SEIA

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SIGNATURE ESTATE & INVESTMENT ADVISORS, LLC®
Established 1997

THE SEIA REPORT

NEGATIVE AND LESS THAN ZERO

BY **Deron McCoy**
CFA®, CFP®, CAIA, AIF®
Chief Investment Officer

It's not supposed to be like this.

In normal times, if someone wants to borrow $10,000 from you for a year, you two might agree that 2% interest is the right amount for the loan, so that at the end of the year, you would have $10,200. And if the borrower asks if the loan could instead be over 5 years, you two might agree that 4% interest is a more appropriate interest rate. And you look forward to collecting twice the amount of annual interest because your money will be locked up a bit longer. Sounds logical right? It's what we all learned in school. Yet today's bond market is not normal and yet another sign that we live in interesting times—consider the following.

If this same scenario were playing out in today's Europe or Japan, you would actually have to pay them the annual interest for the privilege of borrowing your money! And in the U.S. you would earn less interest for the longer loan! In short, the bond market is upside down!

Negative bond yields

Who in their right mind would pay a borrower to take a loan from them? Common logic holds that loans and bonds should not have negative yields. Truth be told, it's a relatively new phenomenon not to be confused with "negative real yields" – where the yield on a money market fund, CD, savings account or bond would be less than the rate of inflation. In those instances, investors would lose money over time when factoring in inflation. But the yields were nevertheless still positive.

Those days now seem quaint as we now view a world of negative nominal yields. So, what exactly is a negative-yield bond? First off contrary to the above example, it's not a bond with a negative coupon—investors don't actually have to pay interest to the borrower. You would still receive normal coupon payments and par value ($100) upon maturity, just as with any bond. The difference lies in what's paid for the bond at the point of sale.

Astute bond investors know that sometimes you have to pay a premium to acquire a bond. If one-year interest rates are 2%, a one-year bond with a 2% coupon will be priced at $100. A 5% coupon bond, on the other hand, will be priced higher (around $103) in order to compensate for the extra income it provides. In essence, an investor would receive $5 in interest but lose $3 in price depreciation as the bond matures at $100. Thus, each bond pays out a net $2 or 2% return over its one-year life.

In an era of negative yields, however, the initial price of the bonds will be higher. Say an investor must pay $106 for the 5% coupon bond. They would still get their $5 in interest, but in this case, they would lose $6 in price depreciation at maturity. The investor would net a $1 overall loss on the investment, making the total yield-to-maturity -1%.

> "Investing involves risk, including the potential loss of principal."

This really exists?

Yes, negative bond yields exist and in a big way! Deutsche Bank estimates that there are more than $15 trillion worth of negative-yielding bonds in the global market, representing 27% of all bonds outstanding.

Japan is the main culprit; but the problem also resides in Europe. In fact, collectively Japan, France, and Germany represent over 70% of negative yielding global debt (with the entire German yield curve currently below zero).

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> I believe successful wealth management is the result of an ongoing collaboration between investor and advisor, built upon trust and maintained according to the highest standards of integrity and expertise.

Brian D. Holmes,
MS, CFP®, CMFC®, AIF®, *President & CEO*

ABOUT SEIA

Signature Estate & Investment Advisors, LLC® (SEIA) is a Registered Investment Advisory firm offering Investment Supervision and Financial Planning Services tailored to align the unique needs of affluent individuals and corporations. Fundamental experience and professionalism enable the financial advisors, with SEIA's research and support staff, to design a financial plan or investment portfolio to align the client's goals.

ABCD'S OF LATE CYCLE INVESTMENT MANAGEMENT

A — **Account Management**
- Rebalance and take profits
- Reposition portfolio

B — **Behavior Management**
- Fix roof now. Don't be a forced seller in a downturn. Get off margin.
- Raise dry powder now that can be redeployed later

C — **Capital Preservation**
- Introduce portfolio hedges if appropriate

D — **Diversify Concentrated Positions**
- Reduce single stock risk and diversify

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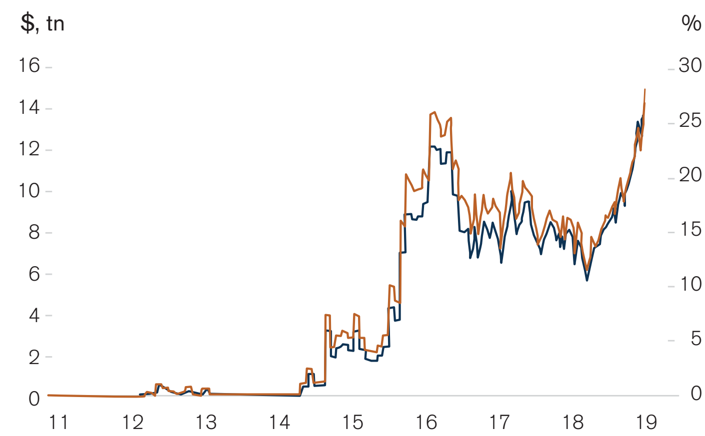
27% of bonds in the world trade at negative interest rates

- Global negative yielding debt, market value (ls)
- Global negative yielding debt as a share of all bonds outstanding (rs)



Why does this exist and who would buy these bonds?

