

An aerial photograph of a beach with waves breaking onto the shore. Several surfers are visible in the water. The image has a teal color overlay.

Litman Gregory

ASSET MANAGEMENT

# 2019 Outlook Webinar

February 13, 2019



# Today's Speakers



Gretchen Hollstein, CFP®  
Senior Advisor, Principal

Gretchen provides investment advisory services to individuals, family groups, foundations, endowments, and group retirement plans. Her experience includes extensive work in personal financial analysis, asset allocation, and retirement planning. Gretchen has served as Board Chairperson for the Financial Planning Association (FPA) of San Francisco.



Jeremy DeGroot, CFA®  
Chief Investment Officer,  
Principal

Jeremy is responsible for overseeing the firm's manager due diligence, asset class research, and portfolio allocation decisions. He is also Portfolio Manager of the Litman Gregory Masters Alternative Strategies Fund and Co-Portfolio Manager of the Litman Gregory Masters Equity, International, Smaller Companies, and High Income Alternatives funds.



Chris Wheaton, CPA, CFP®  
Senior Advisor, Principal

Chris served as Co-CEO of the Litman Gregory companies and the Managing Principal of the company's Investment Advisory business from 2010-2015 before returning to his current full-time Senior Investment Advisor role. Chris' current clients include individuals, family groups, endowments, foundations, and retirement plans.



Alice Lowenstein, CFP®  
Managing Director, Principal

Alice is a member of the firm's three-person Executive Team and leads Litman Gregory's Wealth Management Services (WMS), which encompasses wealth management and institutional advisory services. Alice also provides executive support to Litman Gregory Portfolio Strategies group, turnkey portfolios for investment professionals. Alice is a reviewer for the *Journal of Financial Planning*.

# Agenda

- Welcome and Introductions with Gretchen Hollstein
- Market & Investment Outlook with Jeremy DeGroot
- Tax Planning Strategies with Chris Wheaton
- Perspectives on the Business with Alice Lowenstein

Litman Gregory

ASSET MANAGEMENT

## Market & Investment Outlook

with Chief Investment Officer, Jeremy DeGroot



# Five Market Topics We'll Address Today

---

- Catalysts for market performance in 2018
- Market rebound in January 2019
- Possible scenarios and outcomes in 2019 and forward
- Current investment opportunities in Europe and emerging markets
- History of market leadership between US and international stocks

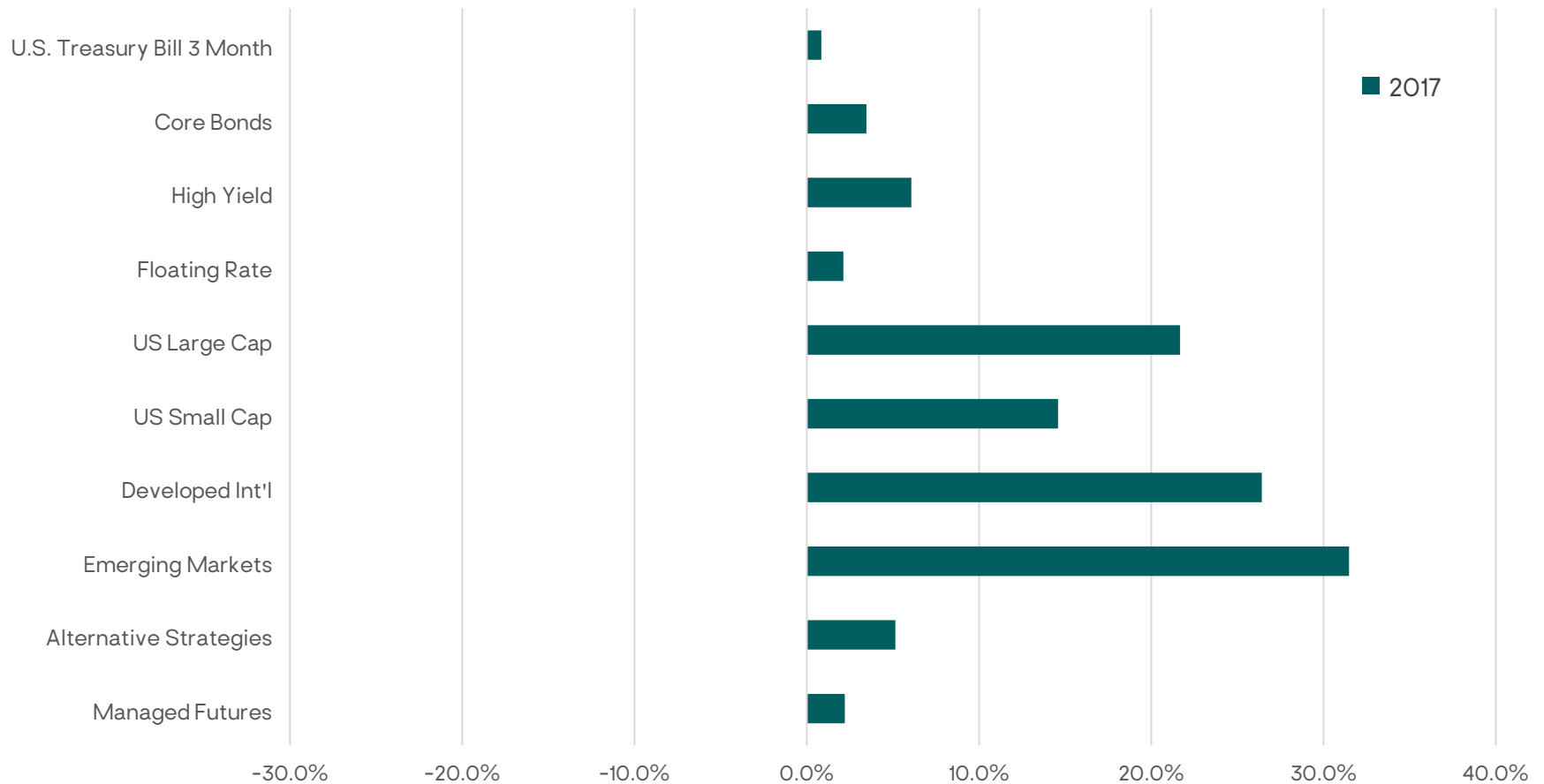
# What Were the Catalysts for 2018?

There were multiple drivers of financial market performance in 2018.

