WELLS FARGO Advisors

# Pandemic Craziness: How to Financially Prepare for the Economic Reopening/Reflation Ahead

Buck Bandura, CFP®

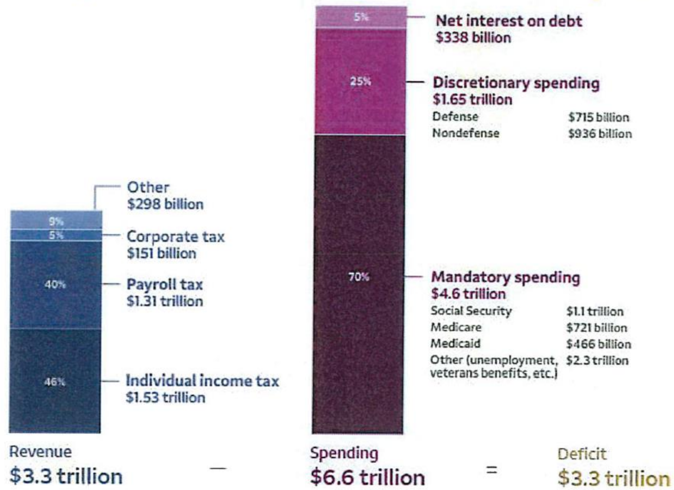
WELLS FARGO
Investment Institute

# Chart of the Week

Weekly market analysis on key market indexes

October 27, 2020

## Doubling down — The U.S. government's lopsided budget




Sources: Congressional Budget Office, September 2020.

### Projected 2020 spending by the U.S. government is $6.6 trillion — double the projected revenue of $3.3 trillion

When a family or business does budgeting and subtracts expenditures from revenues, the goal is usually to end up in positive territory. When the federal government does it, the result often is a negative number, or a deficit. In 2020, the expenses of the U.S. federal government are on track to exceed revenue by $3.3 trillion.

For historical perspective, in 1966, the government spent 4.5% of the gross domestic product (GDP) on mandatory expenses; this year, that figure skyrocketed to 22.4% due to pandemic spending.

**What it may mean for investors**

- Deficits can be an important part of managing through economic cycles. In theory, deficits grow during recessions, as the government spends more to help stimulate economic activity while tax receipts decline.
- Some level of deficit spending is likely sustainable, but as the population ages, the government will shoulder a greater burden to support increased costs for Social Security and Medicare. Although cutting federal spending to help balance the budget can be a matter of intense debate, only about one-quarter of government expenditures is discretionary — meaning they can easily be reduced.

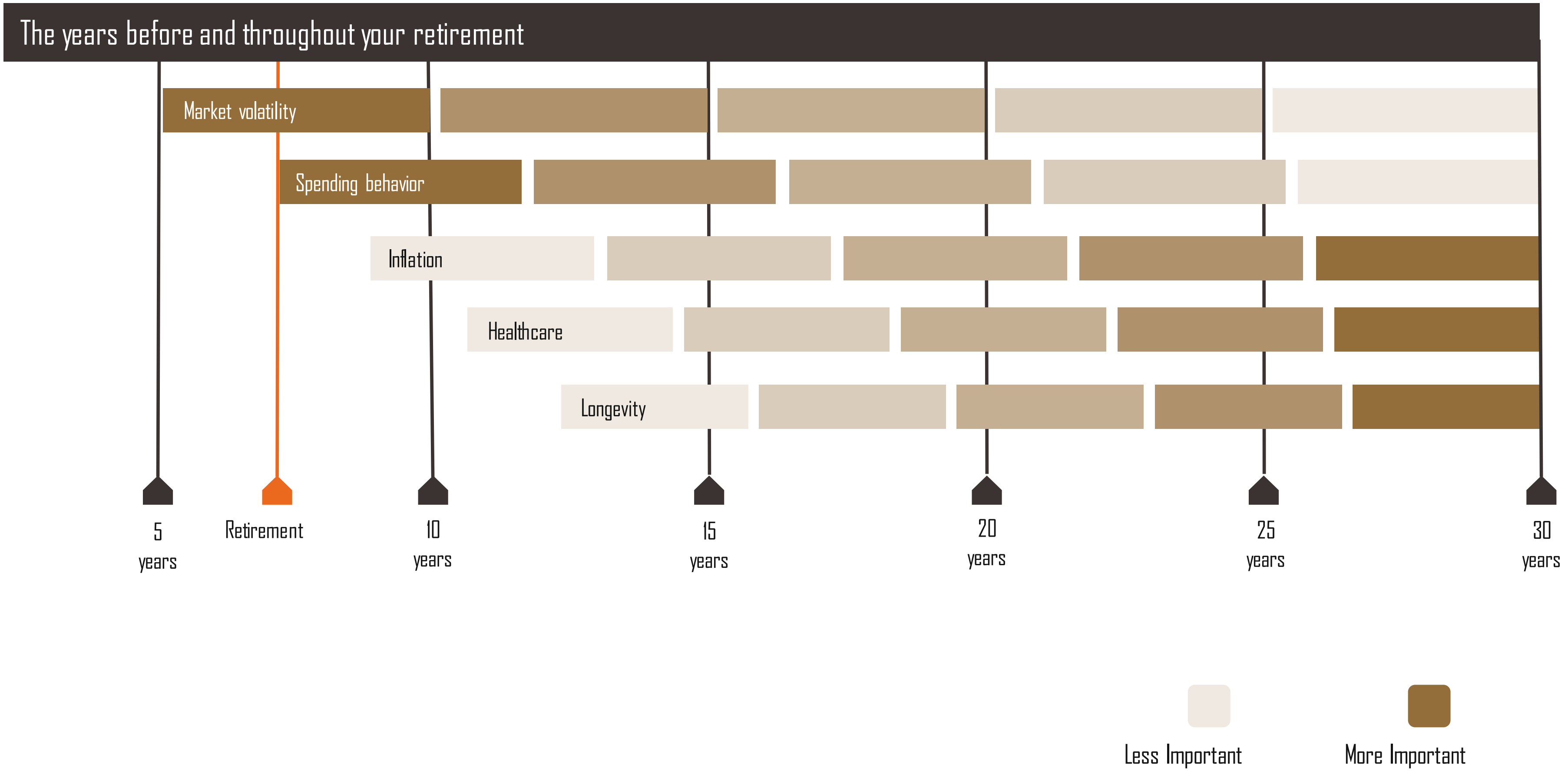
**Brian Rehling, CFA,** *Head of Global Fixed Income Strategy*

This chart was excerpted from the *Paying America's Bills* (October 2020)

