Podcast Transcript: May Investment Discussion

Mark Rosenkranz:

Hi, I'm Mark Rosenkranz, Investment Strategist here at JNBA Financial Advisors in Minneapolis, Minnesota. I'm joined today on May 19th with John Foster, an Investment Committee member and Investment Strategist and Senior Advisor here at the firm. John, thanks for joining us.

John Foster:

Yeah, thanks for having me, Mark.

Mark Rosenkranz:

There's been a lot to talk about over the last couple of weeks and months. And with so much market movement, with so much headlines, from your seat as an advisor and from an investment strategist, what are kind of the few things that you've been focusing on pointing out to clients and where they should really keep their attention during such a tumultuous period, so to speak?

John Foster:

Yeah, it's been interesting, Mark. If all you looked at was the box scores year-to-date and said, "Well, what's going on in the market?" You have U.S. stocks about flat, you have the aggregate bond index up about 2%. You'd say it's been a pretty boring year, but it's been anything but that, right? We've seen stocks top to bottom lose about 20% of their value. We've seen international outperform the U.S. significantly.

And that's why I always tell people your first line of defense is going to be your asset allocation and your level of diversification. If you have a portfolio that's got both stocks and bonds, that's going to add a layer of a buffer to that type of volatility where you see a 20% decline in stocks. Well, if you're half in bonds, half your portfolio is not going to be experiencing that type of volatility.

And then, we've always diversified U.S. to international in all our portfolios as well. And we've seen an interesting divergence in performance there, where while U.S. stocks are about flat on the year, international stocks are up in the teens, about 14% year-to-date. So we've seen different performance out of different asset classes, and that's where that asset allocation, that diversification, that's really going to be your first line of defense.

Mark Rosenkranz:

Yeah, absolutely. And I think the kind of story from a lot of clients that we spoke with, especially in those kind of tough periods at the start of April, was the returns aren't as bad as they necessarily saw in the headlines, when you see the S&P down 20% from highs and you're kind of scared to open your portfolios and see how they look. But there's been a lot of pleasant surprises, but maybe not surprising surprises in terms of bonds doing their role as a portfolio diversifier of adding that layer of security. And with international performance kind of buoying returns so far year-to-date, it's been a little bit maybe smoother ride than maybe some would anticipate just watching the headlines, so to speak.

John Foster:

Oh, definitely, yeah. We've had clients and they've been coming in to meet and they said, "Hey, I haven't really looked at things this year for a few months." And they kind of peek at it, a little bit afraid to look. And then, they look and they'd say, "Yeah, that's not as bad as I thought."

And really, if you think about that, if you were 60% stocks, 40% bonds, and then within your stocks though if 20% of that equity sleeve, so 20% of that 60% was international, well, the bonds are higher, the international stocks are higher, 60 to 70% of a client's portfolio had a positive return throughout the year. And so, that's where again, that allocation, that diversification, that really helped protect people here year-to-date, despite what was anything but a calm market. Top to bottom stocks lost 20%, and even the bond market, we've seen yields on the 10-year as high as 4.8% and as low as 3.9%. And so, while we're sitting here today, yields are flat on the year. They began the year at about 4.5% in the 10-year Treasury. They're 4.5% today, but even that yield environment's bounced all over the place.

Mark Rosenkranz:

Yeah. So I think kind of speaking on that, when we were first meeting those clients in that real tough period in April and we've seen a rebound since, and naturally the conversations shifted to, "What's the kind of outlook going forward?" And there's still a lot of moving pieces. We're definitely not out of the woods by anything, but I think things are in a bit of a waiting period, so to speak. And just last Friday we got a Moody's downgrade on U.S. debt. There's some concerns about some of the economic data still not factoring in the full tariff picture. As you kind of digest a lot of what we've seen in the last month and look ahead a little bit, what are the kind of areas that you're focusing on in terms of where portfolios might have potential opportunities or challenges over the next six to 12 months, so to speak?

John Foster:

Yeah. And I think we've seen obviously a big rebound from the lows after tariffs were announced in April, the market had an initial reaction. We've seen a counter-reaction. The challenge to all that probably is we haven't seen that really play out much in economic data. We're really only talking about a month and a half since tariffs were first introduced. And so, there'll be a lag for that to work its way through the economy. Fed Chair Powell, he's mentioned, "Hey, this could mean a little bit of price pressure as some of these tariffs are passed through to consumers. It could also mean maybe a little bit slower growth as people just look to spend less due to potentially rising prices." And so, it'll be interesting to see how it plays through the economy.