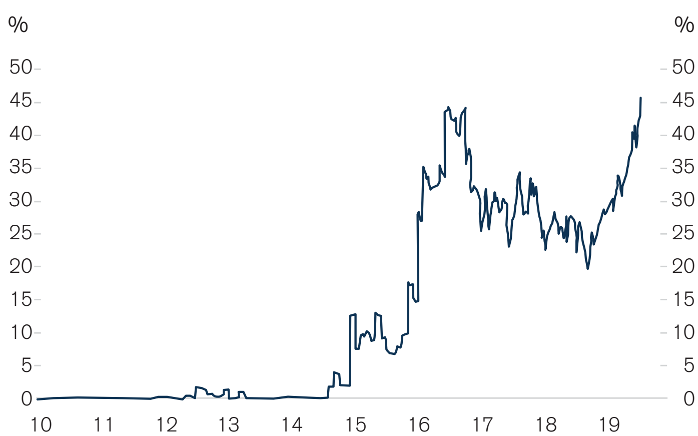
It all started in the aftermath of the Great Recession. Central Banks in Europe and in Asia pushed their short-term interest rates to zero in an effort to stimulate economic activity. The thinking was that by penalizing investors and banks for holding cash, they would be more inclined to do something with it. Businesses would invest, consumers would spend, and banks would lend. Unfortunately, it didn't quite work. So, Central Banks then moved rates into negative territory – which also failed. Seeing no other option, they began to buy their own debt, pushing prices up and interest rates down, all in an unsuccessful attempt to provide economic stimulus. As they continued to keep at it, over time government bond yields moved lower and lower and eventually fell into negative territory—partly due to ongoing buying and partly due to falling inflation expectations amidst the slow pace of economic growth.

This tepid economic environment caused early investors to worry more about a return of their money rather than a return on their money—and they were comfortable with losing a little bit of value in order to keep their savings safe. Think of it in a different way—if you were to store your prize possessions (e.g., cars, art or jewelry) you would expect to pay a small fee to the holder in exchange for keeping your assets safe. Same holds true with your cash—at least if you are European or Japanese. As more and more investors piled in, rates fell further into negative territory. Investors, in turn, began looking towards higher quality corporate bonds to secure a better yield. And as money began shifting into this sector, prices rose and yields fell until they too turned negative. Today, according to Deutsche Bank and Bloomberg, there is close to $1 trillion in negative yielding corporate bonds. Even some European High Yield bonds are trading with negative yields! Maybe its time to change the name back to junk bonds as high yield is certainly a misleading moniker these days.

No one, however, is upset yet because as yields become more and more negative, earlier investors keep winning due to falling yields driving prices higher. Consider our earlier example where a 5% coupon bond traded at $106 for a - 1% yield or $1 loss. Today, that investor might be able to sell their $106 bond for a higher price (perhaps $108); causing the next investor to face even worse negative yields. At some point though, a negative yield bond will ultimately have to offer negative returns.

Excluding the U.S. from the global IG Index shows that 45% of global bond markets outside the U.S. trade at negative yields

Share of negative yielding debt in global IG ex U.S. debt



Source: Bloomberg Finance LP, DB Global Research

What about the U.S.?

The current fear gripping domestic markets is whether negative rates could come to our shores. Schwab sees it as doubtful. "For one thing, the Federal Reserve has said that it's not a policy that they would like to pursue...and secondly, they're not even sure that it's legal under their charter," according to the brokerage behemoth.

Well that's certainly good news but there's a different kind of "negative" problem investors need to worry about.

Less than Zero (Inverted Yield Curve)

Remember the earlier example of a longer loan earning less interest? That's the case now in the U.S. as the yield on money markets is above 2% while the yield on the 2-year Treasury bond is near 1.60% and the yield on the 10-year Treasury bond is near 1.50% (as of late-August). This spread between shorter-dated bonds and longer-dated bonds (which is usually positive) is now less than zero – which in bond parlance is referred to as an inverted yield curve.

> Nevertheless, recession watch is at its highest level this cycle.