# The six questions

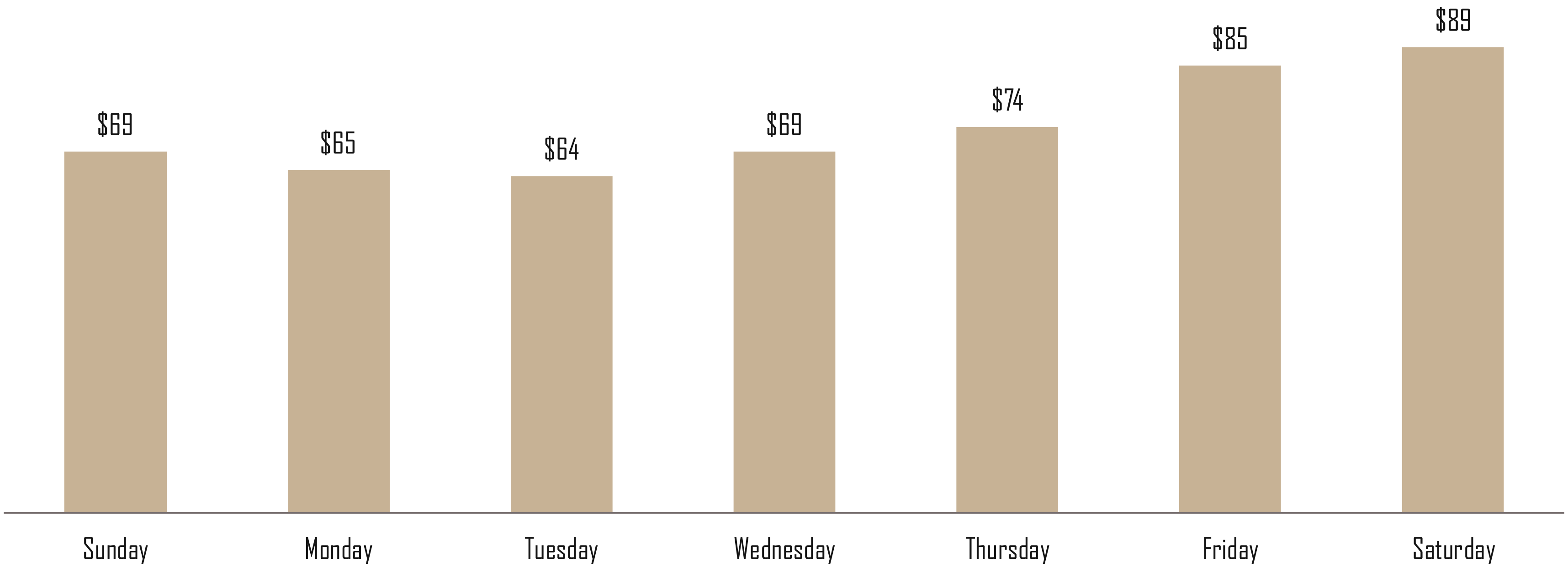
1. What is one of the biggest threats to my retirement?
2. When should I begin Social Security?
3. What are my possible health care costs?
4. How much can I spend in retirement?
5. How should I invest during retirement?
6. Am I on track?

# The retirement income challenges



# You may spend more than you think

Which day of the week do you spend the most money?




SOURCE: GALLUP Survey – 2018. The Gallup consumer spending results are based on random half-samples of approximately 500 national adults, aged 18 and older, each day. For purposes of this analysis, a total of 140,114 interview results were compiled. Samples for individual days of the week totaled more than 19,000 completed interviews while those for weekdays totaled 80,230 and those weekends totaled 59,884. For all of these samples, one can say with 95% confidence that the maximum margin of sampling error is ±1 percentage point.

# Effects of inflation

Inflation's powerful effects

If prices rise 4% annually:


Source: Consumer Price Index

# Americans are living longer

Probability of a 65-year old in good health living to various ages

## A 65 year old can expect on average to live to age:

**84**
years old

**Male**

**86.5**
years old

And those are just averages. About one out of every three 65 year-olds today will live past age 90, and one out of seven will live past age 95.

**Female**

Source: www.ssa.gov/planners/lifeexpectancy.html

## Question 1

What is one of the biggest threats to my retirement?

## Answer 1

Not having a plan. Have a written plan that addresses your potential challenges.

# Question 2
# When should I begin Social Security?

# Social Security claiming facts

26.7% reduction
in total benefits!

29% increase
in total benefits!

Age 62
Earliest claiming age

Full Retirement Age

Age 70
Max benefit age

| Year of birth | Age |
|---|---|
| 1943-1954 | 66 |
| 1955 | 66 & 2 Months |
| 1956 | 66 & 4 Months |
| 1957 | 66 & 6 Months |
| 1958 | 66 & 8 Months |
| 1959 | 66 & 10 Months |
| 1960 & Later | 67 |

# Social Security claiming facts

Assumptions
Full Retirement Age = 66 + 8 months
Monthly benefit = $1,000 per month
Annual benefit = $12,000

## Age 62

If claim early:
Monthly benefit = $716
Annual benefit = $8,592

# 76% Increase

## Age 70

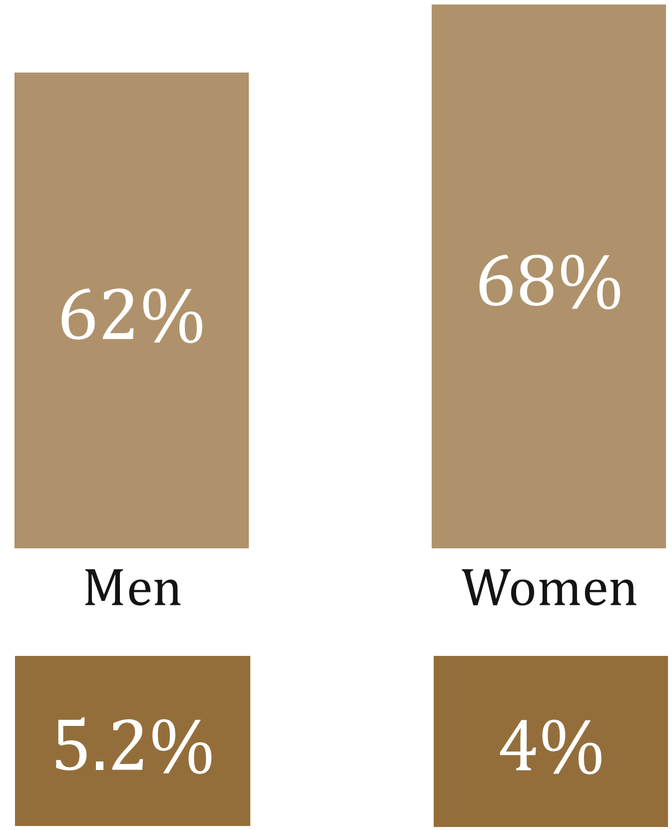
Max benefit age
Monthly benefit = $1,266
Annual benefit = $15,192

This information is hypothetical and is provided for informational purposes only.

