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QUARTERLY PERSPECTIVE

DVI
DAVID VAUGHAN INVESTMENTS

REFLECTIONS

Will Williams *Chairman, President & CEO*

A Turbulent World with Little Market Volatility

It is a bit of an enigma to me that the financial press throughout 2019 embraced headlines describing the investment backdrop as "Turbulent" or "Chaotic" when the market's price action was just the opposite. It is hard to argue that the economic and political landscape is not a bit abnormal with impeachment in the air, trade tariffs with both China and Europe, the instability attributable to Brexit, and the ongoing nuclear ambitions of North Korea. It all would seem a bit out of the ordinary to most. However, despite these developments, the market seems to take it all in stride and quietly moves forward.

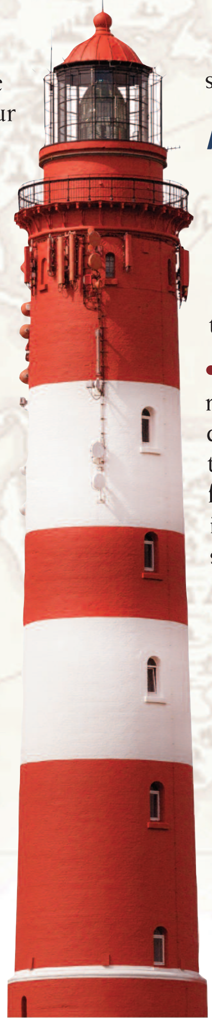
Price volatility is such an important factor in behavioral finance, as it contributes to rational investment behavior. In absence of a gut check, investors tend to get "too far over their skis" and assume market risk far in excess of their mental capacity. When there is the absence of market volatility for extended periods of time, it is extremely difficult to understand how to calibrate the amount of risk that you are assuming within your portfolio. You simply lose the historical frame of reference. As an example, since 2010 an equity investor has only experienced six market corrections in excess of 10%, and many of those declines and recoveries occurred over a series of weeks, not agonizing months and/or quarters. Regaining a better perspective on capital market risk is essential for the long-term sustainability of the current bull market.

I am sure I sound like a bit of a broken record over these past few years predicting more normal market volatility. However, the fact remains that in the past year, the greatest high to low decline was a mere seven percent, (the average historical intra-year decline is roughly 14 percent) and in only ten percent of the trading days did we experience greater than one percent price volatility (the historical average is roughly twenty percent of the trading days).

The Current Economic Headwind from the Disruption in Trade

Due to the robust labor market, the optimistic U.S. consumer continues to be the foundation for the modest (2.0%) domestic economic growth experienced in 2019. On the other end of the spectrum is Corporate America, which is increasingly pessimistic about current as well as future economic conditions. When the Conference Board released its Third Quarter Measure of CEO Confidence™, it was the lowest reading since the First Quarter of 2009. Only 4 percent of CEOs surveyed anticipated improving economic conditions over the next six months. Their pessimism is mainly due to the disruption attributable to the U.S./China trade war and to a lesser degree Brexit. In the release, the Conference Board reported that more than half of the respondents expressed very little or no confidence that the U.S./China trade war would be settled amicably without lasting damage to their business.

However, on December 13, 2019, President Trump announced the agreement between China and the U.S. on a "Phase One" trade deal which is scheduled to be signed on January 15th at the White House. Based upon the recent Conference Board survey information referenced above, continued positive momentum on the trade tariff front and recent legislative gains on Brexit should have positive repercussions on future capital spending Plans.



A By-product of the Race to Zero

As many firms in the broker-dealer community have made headlines by their recent decision to adopt zero equity trade commissions, we in the investment management industry are increasingly aware of some of the negative consequences of this changing industry dynamic.

- Broker Dealers are becoming more like banks rather than investment broker dealers. They have decided to extract their economics from clients in the form of low-interest sweep money market funds. They in turn use these low-cost funds to issue out primarily consumer loans from their bank subsidiaries. DVI in turn has elected to trade non-sweep money market fund options with competitive dividend yields as a means of maximizing client fund income.