Key factors were:

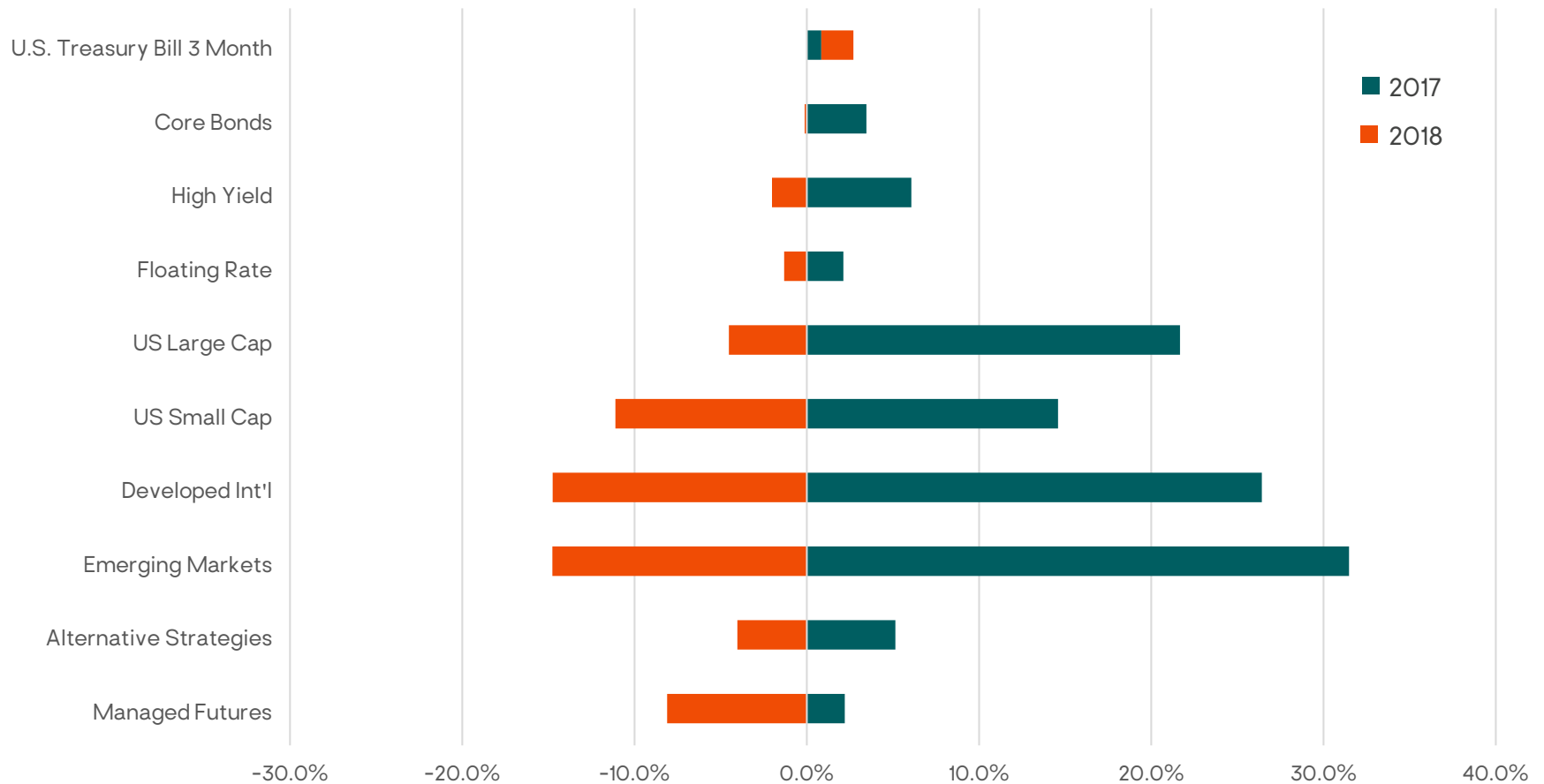
- Concerns about slowing global economic growth
- Tightening Federal Reserve monetary policy
- Geopolitical uncertainties, e.g., US-China trade war, Brexit

# Asset Class Performance: 2017 vs. 2018



Source: Morningstar Direct. Data as of 12/31/18.

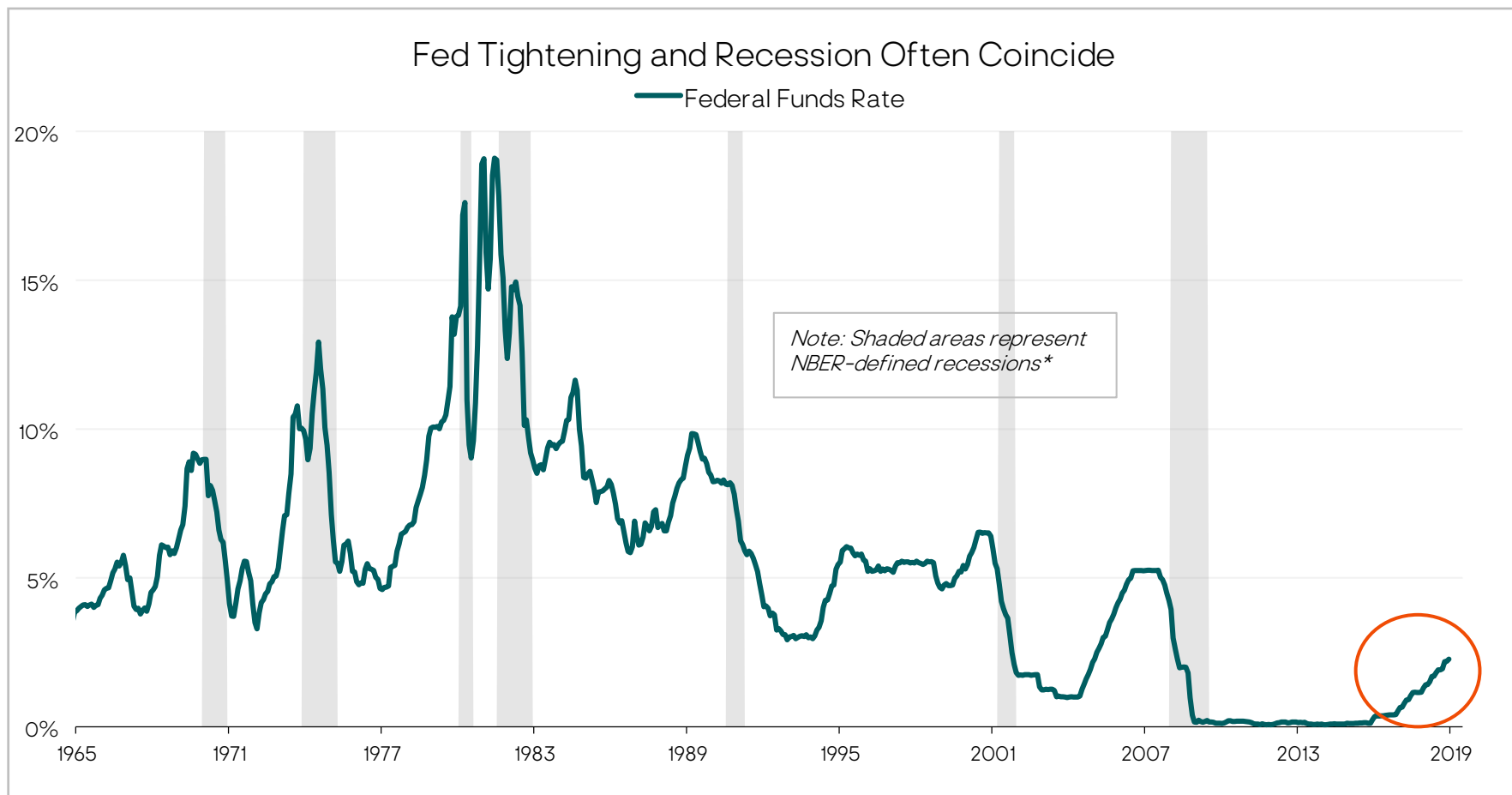
# Asset Class Performance: 2017 vs. 2018



Source: Morningstar Direct. Data as of 12/31/18.