Schwab might have said it best: "not only should bond yields be positive, but longer-term bonds should have higher yields than short-term bonds—that's a 'normal' yield curve. Investors usually demand a risk premium to compensate for tying up their money for a longer period of time."

Why is this a problem? In short, an inverted yield curve often serves as a signal; suggesting good growth today, but lower growth in the coming years. Said another way, an inverted yield curve can be a harbinger of a looming recession.

What does it all mean?

While it's true that a yield curve inversion has predicted the last 5 recessions (all data here is Federal Reserve Bank of St. Louis), it's also true that in each of those instances, the yield curve was inverted for an average of 503 days before the recession came to fruition. It is also true that in each of those 5 recessions, the Federal Reserve's last interest rate hike either inverted the curve itself or came at a time while the curve was already inverted. But the 2019 curve inversion came three months after Jerome's Powell's last interest rate hike. In other words, the last hike this cycle came while the curve was still positively sloped (albeit a mere 30 bps or so) unlike prior recessions. Is it different this time? Perhaps. But even so, if a recession is on the horizon, we appear to be in the very early warning stage. It's also worth noting that during the 12 months following an initial inversion, stocks have averaged a further gain of another 11.13% (Bloomberg).

Nevertheless, recession watch is at its highest level this cycle. And although it certainly doesn't appear imminent, the heightened probability in quarters ahead is something to bear in mind when reviewing your financial plans for the next 24-36 months. The Investment Committee and Senior Advisors here are mindful of the potential risks and have been adjusting our recommendations in a thoughtful and rational manner while looking forward to a time when negative AND less than zero mean the same thing!

PREPARING FOR CONTINUED GROWTH

Christopher Maryanopolis
Chief Operating Officer

In emphasizing the importance of thorough preparation, Abraham Lincoln is quoted as saying “give me six hours to chop down a tree and I will spend the first four sharpening the axe.” Drawing on this same principle of preparing to ensure future success, SEIA is pleased to welcome Chris Maryanopolis to the firm as the new Chief Operating Officer of Signature Investment Advisors. Reporting to CEO Brian Holmes, Chris will oversee and manage business operations to help ensure that our firm continues to employ the most efficient and cost-effective financial and operational procedures into the future.

“When Forbes first listed us as one of the 20 fastest growing Registered Investment Advisory firms in the country in 2016, we had steadily grown assets under management to nearly $4B,” explains Brian Holmes. But our mission is about much more – it’s about ensuring that we maintain the same level of service excellence no matter how much we grow. The addition of Chris to our leadership team will be an important step in delivering on that goal.”

In his previous role as president of John Hancock Financial Network’s Signator Investors, Inc., Chris served the needs of more than 2,000 advisors across the country and ultimately oversaw the smooth and seamless transition of those advisors as part of a merger with Royal Alliance. He brings more than 30 years of financial services experience to the firm, and holds both a Bachelor’s in economics from State University of New York at Stony Brook as well as a Master’s in Business Administration from Fordham University.

“I’ve been incredibly impressed by the relentless growth of SEIA over the years and look forward to helping continue that upward trajectory,” added Maryanopolis. “It’s not just industry and regulatory changes that I’ll be focused on addressing, but also the changes associated with the demands of a growing business – exploring new ways we can streamline our operations to make them more efficient and consistent, and introducing new technologies that can better support both our advisors as well as you our clients.”

SEIA IN THE NEWS

BARRON’S

2019 Hall of Fame Advisor

Brian D. Holmes

BARRON’S Hall of Fame Advisor

FINANCIAL TIMES

2019 Top Financial Advisers

FT FINANCIAL TIMES Top Financial Advisers 2019

FORBES

2019 Best in State Wealth Advisors

Vince DiLeva

Forbes BEST-IN-STATE WEALTH ADVISORS 2019 SHOOK RESEARCH

LA BUSINESS JOURNAL

2019 Best Places to Work

Los Angeles Business Journal BEST Places to Work 2019

Third-party rankings or recognition from rating services or publications are no guarantee of future investment success. These ratings should not be construed as an endorsement of the Advisor by any client nor are they representative of any one client’s evaluation or experience. Additional important information can be found on our website at seia.com

Thank You

SEIA would like to thank you for your partnership and support over the last 22 years. Recently SEIA and its affiliates surpassed $10 billion in assets under management – a significant growth milestone for our firm. In serving our clients, our talented advisors continue to drive SEIA’s success.

We remain committed to our core values and look forward to continuing this incredible journey. It is SEIA’s goal to be a pillar of consistency in your financial lives.