- Equity Research coverage is also on the decline as sell-side firms (investment banks) can no longer justify the expense with reduced trading revenue. Most companies (even very large Fortune 500 companies) are losing coverage from Wall Street, and this trend is more pronounced with the many smaller, less well-known companies. Increasingly, investment management firms similar in size to DVI are turning to research services no longer associated with broker dealer firms.

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Brian Christensen, CFA
Senior Vice President & CIO

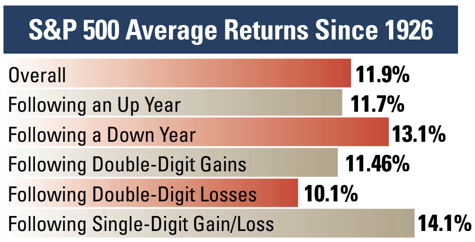
A YEAR TO REMEMBER – WHAT'S NEXT?

It's that time of year when the Wall Street gurus prognosticate about what to expect from the financial markets in the coming days and months of the new year. This year has experienced tremendous returns as the S&P 500 Index is up over 30% year-to-date with two trading days remaining. Human nature leaves most investors skeptical about what to expect in 2020 following such a strong year. The natural question after enjoying such sizeable gains is, "What does history tell us about subsequent years?"

Going back to 1926, the U.S. stock market has generated a calendar year return in excess of 30% on nineteen different occasions. Returns in the year following a gain of 30% or more are mixed. On eleven occasions, the stock market experienced further gains averaging 22.3%. On nine occasions, the stock market experienced declines averaging 8.8%. If we dig further, looking at years with double-digit gains, we find that U.S. stocks have been up double-digits fifty-four times. The following year saw positive returns 72% of the time.

The chart below shows just how consistent the stock market is regardless of the prior year's results.

For those investors inclined to think they can time markets, driven by skepticism about the likelihood of continued upside, my best advice is don't. Investors who headed for the exits during the market correction in the 4th quarter of 2018, likely missed some, if not all of 2019's big gains waiting for the perfect point to re-enter. The chart below looks at the 20-year period ending 12/31/18 and clearly shows why staying invested is the better alternative.



Source: Ben Carlson - awealthofcommonsense.com

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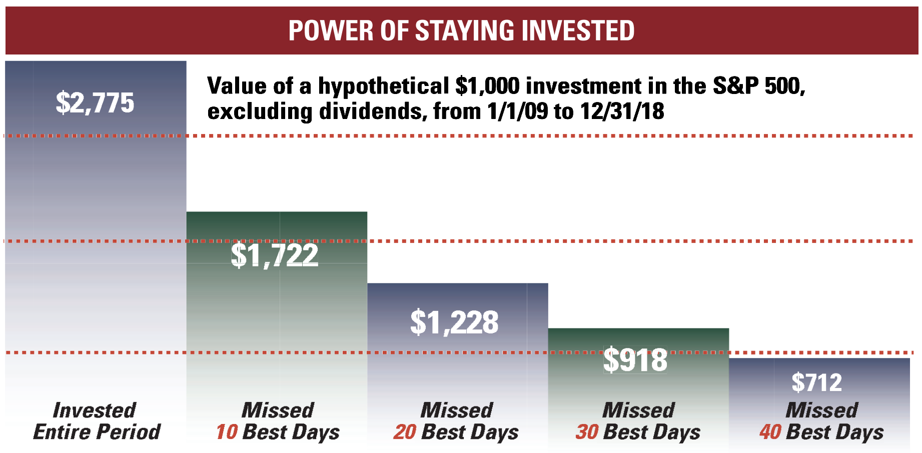

Source: Capital Group

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We all know 2020 is an election year. I've written about market cycles during Presidential terms previously. The chart below compares stock market results between years with no election and years with a Presidential election. As you can see, the months leading up to the Presidential primary can be volatile. However, once candidates are finalized, subsequent 12-month returns have historically been good.

