THE GORTON
WEALTH MANAGEMENT GROUP
of Wells Fargo Advisors

2020 Fall Newsletter

October 2020

An update of performance, trends, research, and topics for the long-term investor

Relevant rates of return a/o 9/30/2020 vs.		2019
Russell 1000® Growth Index: Stocks within this index include: Amazon, Facebook, Google (Alphabet) Home Depot, Visa	+24.33	+36.39
Russell 1000® Value Index: Stocks within this index include: Berkshire Hathaway B, Exxon Johnson & Johnson, JP Morgan	-11.58	+26.54
Barclays US Agg Total Return Index:	+6.79	+8.72
S&P 500 Index:	+4.09	+28.88
Russell 2000® Value Index:	-21.54	+22.39
MSCI EAFE® Index:	-8.92	+18.44
CBOE S&P 500 BuyWrite Index (BXM):	-9.58	+15.68
DJ Real Estate Price Index:	-14.43	+24.13

Long Term Historic Returns, compounded annually (1970-2019)[1]

- Small Value +13.9%
- Large Value +10.6%
- Small Growth +9.3%
- Large Growth +8.9%

Growth and value stocks in this example are represented by the Ibbotson Associates Growth and Value Indexes for 1970–1997 and the Morningstar Style Indexes thereafter. Ibbotson Associates Growth and Value Indexes calculated based on data from CRSP US Stock Database and CRSP US Indices Database, Center for Research in Security Prices (CRSP®). The data assumes reinvestment of income and does not account for transaction costs or taxes.

Description of Indexes

An index is unmanaged and not available for direct investment.

S&P 500 Index - consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

Russell 1000 Growth Index - offers investors access to the large-cap growth segment of the US equity universe. The index is constructed to provide a comprehensive and unbiased barometer of the large-cap growth market. Based on ongoing empirical research of investment manager behavior, the methodology used to determine growth probability approximates the aggregate large-cap growth manager's opportunity set.

Russell 1000 Value Index - measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. These stocks are selected from the 1000 largest companies in the Russell 3000 Index.

DJ Real Estate Price Index - a capitalization-weighted, real-time index that provides a broad measure of the US real estate securities market.

CBOE S&P 500 BuyWrite Index (BXM) - a benchmark index designed to track the performance of a hypothetical buy-write strategy on the S&P 500 Index.

MSCI EAFE Index - a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets, excluding the U.S. and Canada.

Russell 2000 Value Index - measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

Barclays US Agg Total Return Index - covers the USD-denominated, investment-grade, fixed rate, taxable bond market of SEC-registered securities. The index is composed of government and corporate securities, mortgage pass-through securities, and asset-backed securities.

Lessons of History

Economic Equality vs. Efficiency

Michael Gorton, Managing Director - Investment Officer

I have been waking up every morning wondering why we are where we are.

Why is there such a strong reaction and fear around Covid-19 vs. past pandemics? e.g. 1918 Spanish Flu, 1957/58 Asian Flu, 1968/69 Hong Kong Flu.

Here are my thoughts:

I. Heightened sense of fear possibly due to the media/ social media aspect vs. past pandemics.

II. People may have been more likely to accept death in past generations.

III. Medicine has improved significantly and we have higher expectations for cure and prevention.

Also remember, pandemics are deep in magnitude and short in duration with the average at about 18 months.

Why is there so much social unrest?

- I believe this may lead into and be partially explained by long term economic cycles and we could be in the middle of an economic shift. Current complex and sensitive issues, e.g. race relations, can be exacerbated by these shifts.

Economic Shift:

In his book, *Equality and Efficiency: The Big Tradeoff*, published in 1975, Macroeconomist, Arthur Okun[2] wrote about economic equality vs. efficiency in the mid-70's to explain the economic shift occurring at the time. His research back then can also explain what is happening today.

My takeaway is, we were at the end of an equality cycle in the mid-70's which was signaled by high inflation and a stagnant economy, which then led to the start of an efficiency cycle. These cycles can last for 50 - 70 years, occur throughout the world, and are not just a U.S. phenomenon.

An efficiency cycle is marked by reduced regulation, higher immigration, lower tax rates, reduction in tariffs, expansion of trade and low inflation. This incentivizes entrepreneurs to thrive and economies to expand.

The end of an efficiency cycle is usually triggered by a disruptive event, maybe a pandemic? There is a widening disparity in household income between classes and many may feel the wealthy have too much power and influence. Society becomes explosive (e.g. protests, riots). Immigrants may be perceived as taking away jobs and lower wages from the middle class. Technology can also become the enemy as that too can replace jobs. People vote more for economic and social equality and populist candidates resonate.

We may be seeing a “political shift” towards the equality cycle: nationalistic tendencies, protectionism which includes reduction in global trade, tariffs, regulation and socialization of capital through higher taxation of the wealthy, including corporations. Over time this makes the economy less productive and leads to higher inflation. But remember, these cycles last 50 - 75 years and take time to evolve.

If this economic theory is correct, then it explains a lot about why we are where we are today.

Investing, where to go next? We will have to see what the government does in regards to the big tech monopolies to decide if there will be a big enough handicap on tech to move out of the sector. If inflation comes later in the cycle, at some point commodities, precious metals and real estate may be rewarded. Will we have “Medicare for all” in this cycle, which may be a negative for the healthcare managers. Returns on capital will generally be reduced if there is more regulation and higher taxation. It does not mean that you would not get meaningful returns from investing, the returns may just be lower.

I was on a research call recently and if we want to talk election, they feel that the big 5G buildout would be done under either administration. More to come and all for now....

All my best in these tough times. I hope you and your families are safe and healthy.

Let me/Emma know if you would like to discuss this, your portfolio, or if there have been any updates for your plan.

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1. Wells Fargo Advisors. Growth and Value Investing Morningstar Market Charts 2020 Series (CAR# 0920-01117)
2. Okun, Arthur. 1975. Equality and Efficiency: The Big Tradeoff. Washington, D.C. Brookings Institution Press