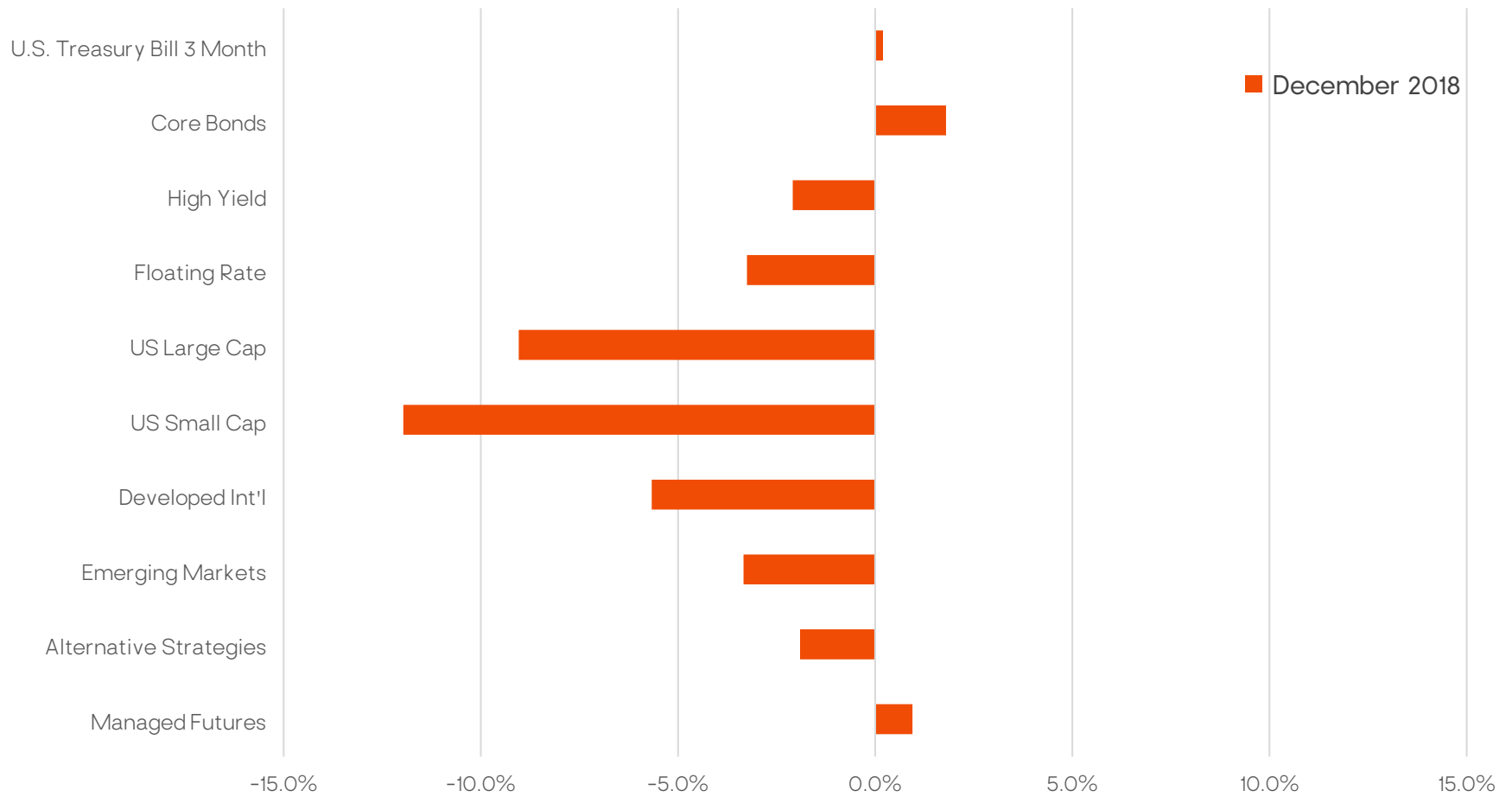
# We are Late in the Market Cycle, But the Timing of the Turn is Always Uncertain



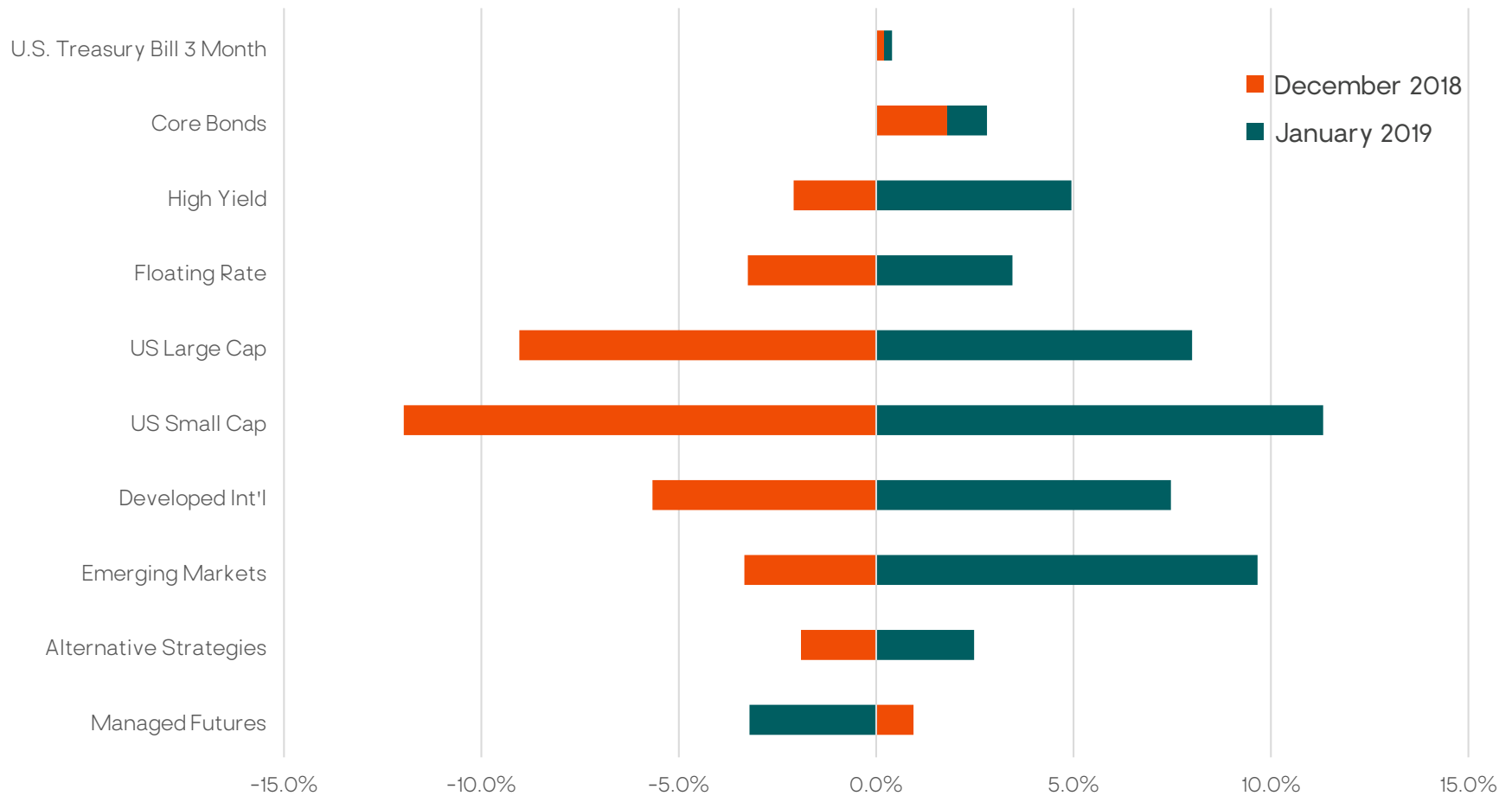
\*National Bureau of Economic Research (NBER) defines an economic recession as a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.