At the same time though, the consumers remained resilient. We've seen the consumer hang in there, strong, underlying investment. Now, economic growth, we did see in the first quarter it made a lot of headlines. GDP was negative 0.3%, but most of that was just due to people importing trying to front-run the tariffs. And it really wasn't due to the underlying economy which had strength more similar to a couple percent of GDP growth. And so, the economy itself, despite the concerns, the economy has remained strong. And so, it's really going to be know what impact does this have. And it's probably too early to tell. But for the time being, the momentum certainly to the upside. Things appear to be in gear. Earnings season was probably a little bit better than people had feared it might be. And so, it's going to be seeing how this all plays out in the economy here the second half of the year, and then really adjusting accordingly.

Mark Rosenkranz:

Yeah. Yeah, I think it's never a fun thing to say, "We're kind of waiting for the data." But I'll take your cue from when you mentioned Jerome Powell, even he said he was waiting. I think he said the phrase about 13 or 14 times. There's just not a lot of hard information out there. And when there's such a constantly changing news flow of what's actually set in place, there's a lot of companies that seem to think, "Maybe it's just time to wait and see where the dust settles." And as long as that's still the case where it's a little more dynamic, that can be a little tricky.

But on the interest rate front and the bond front, a lot of concern gets raised. We've seen this happen with the Moody's downgrade over the last couple years, I think; one in 2011 and another one in '23 from the other rating agencies. When these type of events occur, they're always kind of different and dependent on the market environment. But what's your overall take on when you see something like that, of a rating agency saying the U.S. debt maybe isn't as secure or safer as it used to be?

John Foster:

Yeah. And this has really been a problem that's been building now for four or five decades. And so, I think we've probably reached a tipping point here finally most likely, to where we've been pretty steadily running deficits in the trillion-dollar plus range for the last number of years. It's very challenging due to entitlements. Last year we spent about $1.3 trillion on interest on our debt. You just take entitlements of Social Security and Medicare, interest spending and defense, and you get up in towards about $4 trillion of government expenditures without a lot of flexibility to make cuts there.

It's not ever if you're going to get paid back, but it's more what's the value of that money going to be worth when you do get paid back? And if you today buy a 30-year Treasury, you get compensated 5%, and is that going to keep pace with inflation? Or in order to inflate away some of these debt and deficit situations, is it going to mean that okay, 5% wasn't enough compensation and I didn't maintain my purchasing power? But it's more that. If you can print money, you can always pay somebody back.

Mark Rosenkranz:

Exactly.

John Foster:

You just may not like the value of what it is you're receiving at the end of that period.

Mark Rosenkranz:

Yeah. And I think you touched on a good point, where this isn't necessarily a new issue, so to speak. It's just kind of the latest data point saying, "This trend hasn't been so encouraging over 5, 10, 20, 30 years." And obviously there's work to be done there, but I think the overall takeaway to your point is you will get your money back to some degree. It's just a matter of what you can buy with it at the end of the day.

And we've seen a lot of various reactions over the past when we've seen this. I think in 2011 it was a fairly muted bond reaction, and around '23 was a little bit different environment. And each kind of market environment is different, what they view as important. And so far, today as of half a trading cycle, there doesn't seem to be many alarm bells. And right now it seems like there is still a little bit more wait and see, but never a fun headline to see. But I think maybe not the doom and gloom that you would just read on the surface level, so to speak.

John Foster:

Yeah, I think this has been something, as we mentioned, that's been ongoing for a long time. It's been sitting there in plain sight. I don't think anybody is shocked for somebody to come out and formally say, "Hey, the U.S. doesn't appear to have its fiscal house in order." You're going to get paid back, but will you like the value of what you receive? Or will the dollar undergo significant weakness to where you say, "Hey, 4 or 5%, turns out that wasn't enough compensation to maintain my purchasing power."

Mark Rosenkranz:

Right. So I wanted to shift gears a little bit and go back to, you mentioned at the start, one of the key elements going into a portfolio for periods like this is just your broad asset class positioning, your diversification. But we also try and be tactical around certain environments and take what the environment is into account. And mid-January, we actually shifted that stock/bond allocation a little bit to a more conservative posture. And that so far was a benefit throughout the year. Obviously, took a little bit of the sting of U.S. stocks' under-performance and really was a nice benefit throughout that kind of tougher period.

