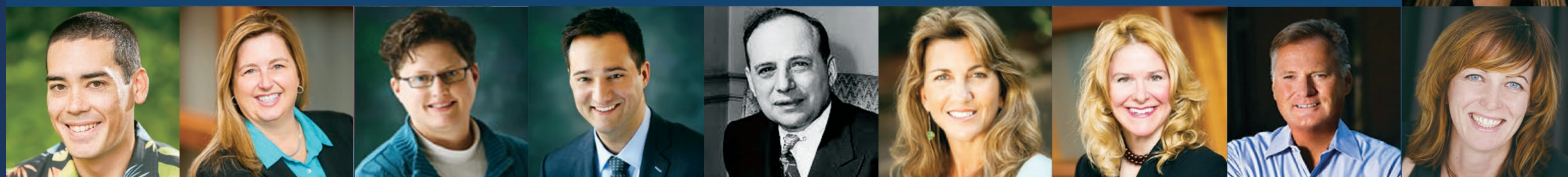


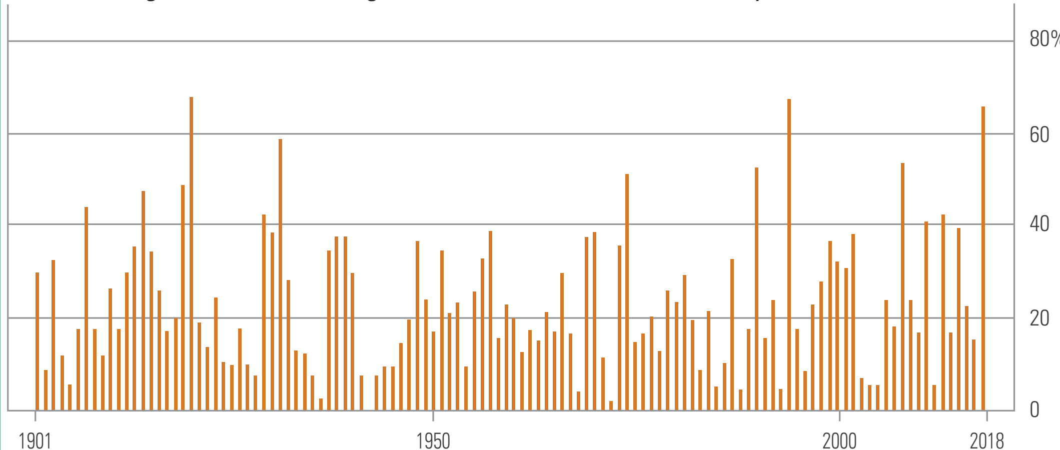
Current Observations

Ready or Not, Cycles Happen *By Paul Sutherland, CFP®*

2019, the Year of the C H A N G E

Years ago, I would attend world futurist meetings and fill my mental bucket with seminars, talks, and chats about "what's next" and – more importantly – the "why" and "how" as to what the future might bring. Throughout my working life, my job has been to capitalize on changes, and then to preserve and make money for our FIM Group clients. Most of our year-end newsletters would include a bit about what we forecast for the future and what we will be doing about it. But I quit doing the annual forecast around the time I stopped going to the world futurists meetings in 2006.

But I still forecast, I still spend my time "standing in the future and looking back," and I still believe those activities are relevant. However, I think our forecasts for FIM Group investors must coincide with all the factors we chatted about in the December newsletter. Refresher: The newsletter dealt with factors that most influence future investment returns. They are: (1) value, and thus the price you pay for an investment, matters – simply buy low and sell high(er);



2018 data as of mid-November. 70 assets tracked this year versus 34 in 1901
Source: Deutsche Bank AG

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(2) quality matters – so, at least with stocks or companies, you want good management, good products, and a good balance sheet, but you don't want to lose sight of the fact that value also matters, therefore you don't want to overpay for quality; and (3) volatility is your friend, is what allows you to buy assets at great prices, and also is where you look for excess returns over time. For example, CDs don't fluctuate, but their returns over extended time frames are horrible compared to those of stocks and corporate bond returns. But, as with all asset classes, there will be times when owning short-term investments like CDs and Treasuries makes sense…but just not all the time.