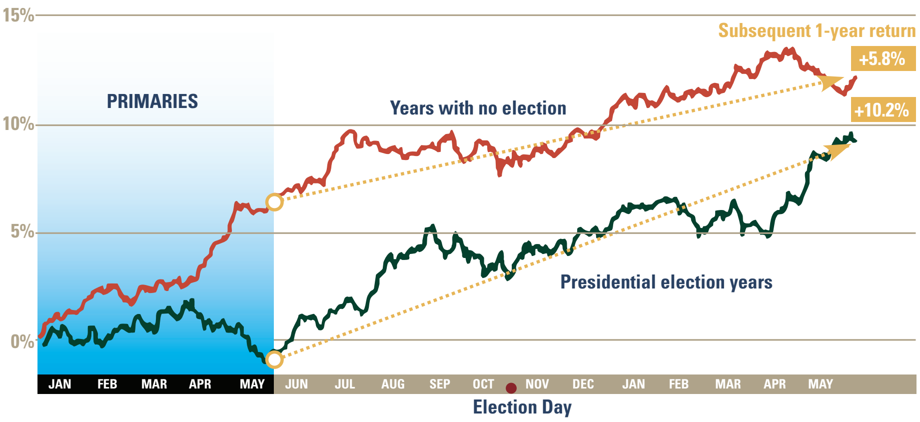
So, where does this leave us for 2020—or, more importantly, the next decade? The U.S. has performed far better than many other places over the past decade: our economy has exceeded most other developed countries, our companies have led in disruptive technologies, we avoided many of the crises that hit other parts of the world, and after the last recession, we fixed our financial system more quickly than Europe. Maybe more importantly, our most recent decade followed "The Lost Decade" of the 2000's where the S&P 500 posted a small loss.

David J. Vaughan, the founder of our firm, always advised us that if you're predicting markets, be sure to do it early and often. My approach has been to avoid making market predictions. However, I'm a firm believer in mean reversion which implies market results fluctuate around a long-term average.

Our most recent decade has clearly been above average. Is it realistic to expect another decade of above average results? Probably not. Can the U.S. financial markets continue to provide results which allow our dear clients to grow wealth? Definitely.

Volatility during primaries is often followed by strong returns

S&P 500 Index average cumulative returns since 1932



Sources: Capital Group, RIMES, Standard & Poor's. Includes all daily price returns from 1/1/32-11/30/19. Years without an election exclude all years with either a presidential or midterm election. Subsequent one-year return calculation begins on May 31 each year, a proxy for the end of primaries. Standard & Poor's 500 Composite Index is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks.

THE SECURE ACT

New Retirement Changes

Maggie Bilby, CFP®
Relationship Manager | Florida Region

On December 20th, the Setting Every Community Up for Retirement Enhancement Act of 2019 (The SECURE Act) was signed into law. The SECURE Act is packed with more than two dozen provisions primarily intended to encourage saving for retirement and is the first significant retirement-related legislation since the Pension Protection Act of 2006. We felt that it was timely to introduce a high-level view on a few major changes.

No Age Restriction on Traditional IRA Contributions

Under the new law, you can contribute to a traditional IRA as long as you are still working.

Age Increase for Beginning to Take Required Minimum Distributions (RMD)

Going forward, the SECURE Act raises the age at which taxpayers must begin to take their RMDs from 70 ½ to 72 years old. If you turned 70 ½ in 2019 or earlier, you are not affected by the new law. If you turn 70 ½ in 2020 or later, you do not need to take the RMD until after reaching 72 years of age.

Death of the "Stretch IRA"

The new SECURE Act eliminates the "stretch" RMD provisions that have allowed beneficiaries of inherited retirement accounts to spread the distributions over their life expectancies. Now, most non-spouse IRA beneficiaries must take their distributions within the 10 years following the account owner's death. This new 10-year rule only applies to accounts where the owner of the IRA dies in 2020 and beyond.