OVER 10 YEARS HAVE PASSED SINCE THE GREAT RECESSION. WHAT HAVE WE LEARNED?

BY **Theodore E. Saade**
CFP®, CMFC®, AIF®
Senior Partner

After closing out 2018 with the stock market posting its worst quarter since 2008, many pundits and investors couldn't help but hearken back to a decade ago and wonder if we were once again on the precipice of a major market meltdown.

While this most recent expansion is by no means one of the historically strongest, it is the historically longest (or second-longest, depending on the criteria you use) having recently passed its 10-year anniversary. There's no doubt that another recession looms somewhere in the not-too-distant future. What's less clear, however, is how deep that recession might be and what can be done to mitigate its impact. But the following wisdom gained from the last crisis may help you to weather the next.

LESSON #1 Time heals all wounds.

During the 17-month bear market period from October 2007 to March 2009, the S&P 500 lost nearly 50 percent of its total value. However, in the decade since recording its post-financial-crisis low on March 9, 2009, the market has generated a cumulative return in excess of 400 percent. For those investors who weathered the storm and stuck with their long-term investment plan despite the market volatility, there's a lot to celebrate.

LESSON #2 Avoid past mistakes.

What caused the Great Recession? While causality is always a difficult thing to determine, most experts can agree on at least a few key factors—most notably lax banking regulations that enabled the housing bubble and attendant subprime mortgage crisis. Some blame can also be laid at the feet of the Federal Reserve. Fearing inflation throughout the 2000s, the Fed refused to change course on monetary policy—keeping interest rates too high for too long and maintaining a tight rein on the money supply. As a result, what may have only been a moderate recession became a global economic crisis.

Today, while total consumer debt remains high, both mortgage and personal debt have fallen due to more stringent mortgage requirements, as well as individuals exercising more caution. And early this year, the Fed wisely demonstrated a willingness to change course by backing away from the steady rate hike scenario it had laid out just a few months earlier. The market reacted positively, and by the end of March the S&P 500 was up over 13 percent for the quarter.

LESSON #3 Policy matters more than politics.

Given the current highly charged political atmosphere, it can be tempting to allow emotion to drive your investment decisions. Yet, despite the party in power having some impact on the economy (and in turn your personal wealth), we tend to vastly overemphasize or entirely misconstrue the long-term effects of partisan politics on the stock market. Rather than viewing the world through a red or blue lens, investors are almost always better served by assessing opportunities through a green profit-making lens.

One can just as easily blame the dot-com bubble on the Clinton administration as you can blame the Great Recession on the Bush administration. But truth be told, it's the natural ebb and flow of long-term economic cycles combined with the monetary and interest policies of the Federal Reserve that are far greater determinants of market performance.

Rather than which party is in power, you are better served by focusing on where we are in the current economic and interest rate cycles, examining how current P/E ratios stack up historically and considering global economic conditions to determine whether any shifts to your allocation strategy and/or sector weightings are warranted.

LESSON #4 Chaos is a ladder.

It's one of the classic lines uttered by the ruthless character Lord Petyr Baelish in Game of Thrones: "Chaos isn't a pit. Chaos is a ladder!" There's a great deal of truth in that observation—particularly when it comes to investing.
Rather than something to be feared, recessions can actually serve as creators of great wealth if (and this is a big if) you have both fortitude and capital to deploy while the market is in free fall. Whether you're investing in single-family residences, skyscrapers or stocks, having the ability to be greedy while others are fearful offers an opportunity to reap huge profits. Volatility is a cost that we as investors must bear in exchange for enhanced investment gains over time. A well thought-out, carefully crafted financial plan along with a diversified portfolio and the guidance of a trusted advisor can help make sure that short-term events don't derail your long-term goals.

Left to right: Sam Miller and his Family, Jamison Williams, Liselotte Richards, Hayley Wood, Jessica Cherness & Joyce Mizuhata

Left to right: Raymond Wan, Howard Chen, Joyce Mizuhata and her husband

SIGNATURE FUND *for* GIVING

The Signature Fund for Giving's ongoing mission is to build meaningful relationships with our partners and foster their continuing efforts of empowering local youth.

The Fund donated $5,000 to A Place Called Home's 2019 Backpack to School Event held on Saturday, August 3rd. The gift helped to provide more than 1,000 new backpacks full of school supplies, books, personal hygiene kits, lunch boxes and more to South Central L.A. youth. We are proud of A Place Called Home's continued dedication to supporting local youth in developing healthy, fulfilling, and purposeful live.

If you have any questions regarding our Fund or how to participate, we invite you to contact Hayley Wood at 310-712-2323 or hwood@seia.com.

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