Recessions

The stock markets of the world are forecasting a recession. Stock markets have successfully "predicted 14 of the last eight recessions" (as that economists' silly joke goes). Bonds, on the other hand, have "predicted 10 of the previous six recessions," which is the follow-up joke if anyone laughs at the first joke. Slumps happen, they are normal, they are right, they are not bad, and mostly they are just reality. As investors, it's critical that we stay grounded in reality. Recessions are simply not bad for stocks.

Lower earnings, lower sales, and lower profits are not suitable for stocks, however. And recessions tend to lower earnings, sales, and profits. Yet that doesn't mean that all stocks go down in a recession. Often the stocks have already gone down as people anticipate a slowdown and since the "bad news" has already been priced into the shares. And often other investments have eroded significantly.

The chart on page 1 gives us a snapshot of investment returns from 1901 through the majority of 2018. If the chart were updated now, in January, it would be even more compelling, because 2018 was not a very pleasant year for most investors. So does that "forecast" a crummy 2019? I don't think so. I think that for investors who don't learn from the past, who stay stubborn, and who just put their head down, it will be sub-par. You don't invest in a recession as you do in boom times; you don't just hold everything through every cycle. As we know, things change, and an investment portfolio must vary with the factors that are a reality at any given moment.

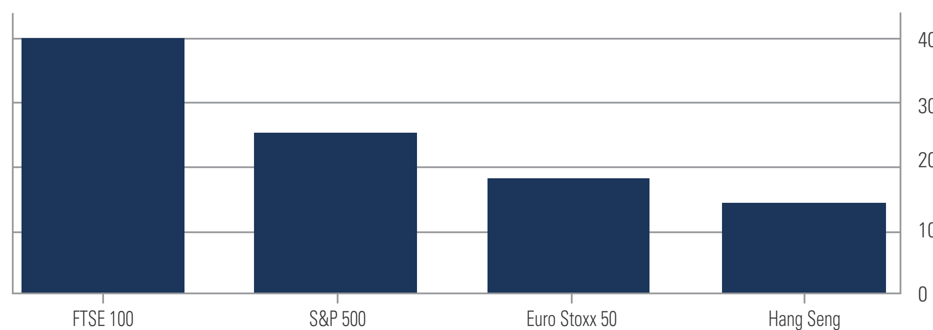
Peak to Trough

U.S. indexes from peak to trough as of December 23, 2018 for the most-watched US S&P 500 are down 17.5%; the Euro Stoxx 50 index is down 18.68%, peak to trough, for the same period. Needless to say 2018, was not a great year for investors, but in these statistics lie a lot of opportunities.

Where will we at FIM Group look? Naturally, we will want to choose investments that have the factors that result in success: value/price and quality. We will also want high-cash-dividend and cash-income investments – not simply because many of our clients are retired, or are living on all or part of their investment portfolio, but because dividends provide two things that help portfolios: cash returns paid out of company earnings, plus an element of quality and value, since stronger companies typically and consistently pay out dividends. Dividends don't tend to lie. Statistically, dividends are a good starting point for finding value in markets and companies. Right now, due to Brexit, a possible recession, and trade issues, U.K. stocks are especially bargain-priced. Such stocks are a good proxy for how something gets to a bargain price.