Source: U.S. Federal Reserve. Data as of 12/31/2018.

# Asset Class Performance: Dec 2018 vs. Jan 2019



# Asset Class Performance: Dec 2018 vs. Jan 2019



## Global Risks & Challenges: Near-Term Issues

The near-term outlook for international and emerging-market stocks is clouded by a series of upcoming events and macroeconomic uncertainty:

- Global economic slowdown
- Global trade and tariffs
- Brexit showdown
- Italian budget dispute
- Federal Reserve monetary policy tightening
- US political dysfunction

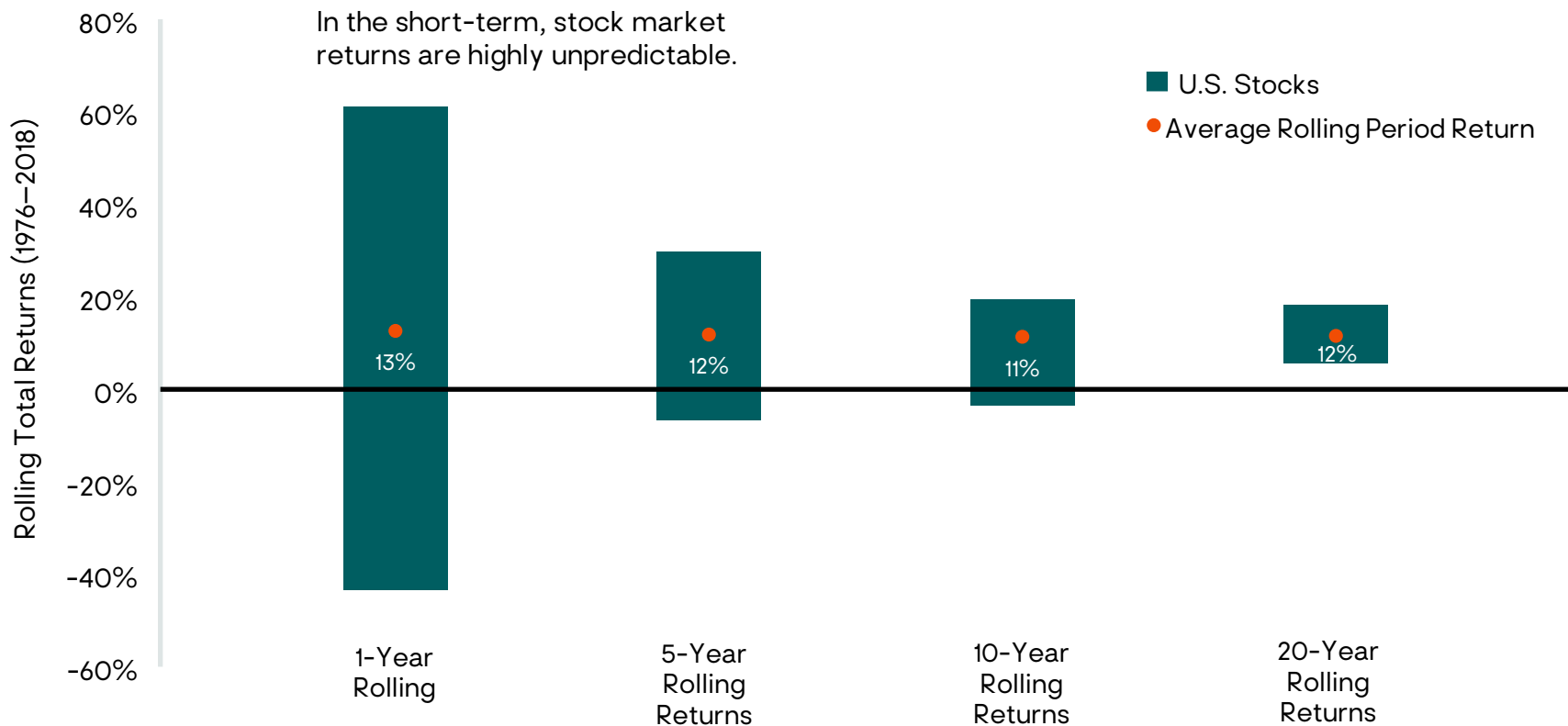


# Global Risks & Challenges: Long-Term Optimism

There are still reasons for optimism for long-term investors:

- Uncertainty and fears of an economic slowdown have been discounted by the market – to a certain extent
- Valuations for European and emerging-market stocks are historically cheap relative to the US
- The outperformance of US versus international stocks isn't sustainable, especially given current valuations
- Our active fixed-income and equity managers are finding attractive bottom-up (company specific) investment opportunities, especially after the recent sharp sell-off

# The Range of Outcomes Narrows as Your Investment Horizon Extends



“In the short run the market is a voting machine, in the long-run it is a weighing machine.”

- Benjamin Graham



# Global Balanced Portfolio Strategy & Asset Allocation

**Investment Objective:** to maximize long-term total return while minimizing the frequency and magnitude of a 12-month decline in portfolio value in excess of 10%\*. The portfolio will consist of a combination of growth and income oriented investments, with a slight emphasis on growth oriented assets.