At David Vaughan Investments (DVI), we are prepared to discuss and guide you on the best course of action under the new SECURE act. In early February 2020, we will be publishing a more in-depth discussion on the SECURE Act to our website and will be sending a notification of the article to our clients' emails. If you have any questions in the meantime, please contact your DVI representative.

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A Master Stockpicker Speaks Out

After nearly two decades at the knee of David Vaughan, it should come as no surprise that I gravitate towards investment legends such as Warren Buffet and Peter Lynch. They both delight in the process of identifying individual companies to invest in and they also share a common trait: their eternal optimism on the future of the United States and its economy. I have never met a successful common stock investor that did not maintain a glass-is-half-full mindset. David Vaughan once forecasted the DJIA to reach 132,980 and was so confident in his prediction that he had the chart printed on golf balls! After you read Lynch and Buffet's writings, it is obvious that they are blessed with encyclopedic knowledge that allows them to reference company specific statistics as if they were baseball cards. They both also share the knack of being able to turn the complex elements of common stock investing into something simple and entertaining—a true gift! Though Buffet is still active running Berkshire Hathaway, Peter Lynch retired from money management long ago, all the way back in 1990, my first year at DVI! Lynch gave up the reigns of running the Fidelity Magellan Fund (Fidelity's largest fund at the time) and became their Vice Chairman and investment mentor. Barron's magazine recently interviewed Lynch and, as always, there were words of wisdom that I felt well worth sharing.

ON INVESTING IN TURNAROUNDS *That's why you ought to write down,"Why am I owning this?" Cheap is different from a good story. There's a great expression on the Street: It's always darkest before pitch black. Wait until something's gotten better...*

QUOTE THAT WARREN BUFFET BORROWED FOR 1989 BERKSHIRE HATHAWAY ANNUAL REPORT *Getting rid of your great companies and adding to your bad companies is like cutting your flowers and watering the weeds...*

ON MARKET CORRECTIONS *Because the 1929 crash was followed by the Great Depression, people associate stock market declines with economic collapse. Yet in the past 100 years, there have been 60 declines of 10% or more. "More people have lost money anticipating corrections than in the actual corrections"* **Source: Barron's December 23, 2019**

Thirty Years at DVI

Years ago, I shared my experiences of David Vaughan asking me complex questions with me always telling him, "David, I am just 26 years of age!" Well unfortunately, on so many fronts, those days are in the rearview mirror. Fortunately, my enthusiasm for the work that we endeavor to do here at DVI has not been diminished by the passing of time. I am proud of what the DVI team has accomplished over the past three decades and the very bright future that lies ahead as we work in collaboration with our strategic partner Morton Community Bank. Over the past thirty years we have slowly but surely become part of one of the largest privately held financial institutions in downstate Illinois, but we have never lost sight as to how we got there: one client at a time, serving solely in their best interest and always cognizant of the significant responsibility placed upon our shoulders as their trusted financial advisor. We have always aspired to be a firm "built to last", and though that journey is still not over, we have made great strides towards that end goal. And we will be forever grateful to David J. Vaughan, our beloved founder, for always leading by example and showing us the way…

THE HANK LEBIODA CHALLENGE SWINGS FOR THE GREEN

David Vaughan Investments hosted the inaugural Hank Lebioda Golf Challenge on December 8th, 2019 at Drive Shack in Orlando, Florida. Teams participated in a driving range style tournament, playing a game known as "Shack Jack," battling it out for the inaugural trophy cup. The challenge featured special guest, Hank Lebioda, a PGA tour player and Central Florida native. With over 90 guests in attendance, the event raised $45,687 for the Crohn's and Colitis Foundation to further research, education and support for over 3,000,000 patients with Crohn's Disease. Sponsors for this wonderful event included Peter Millar, Titleist, PGA Tour, Barnies Coffee, John Craig Clothier in Winter Park, and The Brewstillery in Winter Park—just to name a few! DVI is looking forward to the next Hank Lebioda Golf Challenge in 2020!