Psychology is, of course, king – and investors often will assume that something that currently is going down will keep going down. That's pure silliness! If your house was priced at $800,000 in 2008 and you bought it in

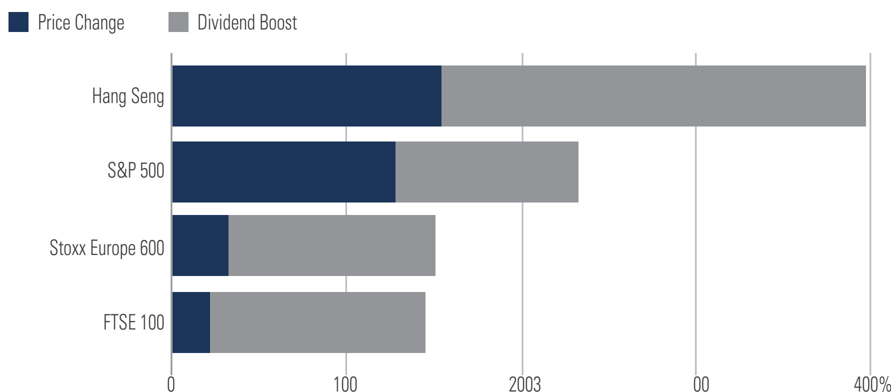
The number of top companies yielding 5% or more is highest among major indexes



Note: Forward dividend yield
Source: Bloomberg

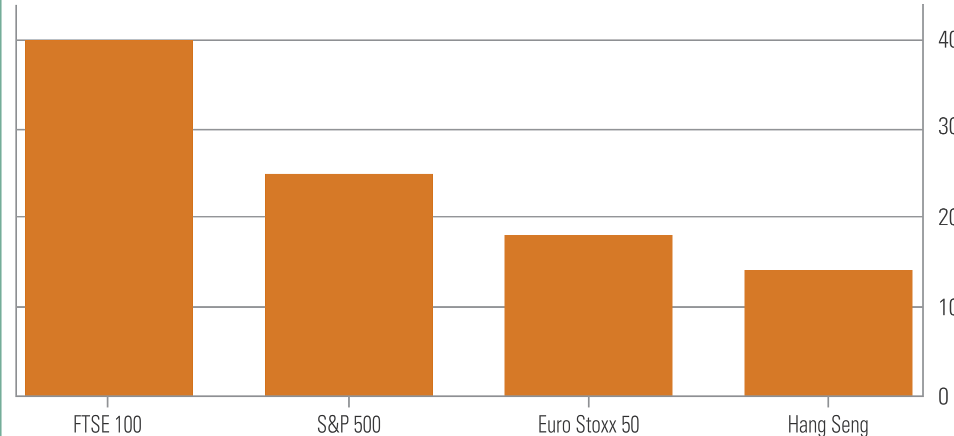
Cash Is King

U.K. blue-chips have the highest contribution from dividends in their total return over 20 years



U.K. Pays More

The number of top companies yielding 5% or more is highest among major indexes



Note: Forward dividend yield
Source: Bloomberg

2015 for $400,000, does that suggest it will slump to $200,000 in the future? No, it means the gal who bought the house for $800,000 lost money when selling it later. If a U.K. company's share price goes down, does that mean it will just keep going down? Prices fluctuate, change happens, and that's why 2019/2020 could be excellent years for our investors. The chart above give a good snapshot of how cheap U.K. stocks are, compared to stocks of companies in other parts of the world.

Surviving and Thriving in a Recession

During recessions, the best are separated from the rest. Many great companies come out stronger after a recession.

Why? First, competitors with inept management or awful balance sheets must downsize, discontinue lines of business, lay off talent as the overall market shrinks, get very cost competitive as market share falls away, or become marginalized. Second, great companies have tremendous staying power, so during recessions they can buy their competitors, often at a great price, and can hire away top managers from less-stable companies. Third, other companies can use the "recession" as an excuse to tighten their belts and get rid of lines that are marginal, or can move out of markets that are not profitable, or can explore new markets where the price of entry might be much lower due to the recession.

Investing in Recessions = Own Income!