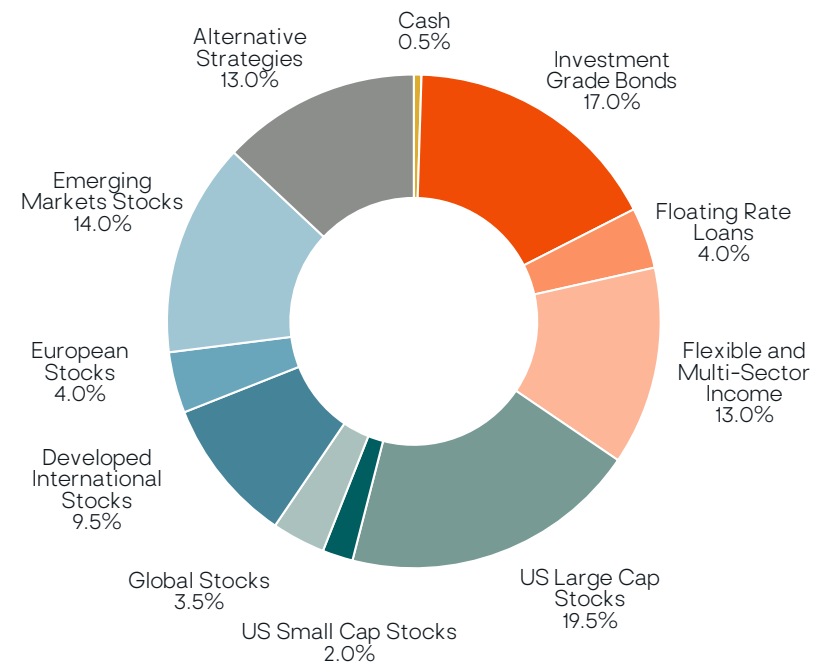
Long-Term Strategic Allocation



Current Tactical Allocation



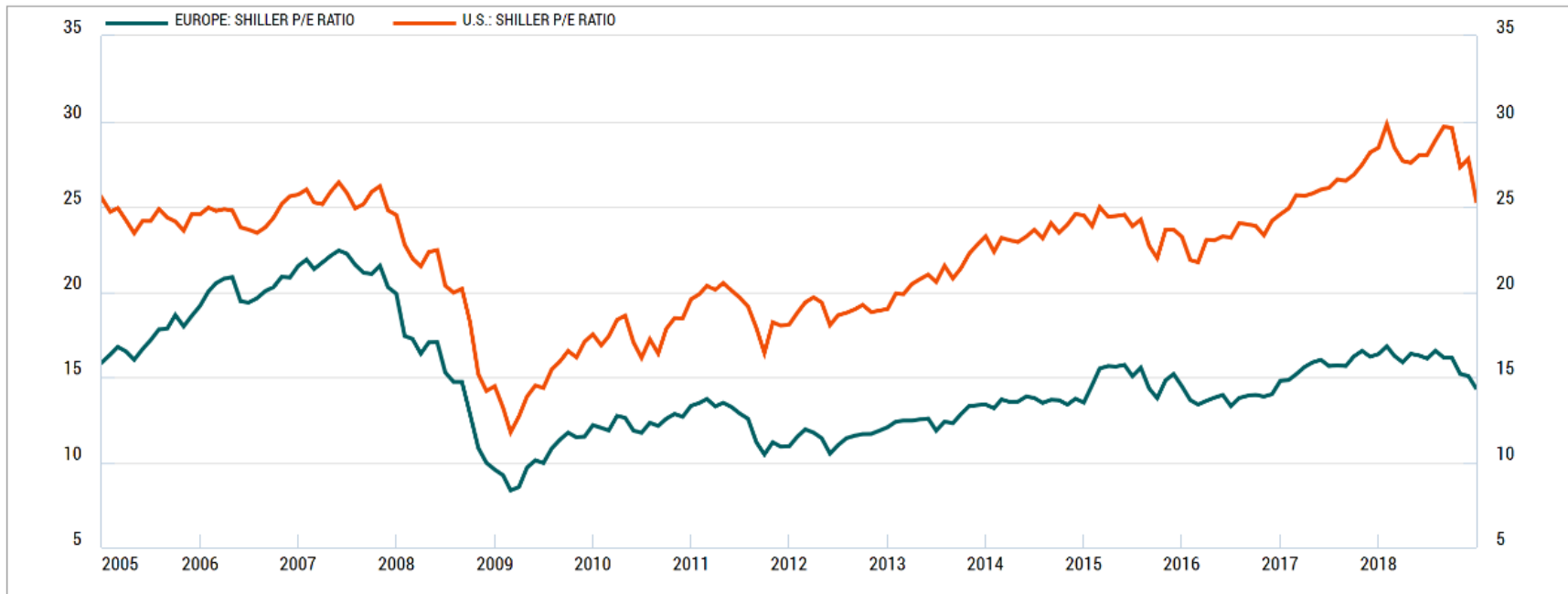
Global Balanced Portfolio Current Tactical Allocation



\*Although this is the stated goal of the risk-management strategy, declines in excess of 10% can occur during periods of high volatility, such as an extreme bear market. Tactical Allocation as of 12/31/18.

# European Stocks are Trading at a Significant Discount to the U.S.

## Shiller P/E Ratios



# Litman Gregory's 5-Year Asset Class Return Estimates

## Average Annual Returns Over Next Five Years

### Equity Asset Classes

	Bear Case	<b>BASE CASE</b>	Bull Case
U.S. Larger Cap	-6.1%	3.3%	11.6%
Developed International - Europe	-6.1%	16.6%	19.9%
Emerging Markets	0.2%	11.3%	18.7%

### Fixed-Income Asset Classes

	Bear Case	<b>BASE CASE</b>	Bull Case
Investment-Grade Bonds	4.5%	2.8%	2.1%
High-Yield Bonds	2.7%	3.3%	3.1%
Floating-Rate Loans	7.4%	6.1%	7.2%

### Alternative Asset Classes

	Bear Case	<b>BASE CASE</b>	Bull Case
Alternative Strategies	Mid-single-digit returns in most scenarios		

# Stock Examples: Europe

Two investments currently owned by portfolio manager David Herro :



## Lloyds Banking Group

- Pre-eminent retail banking franchise in the UK market
- Its balance sheet has improved greatly, with strong levels of capital, liquidity and reserves
- Herro's analysis suggests the stock's fair value is at least twice its current price