# Social Security claiming statistics

Claiming early
(reduced benefits)

Claiming late
(increased benefits)



# Health care costs in retirement

What you need to know

- Medicare starts at age 65
- The dangers of losing coverage before age 65
  - Finding coverage can be challenging and costly
  - Possibly derail your retirement income plans well before retirement
- Be aware of your potential medical costs
- Create a strategy for meeting your costs through retirement

# Divide and conquer your expenses

Types of retirement expenses

## Essential - basic necessities

- Food
- Mortgage
- Healthcare

## Discretionary - luxuries

- Travel
- Entertainment
- Recreation

# The Gap = Shortfall vs. Surplus

- Total Income – Total Expenses = "the income gap"
- Total Income < Expenses = Shortfall
- Total Income > Expenses = Surplus

## Decisions & Trade-offs that affect your retirement

| Shortfall |
|---|
| 1. Work longer (retire later) |
| 2. Spend less during retirement |
| 3. Save more while working |
| 4. Leave less to beneficiaries |
| 5. Increase risk tolerance |
| 6. Withdraw from your investment portfolio |

| Surplus |
|---|
| 1. Retire earlier |
| 2. Spend more during retirement |
| 3. Spend more while working |
| 4. Leave more to beneficiaries |
| 5. Decrease risk tolerance |
| 6. Contribute to your investment portfolio |

## Question 4

How much can I spend in Retirement?

## Answer 4

1. Match income to expenses (include health care).
2. Calculate the gap.
3. Determine your priorities(s).

MATRIX
WEALTH MANGEMENT

# *Ready....Set....Retire*

*Step 1: List your Expenses*

Food and Clothing Expected monthly expense: $ __________
(Because you're no longer working, you probably won't be spending as much on clothes. But not having an expense account, you might pay more for lunches.)

Housing Expected monthly expense: $ __________
Rent/mortgage payments, property taxes, home owners insurance, property upkeep and repairs

Utilities Expected monthly expense: $ __________
Gas, electric, water, telephone, cable, internet

Transportation Expected monthly expense: $ __________
Car payments auto insurance, gas, maintenance and repairs, public transportation (You may drive less with no more daily commute, but might you be taking more driving vacations?)

Insurance Expected monthly expense: $ __________
Medical, dental, life, disability, long-term care

Healthcare costs not covered by insurance Expected monthly expense: $ __________
Deductibles, co-payments, prescription drugs (Figure on these increasing as you age.)

Taxes Expected monthly expense: $ __________
Federal and State income tax, capital gains tax

Debts Expected monthly expense: $ __________
Personal loans, business loans, credit card payments

Education Expected monthly expense: $ __________
Children's or grandchildren's college expenses

Gifts, charitable and personal Expected monthly expense: $ __________

Recreation Expected monthly expense: $ __________
Travel, dining out, hobbies, leisure activities (These will probably increase with your added free time.)

Care for yourself or others Expected monthly expense: $ __________
Costs for a nursing home, home health aid, or other types of assisted living

Miscellaneous Expected monthly expense: $ __________
Personal grooming, pets, club memberships

*Step 2: Add them up to get total monthly expenses*
Total Monthly Expenses: $ __________

*Step 3: Multiply by 12 to get yearly expenses*
Total Yearly Expenses: $ __________

# How much can you take out of your portfolio?

## Chance of a portfolio lasting 30 years

| Withdrawal Rate | Stock / Bond Mix % 100/0 | 75/25 | 50/50 | 25/75 | 0/100 |
|---|---|---|---|---|---|
| 3% | 90% | 95% | 98% | 99% | 98% |
| 4% | 77% | 80% | 84% | 82% | 55% |
| 5% | 60% | 59% | 53% | 31% | 8% |
| 6% | 45% | 38% | 23% | 4% | 0% |
| 7% | 31% | 21% | 8% | 0% | 0% |

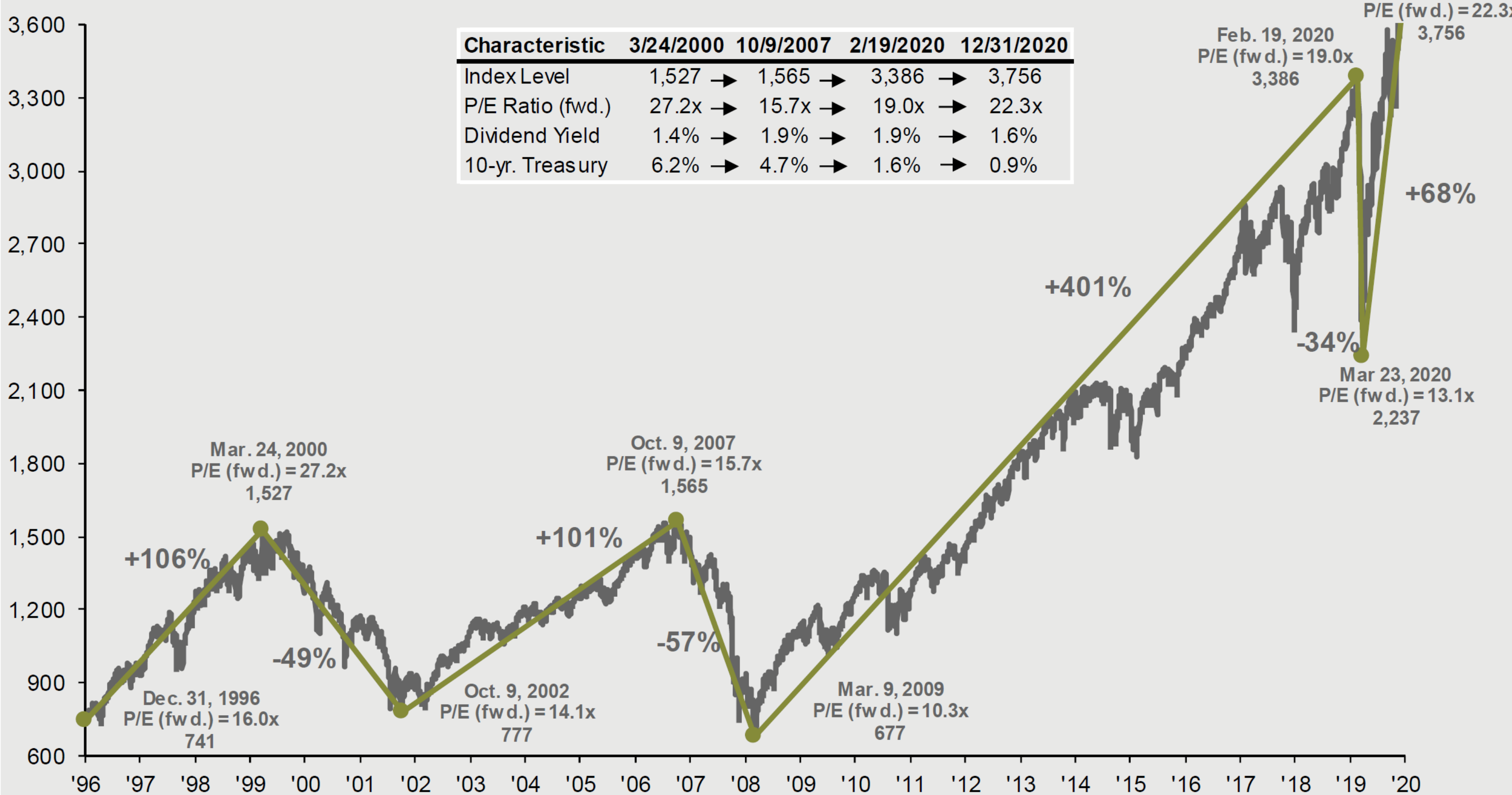
Analysis conducted by Wells Fargo Advisors' Advisory Services Group using 50,000 simulations. For stocks, a mean return of 8% and standard deviation of 16.5% was utilized. For bonds, it was 4.10 and 5% respectively. The projections or other information generated by this analysis regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. Results may vary with each use and over time. This simulation (commonly referred to as Monte Carlo) generates random returns based on the historical standard deviation forming a normal distribution around the mean. After returns for each asset class are generated, the returns are further refined by factoring in approximate 75-year correlations among the asset classes. This will result in a universe of returns for each asset class. The portfolio's weighted average return is calculated based on each asset class's weight in that scenario's asset allocation, in effect rebalancing every year. The analysis does not contain information related to any specific security and as such does not favor any certain or specific security. To evaluate the impact that unpredictable markets may have on financial objectives, the simulation measures these objectives against 1,000 randomly generated market performance scenarios. It uses both historical averages and volatility (ups and downs of the market as a standard of risk) of stocks, bonds and cash to generate the random portfolio return scenarios.