As a professional worrier and a recovering perfectionist, I always tend to contemplate what might occur if a recession runs long and deep. It seems logical that we should manage risk as if we could have an outsized downturn. In fact, I have been doing this for 40 years,

Be Early Bear Markets	Average Annual Return Following Bear Market		
	12-Month Period	24-Month Period	36-Month Period
If fully invested after bear ends	47%	28%	20%
1 month of cash after bear ends	33%	22%	17%
3 months of cash after bear ends	18%	16%	12%
6 months of cash after bear ends	11%	13%	10%

* This table illustrates the importance of "being there" when stocks (or other assets) are bargain priced. The key is to start buying when stocks are cheap, using price/earnings, dividend yields, price/earnings to expected growth, price/earnings to inflation, and other valuation techniques; to buy when the investments are bargains; and to be well-invested when the bear market ends. This, of course, is only known after it ends, so you must invest as the investments become bargains over time, using judgment. The term "fully invested" (above) is represented by total monthly returns of the Standard and Poor's 500 Index, January 1926 through December 2002. Cash is represented by total returns of the 30-day Treasury bill. The 14 bear markets analyzed are defined as periods with cumulative declines greater than 10% and duration of at least 6 months and do not include the current market. Past performance is no indication of future results. This table is only one input to the investment process.

**Source Schwab Center for Investment Research with data from Ibbotson Associates; FIM Group*

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and this logic has helped us through the rough patches from Black Monday to the global financial crisis. As I said earlier: income matters, dividends matter, and price matters. All this adds up to the goal of owning a diversified portfolio of well-selected and good-income investments, priced at bargain prices, and of course being patient. Patience is key here, as many investors panic due to volatility, unrelenting bad news, and fear that often are hallmarks of a recession or a slow economy. Again, "buy low, sell high!" You don't buy low at market peaks, and you don't sell high in recessions. So you must be invested in recessions to get the bargains. We are seeing many bargains develop, since prices are coming down fast as investors panic a bit, not realizing the true value of their investments and making decisions based merely on the price action of those investments.

Sitting on the Sidelines: A Loser's Game

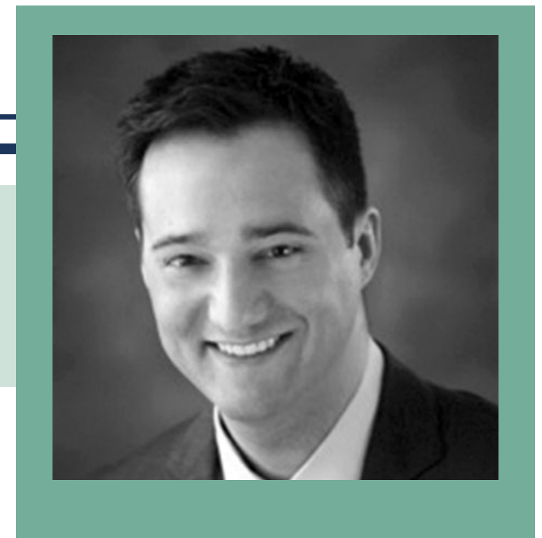
Successful investing is about buying right, and then holding and investing in the right stuff. It is about having disciplined sell parameters and, as I noted earlier, always about being patient. It is not about going to cash or to CDs when there are significant investments, priced right, to be made. Cash and CDs are all right if you can't find anything better. But in weak and volatile markets, like those that we have today and that I expect we'll have in at least the early part of 2019, there are bargain-priced investments to be made. Will the investments we buy go down more, before they go up? Who knows? Yet history, the science of investing, and the factors that influence investment returns all point to the fact that we will be well rewarded for our diligence and patience. The chart on page 3 shows how expensive it is *not* to be invested well in a "bear market" or when things are just cheap.

So, here's my forecast for 2019/2020: There'll be more volatility; bargains will continue to be created; a recession may occur; and we'll see lots of changes. In future newsletters, I'll chat about some of the things going on that may have an oversized influence on investments, capital flows, and returns. Certain macroeconomic factors that we think will be especially influential are the global moves politically toward nationalism, protectionism, and the influence of trade wars, global warming, actual wars, and such on how people, countries, and trade areas spend, save, invest, and interact. The good news: There will always be opportunities for those investors who are both awake and prepared.