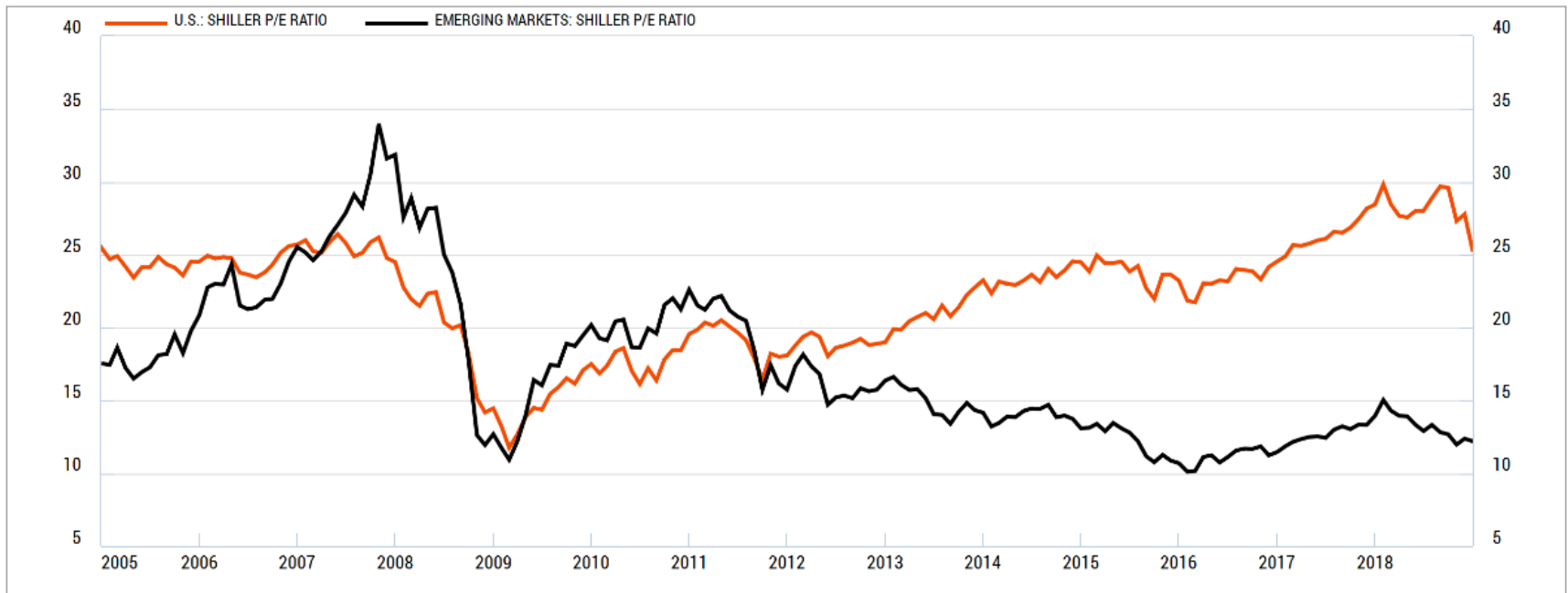


## BNP Paribas

- Dominant retail bank in France with a diversified business base that gives it economies of scale versus its smaller peers
- Strong management and a solid and improving balance sheet
- Herro thinks it should trade at more than 1x book value - more than 100% upside in his view

# Emerging-Market Stocks are Trading at a Significant Discount to the U.S.

## Shiller P/E Ratios



# Litman Gregory's 5-Year Asset Class Return Estimates

## Average Annual Returns Over Next Five Years

### Equity Asset Classes

	Bear Case	<b>BASE CASE</b>	Bull Case
U.S. Larger Cap	-6.1%	3.3%	11.6%
Developed International - Europe	-6.1%	16.6%	19.9%
Emerging Markets	0.2%	11.3%	18.7%

### Fixed-Income Asset Classes

	Bear Case	<b>BASE CASE</b>	Bull Case
Investment-Grade Bonds	4.5%	2.8%	2.1%
High-Yield Bonds	2.7%	3.3%	3.1%
Floating-Rate Loans	7.4%	6.1%	7.2%

### Alternative Asset Classes

	Bear Case	<b>BASE CASE</b>	Bull Case
Alternative Strategies	Mid-single-digit returns in most scenarios		



# Stock Examples: Emerging Markets

Investment currently owned by portfolio manager Michael Kass of Baron Emerging Markets Fund:



## Yunnan Baiyao

- 100-year old Chinese consumer pharmaceutical company known for its proprietary herbal formulas, which are considered a state secret
- Kass believes Baiyao will leverage its strong brand into consumer products like shampoo and toothpaste to gain further market share from multinational brands

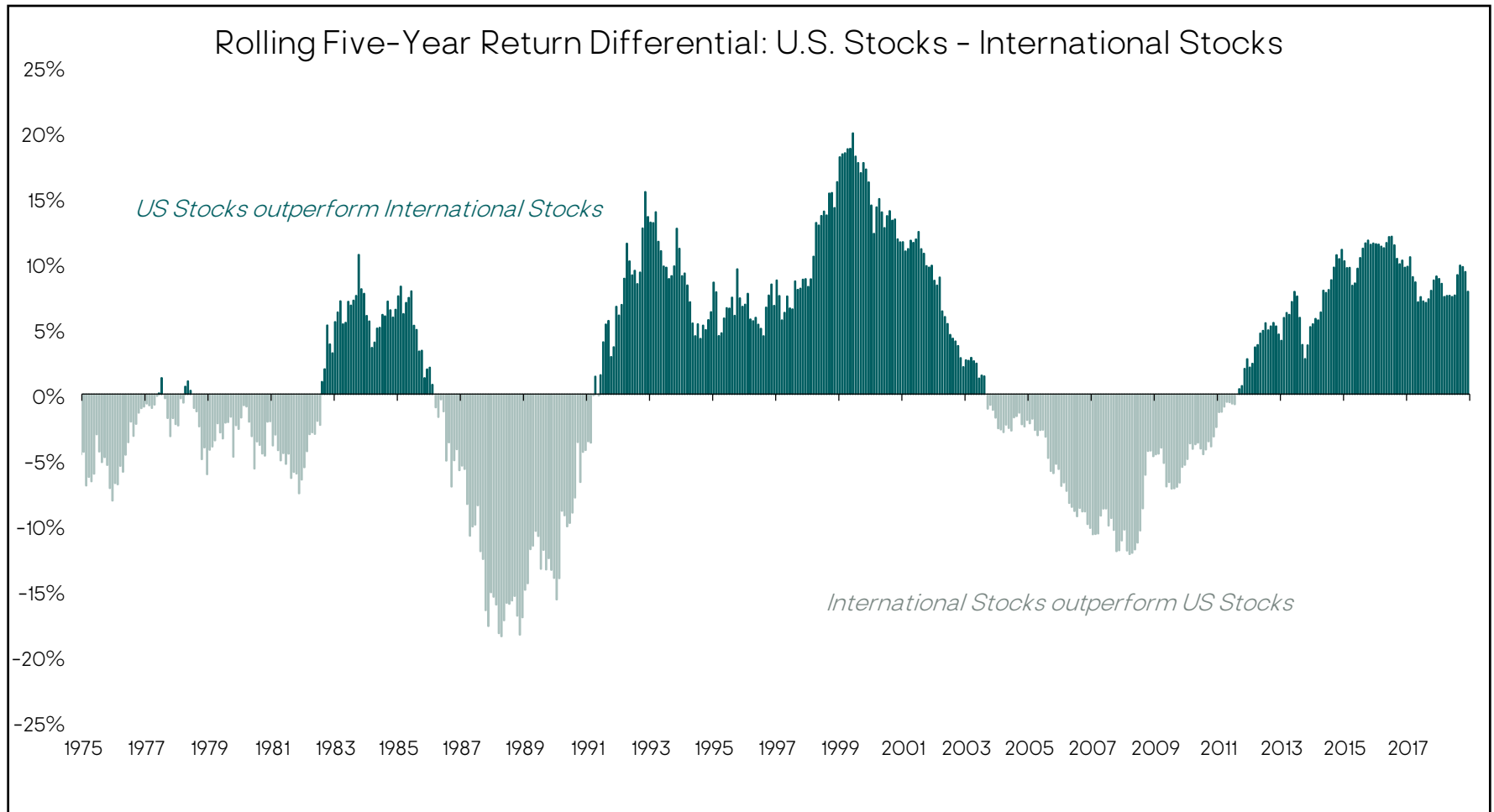
Investment currently owned by the value managers of Brandes Emerging Markets Fund:



## Flex

- One of the world's largest electronics manufacturing services providers to original equipment managers, based in Singapore
- Brandes believes Flex's expansive low-cost global manufacturing footprint is a big competitive advantage

# US and International Equity Market Leadership Moves in Cycles



Source: Morningstar Direct. Data as of 12/31/2018. Note: Int'l stocks is represented by MSCI World ex. U.S. from 1970 to 1988 and MSCI ACWI ex. U.S. from 1988 onward

# Stay the Course

---

- Stick to a globally diversified, balanced approach
- Stay disciplined and focused on objective, fundamental analysis
- Be a patient, long-term investor
- Prepare for a wide range of short-term outcomes
- Remember that markets are cyclical
- When making active investment decisions, abide by Warren Buffet's maxim: "Be fearful when others are greedy, and greedy when others are fearful."

Litman Gregory

ASSET MANAGEMENT

## Tax Planning Strategies

with Senior Advisor, Chris Wheaton



# Planning Opportunities and Key Tax Law Provisions

- **Higher standard deduction** and fewer itemized deductions
  - Standard deduction now \$12,200\* for individuals, \$24,400\* for married couples
  - Deductions for state income taxes and property tax now capped at \$10,000
- **Charitable gift bunching** may be helpful for clients with less than \$24,400\* in deductions
  - Combine multiple years of intended charitable gifts into one tax year
  - Higher deduction helps reach past the standard deduction amount into extra tax savings
  - Use a Charitable Donor-Advised Fund account for these donation, then grant from the account to charities on your own schedule
- Consider **paying off smaller mortgages** if interest deduction isn't helping itemized deductions reach past the standard deduction

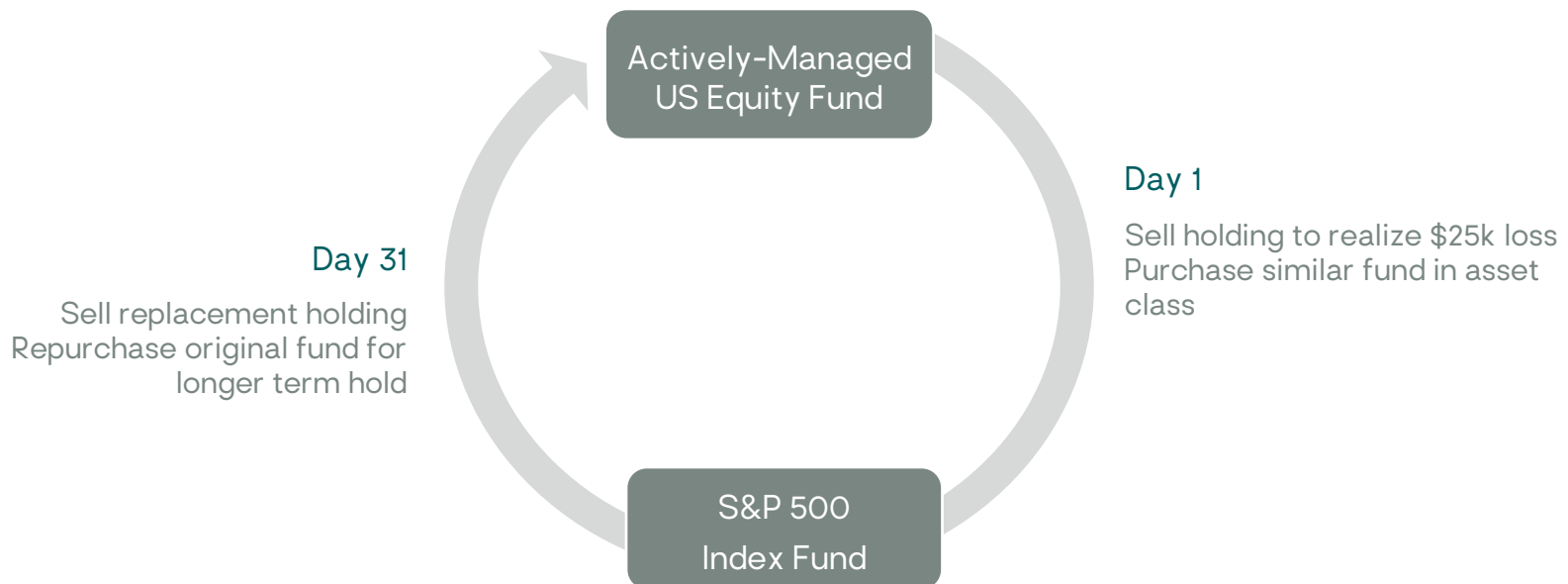
# Tax Strategy: Qualified Business Income Deduction

- Section 199A: Qualified Business Income Deduction
- Eligible for business owners (S corps, LLCs, Partnerships, and Sole Proprietors)
  - Possible access to an extra tax deduction equal to 20% of their business income
  - For service professionals, taxable income must be less than \$315,000 (married, filing jointly) to possibly qualify for full deduction
  - For non-service businesses, taxable income limits may not apply
- Review your situation with Litman Gregory, then cover in more detail with your tax advisor



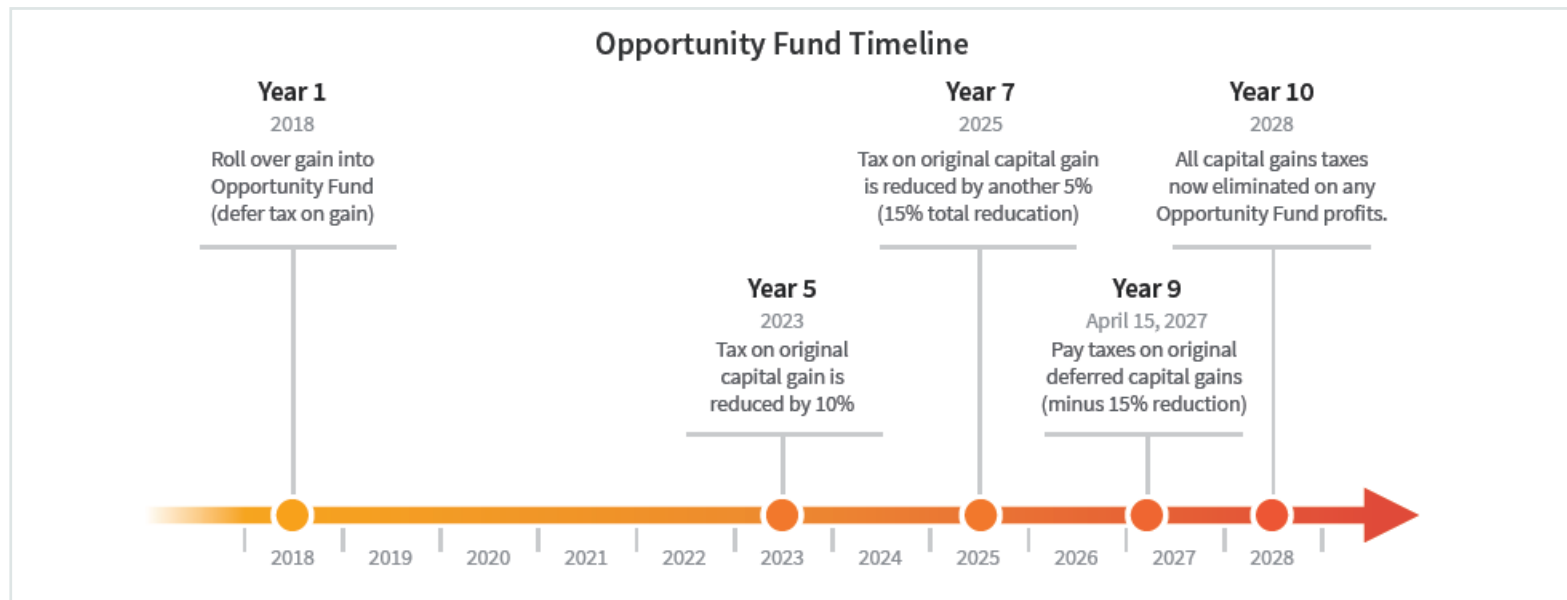
# Tax-Optimization in Portfolio Management