# S&P 500 Index at inflection points



## S&P 500 Price Index

| Characteristic | 3/24/2000 | 10/9/2007 | 2/19/2020 | 12/31/2020 |
|---|---|---|---|---|
| Index Level | 1,527 → | 1,565 → | 3,386 → | 3,756 |
| P/E Ratio (fwd.) | 27.2x → | 15.7x → | 19.0x → | 22.3x |
| Dividend Yield | 1.4% → | 1.9% → | 1.9% → | 1.6% |
| 10-yr. Treasury | 6.2% → | 4.7% → | 1.6% → | 0.9% |




Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price-to-earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
*Guide to the Markets – U.S.* Data are as of December 31, 2020.



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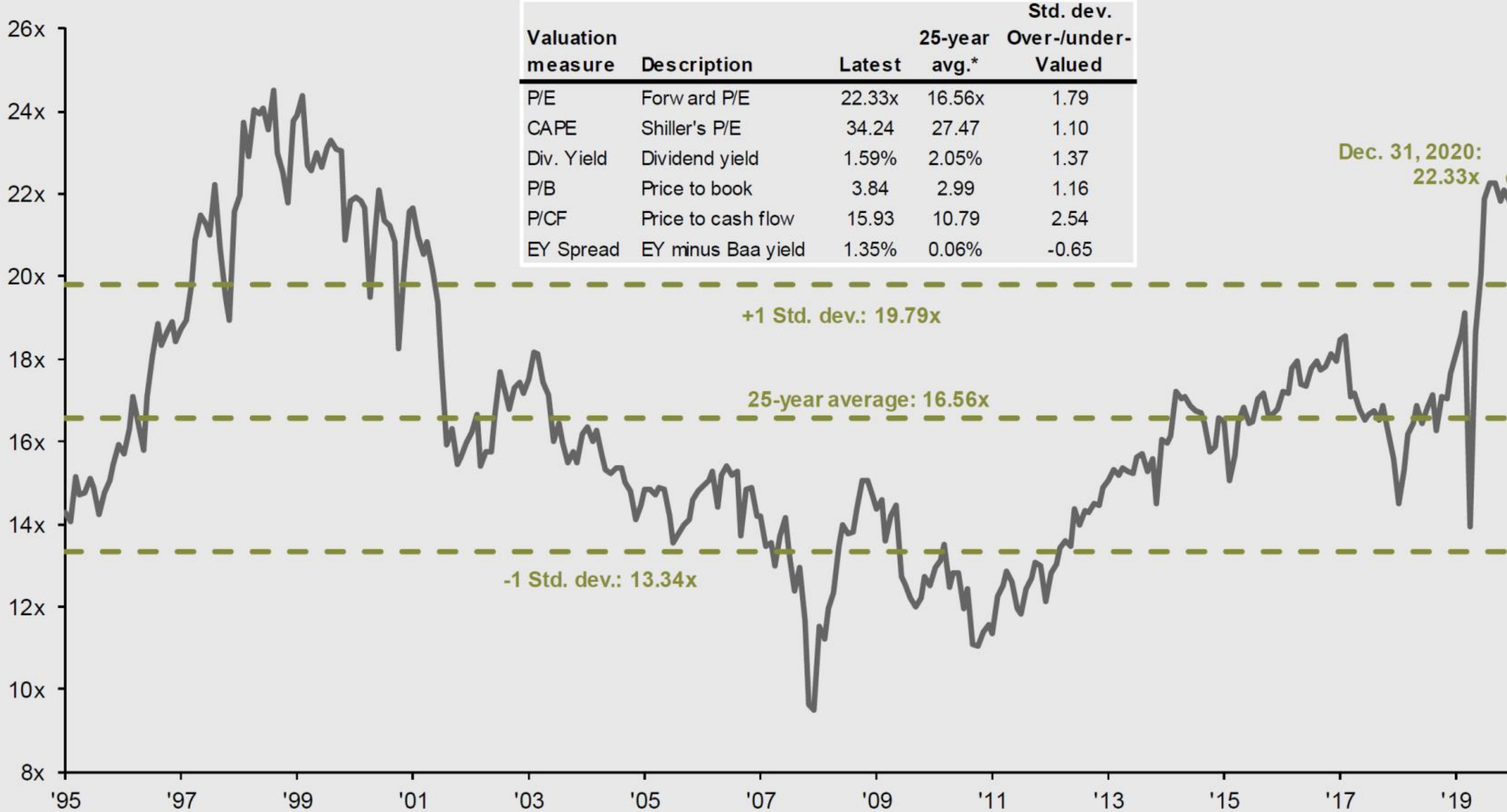
# S&P 500 valuation measures