Happy New Year!

Modern Estate Planning: It's About Heirs, Not Taxes

by Lucas Schwaller, CTFA®, CES®



When meeting with clients to discuss estate planning, I frequently encounter a common misperception: that the primary goal of estate planning is tax mitigation. While tax planning is certainly an important factor, it is only one small piece of a very large puzzle. In fact, following the Tax Cuts and Jobs Act of 2017, fewer than 1 in 10,000 decedents' estates, or 0.0001%, will owe federal estate taxes!

Does this mean estate planning is no longer necessary? Absolutely not! Estate planning remains a vital component and complement to sophisticated financial planning and investment management. And while taxes are an important consideration at the federal or state levels (especially for you Hawaii and Minnesota clients), the real focus of estate planning should always be on who your estate plan will benefit and how it will be executed.

To address the who and the how, clients and advisors must sometimes navigate difficult or complex conversations. In our experience, there are typically three key issues to address:

1. The grantor's desire to define how their heirs will use the funds
2. The heirs' ability to comply with those desires
3. Protection from outside threats such as lawsuits, creditors, or divorce

Because circumstances and values differ greatly from one family to the next, there is no one-size-fits-all approach to estate planning. Carefully planning and periodically reviewing your estate plan with a skilled advisor can help you sidestep potential land mines while assuring that your wishes are carried out following your death.

Below, I've outlined a few trust strategies for consideration. It's important to note again that no two situations – and therefore no two trusts – are identical. How your estate transfers, and to whom, is limited only by your imagination. However, should any of these speak to your situation, I invite you to contact us and set up an appointment to discuss it further with one of our advisors.

Incentive Trusts

If grantors are not fully confident in their heirs, so-called "incentive trust" language can be devised and included in estate plan documentation. As long as the provisions are generally practical and do not violate public policy, incentive trusts can provide guidance to heirs by creating a variety of motivations to perform certain desired behaviors or creating motivations to avoid behaviors. Examples I've seen include refraining from alcohol or drug usage, gambling, or uncontrolled spending; or, conversely, achieving or even merely striving for educational or professional objectives. Sitting down with your FIM Group advisor for a discussion and then utilizing an experienced estate planning lawyer will help you define these issues accurately to avoid violating public policy, rendering a certain clause unenforceable, or stating it in too general a manner. These conversations can help you to discover and articulate your most important concerns.

Special Needs Trusts

Special needs trusts can be devised for beneficiaries with disabilities and for minors too young to make their own decisions regarding money. Parents naturally want to protect those children who cannot protect themselves. Trusts with discretionary language in the hands of a trustee, perhaps aided by the aforementioned incentive trust provisions or a "letter of wishes" giving insight into any concerns, may be the right way to structure an inheritance.

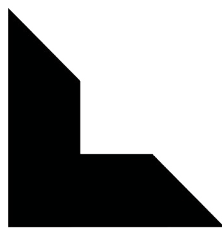
Philanthropic Trusts

Philanthropy is a type of inheritance itself, though structured in a manner that provides the beneficiary with the "gift of giving" rather than the funds for personal use. This can allow the beneficiary to continue the family legacy, improve the world around them, maintain assets outside the threats of taxation and creditors, and pass them on to the next generation.

Asset Protection Trusts

Protecting beneficiaries and funds from external threats such as lawsuits, creditors, and divorce are concerns for many people. Trusts often make sense to protect the assets of people in careers such as medicine or law where lawsuits and claims against wealth may be more likely. In addition, your success may mean that, while you may not have a taxable estate, your children may have one, which would increase the amount subject to taxation that they then pass to *their* children. Using a professionally structured and carefully worded irrevocable trust, you can have the best of both worlds: funds that are available if needed while simultaneously excluded from a taxable estate and inaccessible to creditors.