- Litman Gregory's portfolio tax-management strategy includes harvesting capital losses when available, in order to offset realized capital gains
- Example:
  - Client has \$25,000 in realized taxable capital gains this year
  - Client owns \$125k of actively managed US equity fund, with unrealized capital losses of \$25,000
  - Day 1 – Sell \$25k to realize losses (use against gains) and purchase S&P 500 Index Fund
  - Day 31 – Sell S&P 500 Index Fund and repurchase actively managed US equity fund



# Tax Strategy: Qualified Opportunity Zone Fund Investment

- Qualified Opportunity Zone (“QOZ”) Funds
  - Incentivize investment in lower-income areas of real estate around the country
  - Allow investment of taxable capital gains within 180 days of gain realized
  - Deferral capital gain recognition to 2026, and recognize no federal capital gain on appreciation in the fund investment
- Capital gains from later in 2018 can still be rolled over into a QOZ investment in 2019



Litman Gregory

ASSET MANAGEMENT

## Perspectives on the Business

with Managing Director, Alice Lowenstein



# Stay disciplined and focused in turbulent times

*Dichotomy of control*: there are things you can control and things you can't.

What we can't control:

- Markets
- Geopolitics
- Economic cycles

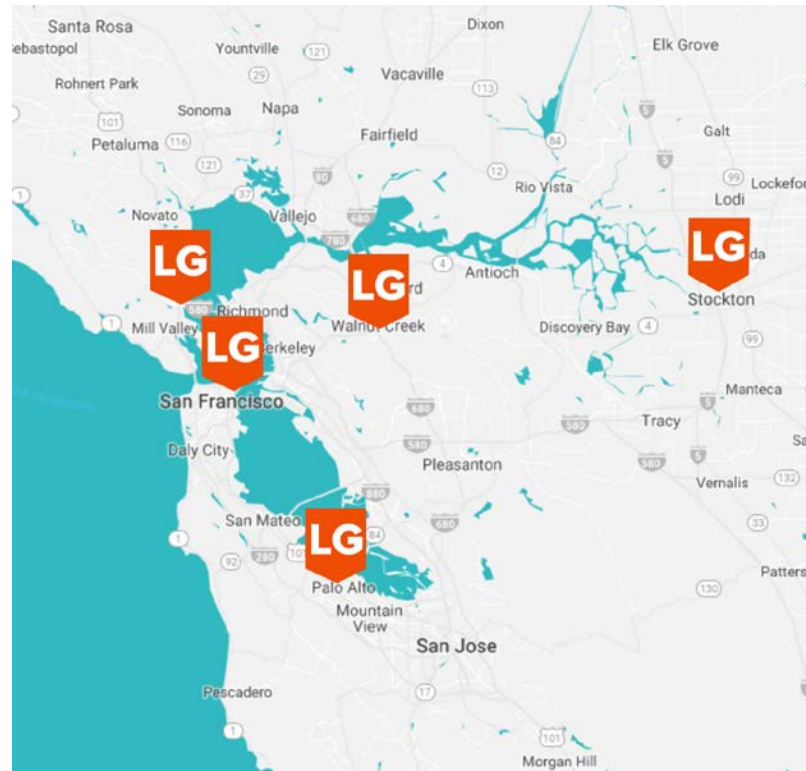
What we can control:

- How hard we work
- Values that define our firm
- The ways we seek to serve clients



# Expanding our geographic footprint

- Danny Miladinovich, CPA, CFP/CFS added as advisor in 2018 based in the Central Valley
- Welz Financial Services joined the Litman Gregory team on December 31
- We are opening a new Central Valley office in Stockton!



# Using Technology to Enhance our Partnerships with Clients

Empowering our clients and our team:

1. Client Data Portal & Document Vault
2. Upgraded trading infrastructure
3. Cybersecurity
  - Third party relationship
  - Vendor due diligence
  - Team training



Thank you for joining us today!

*For further questions, please contact your advisor directly,  
or the Litman Gregory team at:*



*415.526.4380*



*information@lgam.com*



*www.lgam.com*

# Disclosure

This writing is provided by Litman Gregory Asset Management, LLC (“LGAM”) for informational purposes only and may contain information that is not suitable for all investors. No portion of this commentary is to be construed as a solicitation or recommendation to buy or sell a security, or the provision of personalized investment advice, tax or legal advice. Past performance may not be indicative of future results and may have been impacted by market events and economic conditions that will not prevail in the future. There can be no assurance that any particular investment or strategy will prove profitable and the views, opinions and projections expressed herein may not come to pass. A complete list of portfolio holdings and specific securities transactions for the preceding 12 months is available upon request. All information is subject to change without notice. Any direct or indirect reference to a market index is included for illustrative purposes only, as an index is not a security in which an investment can be made. Indices are benchmarks that serve as market or sector indicators and do not account for the deduction of management fees, transaction costs and other expenses associated with investable products. LGAM does not make any representations as to the accuracy, timeliness, suitability, completeness or relevance of an information prepared by any unaffiliated third party and takes no responsibility therefore. Any projections provided regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. Investing involves risk, including the potential loss of principal, and investors should be guided accordingly.

The graphs, charts and other visual aids are provided for informational purposes only. None of these graphs, charts or visual aids can of themselves be used to make investment decisions. No representation is made that these will assist any person in making investment decisions and no graph, chart or other visual aid can capture all factors and variables required in making such decisions.

LGAM is an independent investment adviser registered with the U.S. Securities and Exchange Commission (SEC). For additional information about LGAM, please consult its Form ADV disclosure documents, the most recent versions of which are available on the SEC’s Investment Adviser Public Disclosure website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).