## S&P 500 Index: Forward P/E ratio

| Valuation measure | Description | Latest | 25-year avg.* | Std. dev. Over-/under-Valued |
|---|---|---|---|---|
| P/E | Forward P/E | 22.33x | 16.56x | 1.79 |
| CAPE | Shiller's P/E | 34.24 | 27.47 | 1.10 |
| Div. Yield | Dividend yield | 1.59% | 2.05% | 1.37 |
| P/B | Price to book | 3.84 | 2.99 | 1.16 |
| P/CF | Price to cash flow | 15.93 | 10.79 | 2.54 |
| EY Spread | EY minus Baa yield | 1.35% | 0.06% | -0.65 |




Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since December 1995, and FactSet for December 31, 2020. Current next 12-months consensus earnings estimates are $167. Average P/E and standard deviations are calculated using 25 years of IBES history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Price-to-book ratio is the price divided by book value per share. Price-to-cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure.
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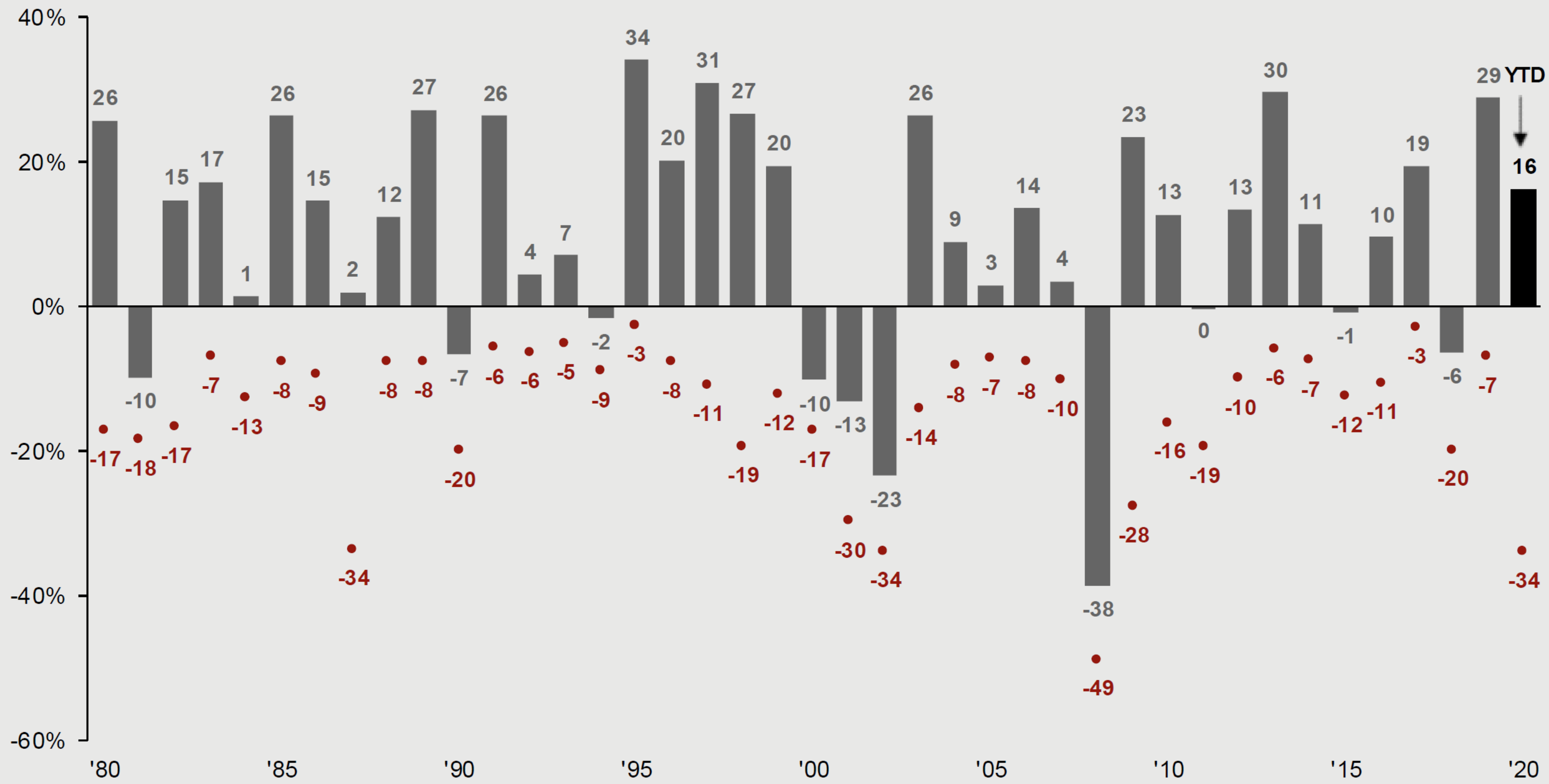
**S&P 500 intra-year declines vs. calendar year returns**

Despite average intra-year drops of 14.3%, annual returns positive in 31 of 41 years