British Land & Land Securities:



Summary Snapshot

Ticker: BLND LN & LAND LN

Share Price | Market Capitalization (12/20/2018): £5.436 | £8.062.4B & £8.27 | £9.852.9B

Website: www.britishland.com/investors & landsec.com/investors

Company Descriptions: Land Securities' portfolio of real estate is valued at roughly £14B; at 24 million sq. ft. that is roughly 417 football fields (American) worth of floor space, providing a place for some 153,000 people to work.

British Land's portfolio of real estate is valued at roughly £13.7B; at 24.8 million sq. ft. that is roughly 431 football fields of floor space. In addition, there is 10 million sq. ft. of development in the pipeline, with half of this at Canada Water, a 53-acre mixed use project in central London.

Investment Cases

Brexit, from the headlines, you would think the Brits have decided to strap rockets to their rock and head off into the stars. Though under such a scenario our "Brexit" tack would likely work, in a way… We've given things time, greater than two years, and have decided to play offense via defense – aka prime real estate.

Both Land Securities and British Land (the number one and two U.K. REITs by asset value) are split roughly 50-50 between office property and retail/

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mixed use. They've got solid balance sheets, quality properties, and low loan to value ratios; this means they've got "dry powder" to deploy. Both also have land banks, undeveloped/underdeveloped land for the future, which they have expanded.

Land Securities has taken a cautious tack choosing not to develop during this period of uncertainty, which doesn't mean they've sat on their hands – if an opportunity internally or externally arises they have been and will continue to be active. While British Land has continued to develop, they have been cautious; like Land Securities they are constantly evaluating their portfolio and doing work on potential additions.

We also looked at their pure office property peers but decided to take a more diversified approach. Also of note, their peers have been more aggressive (though historically speaking it has been rather tame) with the building so they aren't as flexible, in our estimation. In the aggregate, activity is down materially, all the while demand has remained strong – this seems to be overshadowed by Brexit (for now).

What should have been another boom/bust cycle in U.K. property saw an early cooling period arrive with Brexit and the ensuing political upheaval. Which is to say the cycle doesn't overly concern us and if we adjust for inflation, rents seem fair (perhaps even cheap). Yet both secutities are valued as though the property sector were in the full throes of a bust. Which is even more curious when you consider how conservatively they are positioned.

Both entities have proven adept at navigating through economic cycles, all the while being opportunistic. When we look at long-term trends, both are clearly focused on urbanization, mixed use, and efficiency. They are quite forward in their beliefs that the future of real estate must include an understanding of the environmental and social impacts their businesses have. In other words, they believe that green and wellness efforts flow back to the bottom line, so they incorporate them into their decision matrix.

For both, Brexit is at once a mere and an actual risk factor, though we believe firmly that whatever the outcome or process in time, prime real estate will remain "prime". For Land Securities the greatest risk may actually be how conservative they have been – do they risk missing out? All taken together this is why we've decided to invest in both Land Securities and British Land.

We also check our favorite boxes: environment – they are consciously incorporating impact, social – they are trying to build so as to foster work-life balance, governance – great management teams/boards, scalability – they are both of size and have honed playbooks for repeatability, moat-iness – prime properties and brands that build a network effect. They are robust, their corporate culture is clear and strong, both have proven prudent, and ultimately their assets and efforts align well with what we deem to be the most significant demographic trends.

In our analysis we've accounted for property yields' moving higher (which would pressure property values); from these levels, the stressing we did might not be realistic, yet we still found steep discounts to be priced in today. You would call this our absolute value analysis.

We then did economic value-added analyses, which means that we analyzed the track records of the companies and their management teams; using these numbers, we adjusted the companies, asset values accordingly. Again, we found steep discounts to be priced in today.

For both entities we expect to receive solid dividends (5.5–6% range), moderate growth over time, and valuations to normalize higher; altogether we would expect healthy upside – equating to solid double digits for many years to come.

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