3. The Wall Street Journal, November 13, 2020
4. cmgwealth.com/ri/on-my-radar-the-masters/#5Percent