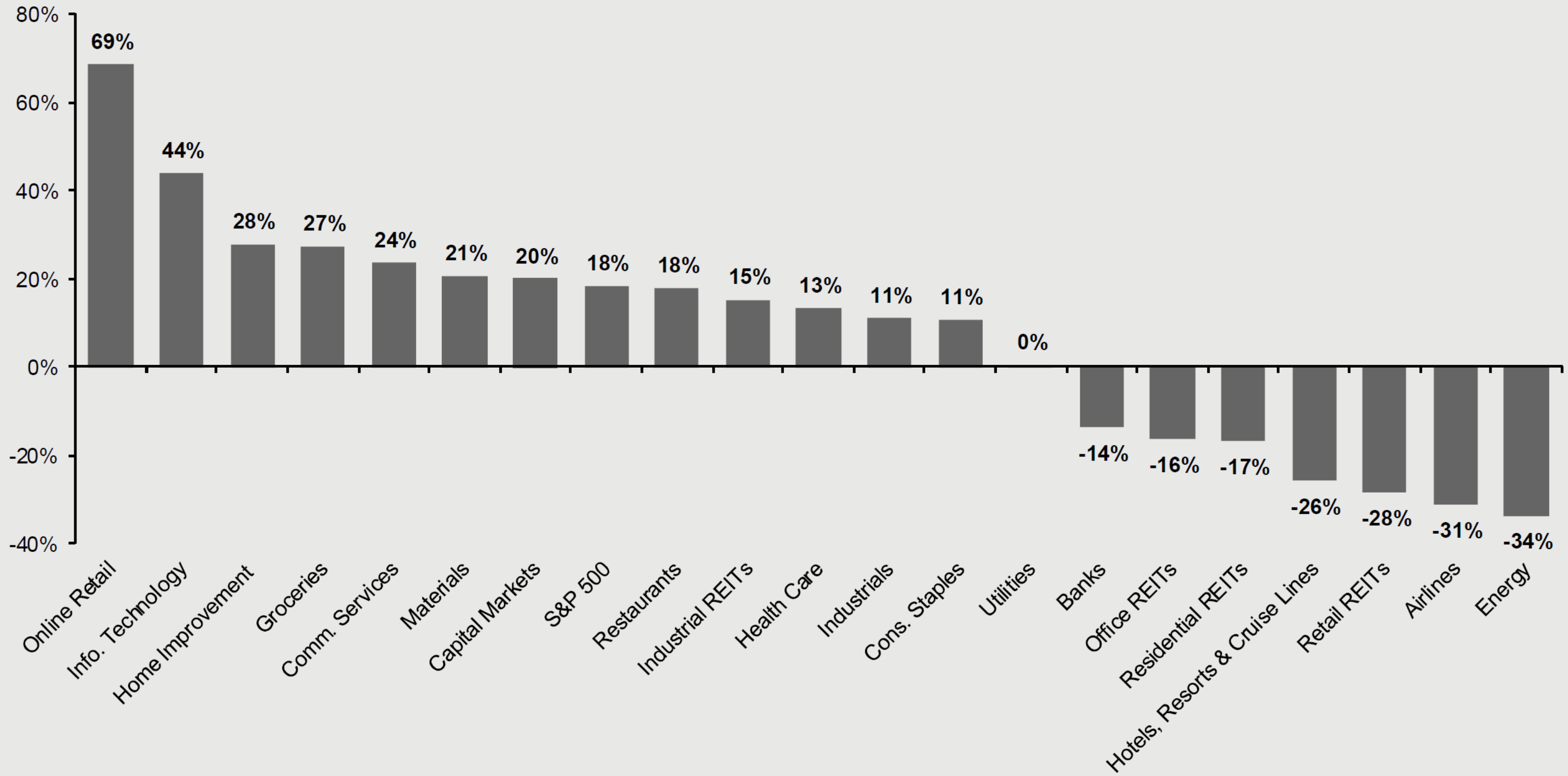



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2020, over which time period the average annual return was 9.0%.
*Guide to the Markets – U.S.* Data are as of December 31, 2020.

Equities

## Returns since December 31, 2019

Total returns by sector and industry




Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
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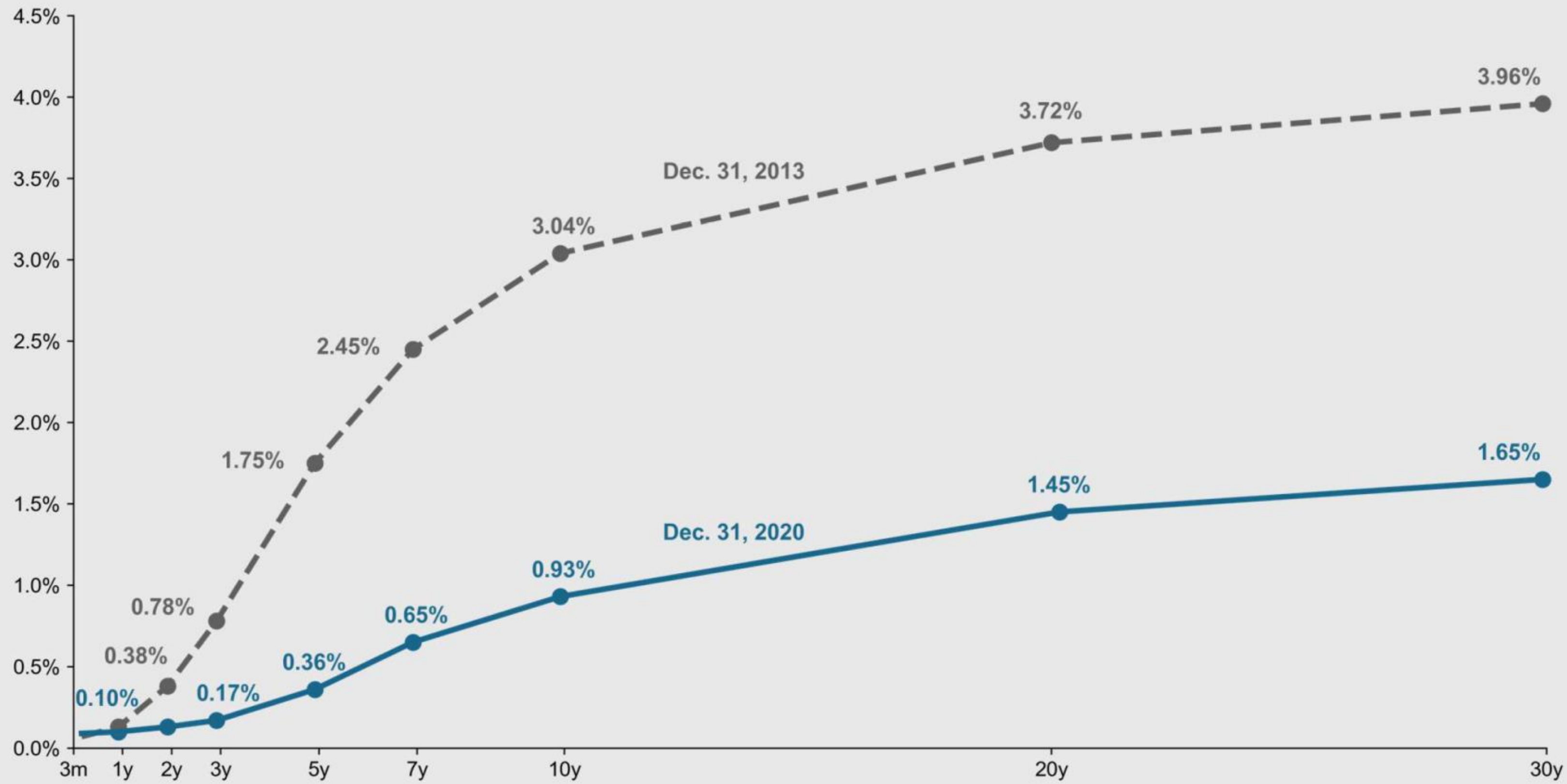
## Yield curve