A month and a half later, we started to see the market rally a little bit on maybe some short-term kind of easiness, so to speak. And as we are positioned today, we've actually seen that broad asset class indicator trend more positively. And it's kind of painting a picture of maybe some of the damage is more understood, but not necessarily saying that it's a full go year, like a '23 or '24. But how do you frame how our broad asset class position is, and what it can kind of mean in different ways versus just what you see of higher stocks versus bonds and when we go overweight asset classes like that?

John Foster:

Yeah, and I think when we're really talking about when we want to be overweight, when we want to be underweight stocks, it's really making sure you're in alignment with the tide or the primary trend. There were concerns that that primary trend, that the market had run out of steam after good years in '23 and '24. So we did get a bit more cautious, as you had mentioned in January. Certainly, that took a lot of volatility out of the portfolios. Now our allocation indicators are turning more constructive as the rally's broadened out to include small cap stocks. It's been much broader across the board. And it's probably just pointing to the fact that, "Hey, from here, it looks like the difference between what you make in stocks and what you make in bonds might turn out to be favorable for equities the second half of the year." But as we mentioned, there's a lot of unknowns here to navigate the second half, and we'll have to remain nimble as we get new data points.

Mark Rosenkranz:

Yeah. No, absolutely. And I think whenever we see environments like this, the broad asset class changes get a lot of attention. But a lot of times during especially volatile periods like this, it's the work you're doing on the portfolio management side day in and day out. And especially a period like April, I think that's a really good point to highlight is a strength of active rebalancing. And just because you aren't making any necessary changes, your portfolio is moving whether you like it or not. And where we saw maybe traditional 60/40 after a market downturn become a 55/45. And we were able to kind of step in there and rebalance things to target; not necessarily changing the broad asset class target, but bringing things back so when we do experience these types of recoveries, you do get that active benefit a little bit. And I think that's a key strength we have here, that 10-day business day review, and being in there in the markets and understanding very close to when portfolios can drift away from their targets.

John Foster:

Yeah. Rebalancing is really a nice way. I always like to tell people, "Ideally, you have more shares on the way back up than you had on the way back down." And if you're running a portfolio that's 60% stocks, 40% bonds, if stocks go down 15, 20%, you sell some bonds, you buy some stocks, well now when the market recovers, you'll have more shares on the way up than you had on the way down, which should have the portfolio hitting new highs before the market does.

Mark Rosenkranz:

Yeah. And I think the kind of underlying key to that all is aligning with that long-term target, and back to your original point of that broad positioning and having your long-term picture in place; understanding that if you are to see that market rebound, whether it happens in a couple weeks maybe like we saw so far today, or maybe even longer term, three, five years like we typically see in market history. That active rebalancing can be a benefit, it's just a matter of when that story plays out a little bit.

John Foster:

Absolutely.

Mark Rosenkranz:

Yeah. Well, thank you for your time, John. I appreciate it. And thanks to our listeners. We hope you visit jnba.com and tune into our other podcasts and videos where we cover a variety of topics. Thank you for your continued trust in JNBA, not just as your financial advisor, but also your advocate.

DISCLAIMER:

The previous presentation by JNBA Financial Advisors, LLC, was intended for general information purposes only. No portion of the podcast serves as the receipt of, or as a substitute for, personalized investment advice from JNBA or any other investment professional of your choosing. Different types of investments involve varying degrees of risk, and it should not be assumed that future performance of any specific investment or investment strategy, or any non-investment related or planning services, discussion or content, will be profitable, be suitable for your portfolio or individual situation, or prove successful. Neither JNBA's investment adviser registration status, nor any amount of prior experience or success, should be construed that a certain level of results or satisfaction will be achieved if JNBA is engaged, or continues to be engaged, to provide investment advisory services. JNBA is neither a law firm nor accounting firm, and no portion of its services should be construed as legal or accounting advice. No portion of the podcast or video podcast content should be construed by a client or prospective client as a guarantee that he or she will experience a certain level of results if JNBA is engaged, or continues to be engaged, to provide investment advisory services. Please Remember: If you are a JNBA client, please contact JNBA, in writing, if there are any changes in your personal and or financial situation or investment objectives for the purpose of reviewing, evaluating and or revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. Unless, and until, you notify us, in writing, to the contrary, we shall continue to provide services as we do currently. A copy of JNBA's current written disclosure Brochure discussing our advisory services and fees is available upon request or at jnba.com. Please see important disclosure information at jnba.com/disclosure.