U.S. Treasury yield curve




Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
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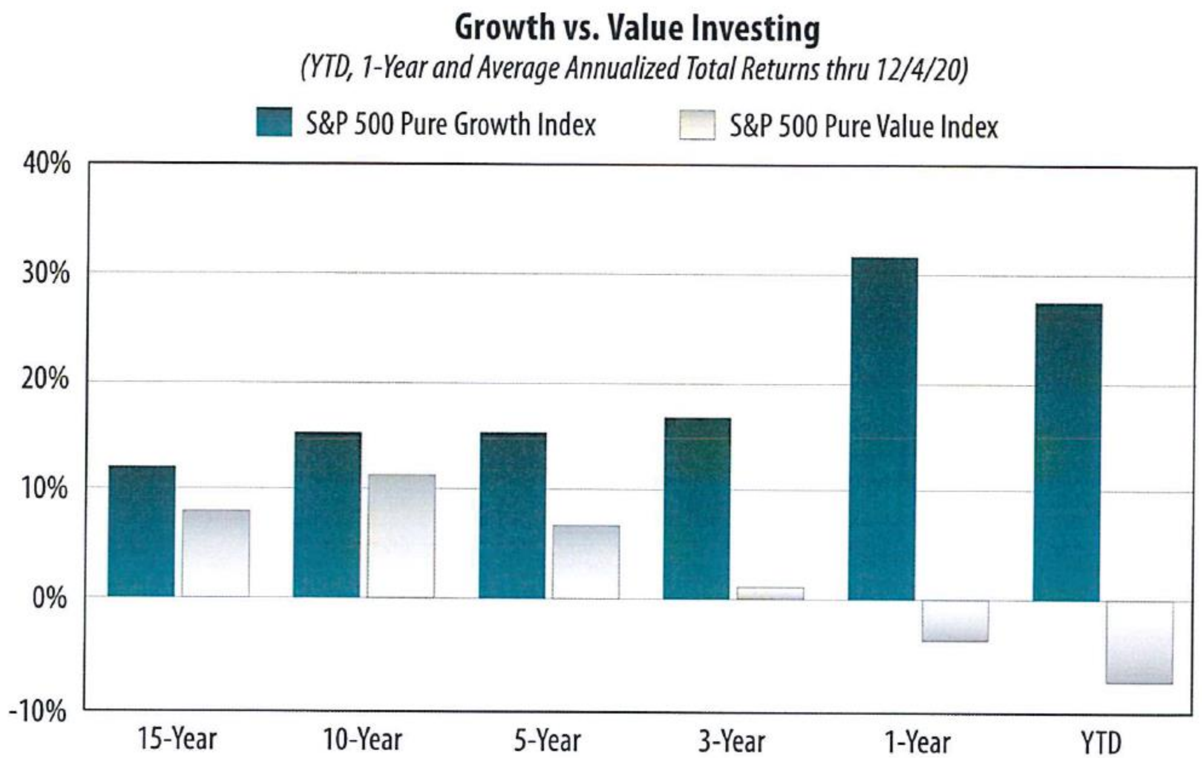
# A 20-Year Snapshot of Bond Yields

## ICE BofA Bond Index Yields & CPI Rates

| Index | YTM (12/11/20) | YTM (20-Year Avg.) | YTM (20-Year High) | YTM (20-Year Low) |
|---|---|---|---|---|
| CPI Rate* | 1.2% | 2.1% | 5.6% | -2.1% |
| 7-10 Yr. U.S. Treasury | 0.76% | 3.19% | 5.86% | 0.43% |
| Freddie Mac Mortgage Backed Sec. | 1.03% | 3.71% | 6.97% | 0.91% |
| 22+ Yr. U.S. Municipal Sec. | 3.50% | 4.85% | 7.09% | 3.49% |
| U.S. Corporate | 1.91% | 4.42% | 9.00% | 1.90% |
| Fixed Rate Preferred Sec. | 4.21% | 6.57% | 18.90% | 4.21% |
| U.S. High Yield Constrained | 5.17% | 8.60% | 22.38% | 5.15% |
| Global Corporate | 1.46% | 3.81% | 7.50% | 1.46% |

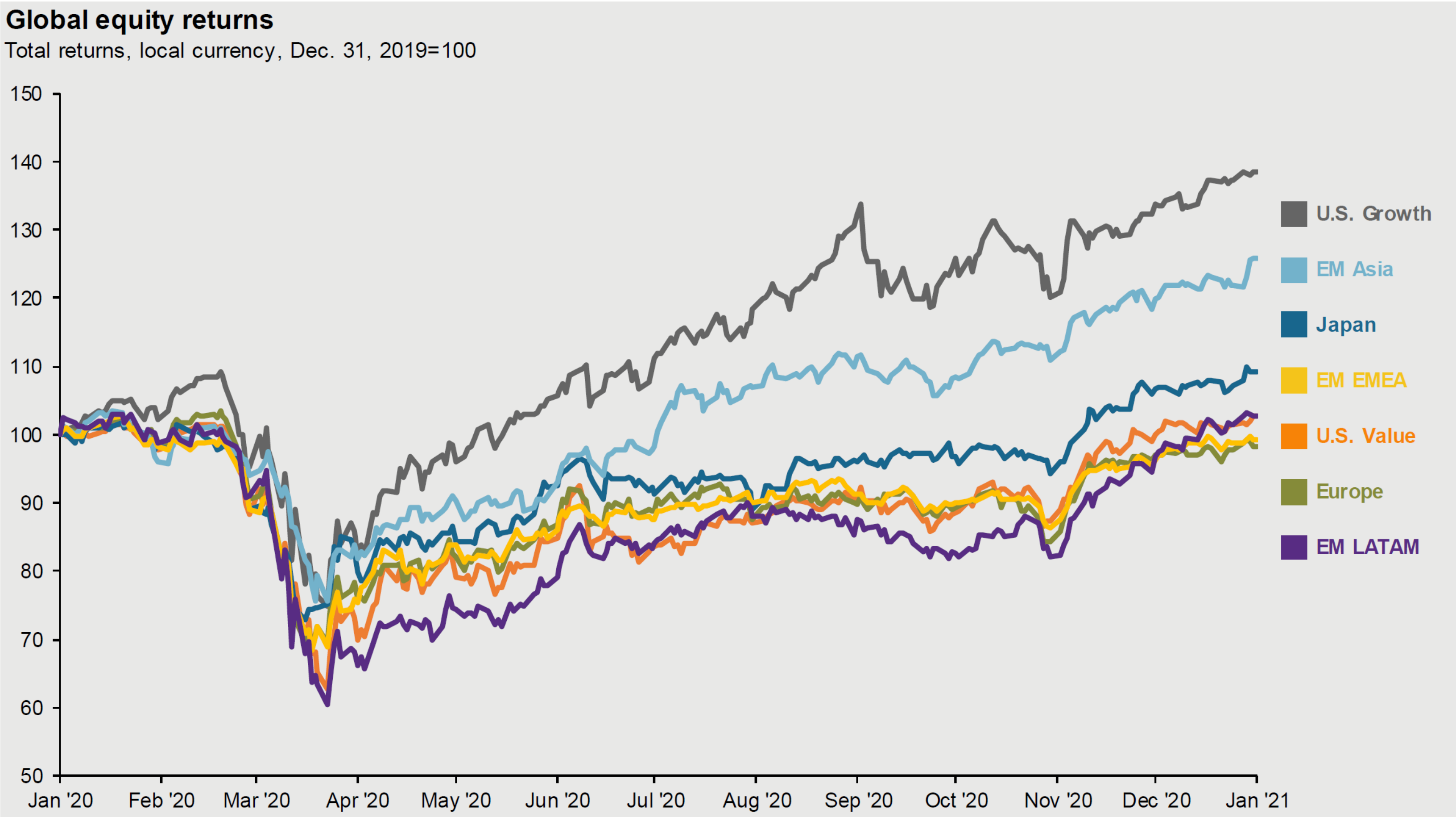
Source: Bloomberg. Yields reflect yield to maturity (YTM) calculations from 12/11/00-12/11/20.
*CPI (Consumer Price Index) monthly data points from 11/30/00-11/30/20.

# A Snapshot of Growth vs. Value Investing




Source: Bloomberg. **Past performance is no guarantee of future results.**

International




Source: FactSet, FTSE Russell, MSCI, J.P. Morgan Asset Management.
Growth is represented by the Russell 1000 Growth Index and Value is represented by the Russell 1000 Value Index.
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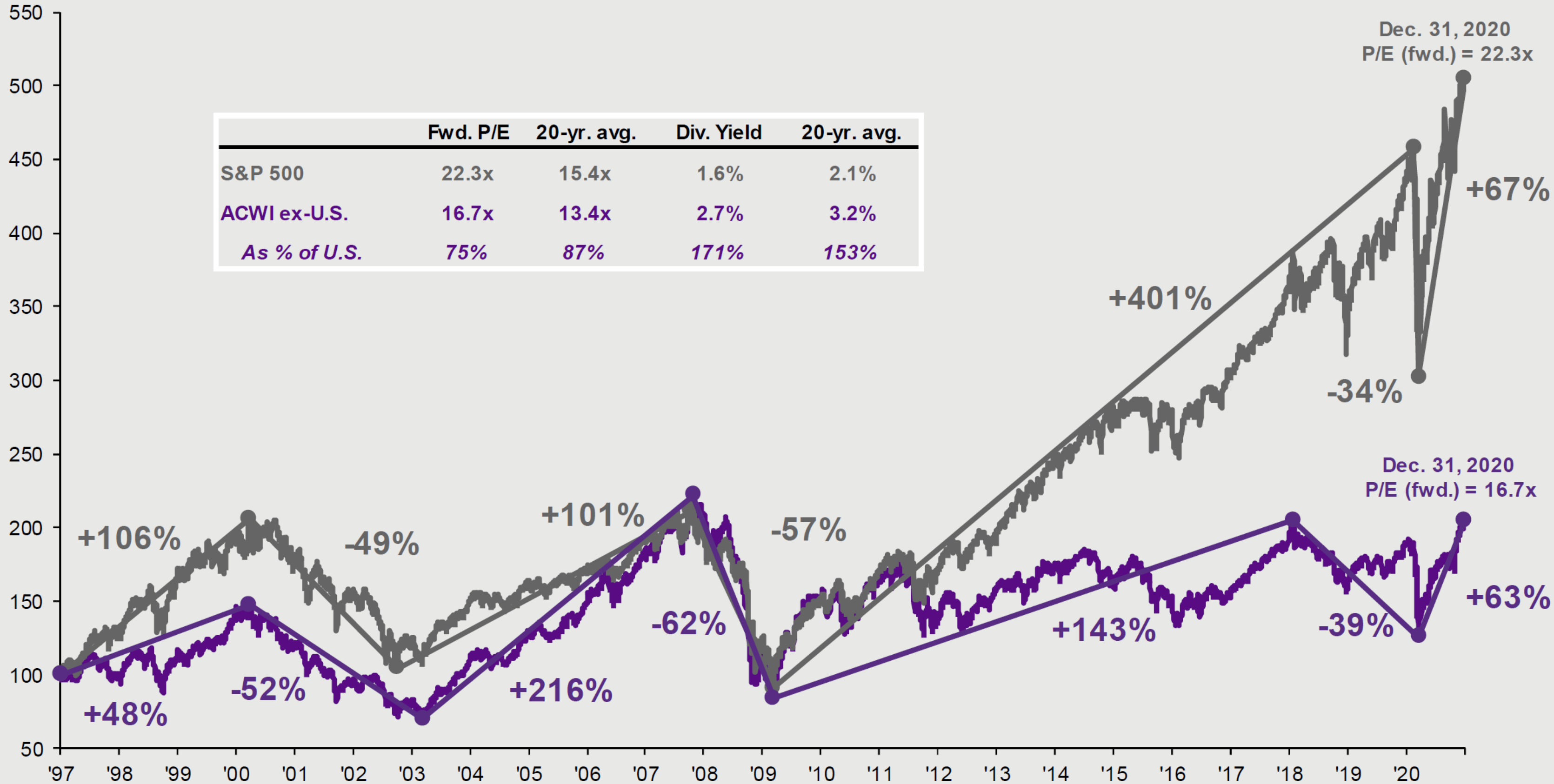
International

## MSCI All Country World ex-U.S. and S&P 500 Indices

Dec. 1996 = 100, U.S. dollar, price return




| | Fwd. P/E | 20-yr. avg. | Div. Yield | 20-yr. avg. |
|---|---|---|---|---|
| S&P 500 | 22.3x | 15.4x | 1.6% | 2.1% |
| ACWI ex-U.S. | 16.7x | 13.4x | 2.7% | 3.2% |
| *As % of U.S.* | *75%* | *87%* | *171%* | *153%* |

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Forward price-to-earnings ratio is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on price movement only, and do not include the reinvestment of dividends. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by FactSet Market Aggregates. Past performance is not a reliable indicator of current and future results.
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# Thank you