RECESSION RISK STILL DOES NOT APPEAR ELEVATED

BUT FIRST … SOME IMPORTANT TAX-REPORTING INFORMATION

SHAREHOLDERS SERVICE GROUP'S 2019 TAX REPORTING SCHEDULE

The delivery of year-end Tax Information Statements depends upon the *specific* holdings in an account. A first wave of Form 1099 tax statements will be issued (mailed and online) by January 31st. Because some securities issuers will not finalize their distribution information by then, tax statements pertaining to accounts holding such securities will be issued after the relevant information is received. For the 2019 tax year, tax statements containing all aspects of Form 1099 will be issued, as follows:

⇒ January 15th: Drafts (not final) will become available in our office and, I believe, to those who have online access. I do not know if drafts of statements will be mailed.

⇒ January 31st: Final statements will be issued (online and by mail) for accounts with holdings and income that typically do not require reclassification or additional information from issuers (e.g., accounts holding individual equities and bonds).

⇒ February 15th: Tax statements will be issued for accounts that hold mutual funds, certain unit investment trusts, real estate investment trusts and certain equities where the issuer provides final tax information after January 31st. "Pending" tax statement notices will be mailed for accounts that are awaiting data from issuers or in cases where Shareholders Service Group has not yet processed and/or reviewed tax information. Pending notices will list the holdings for which Shareholders Service Group is awaiting information or for accounts awaiting final review and they will indicate a possible mail date of the statement. Such notices will be mailed when issuers of reportable income cannot provide final tax information before February

15th. Previously issued statements may also be revised, if necessary.

⇒ **February 29th**: Tax statements will be issued for accounts for which reclassifications of income by issuers of mutual funds, real estate investment trusts, and/or certain equities had been pending. If necessary, revised statements may be issued to amend previously-issued tax statements.

⇒ **March 15th**: Tax statements will be issued for all remaining accounts, regardless of whether pending income reclassifications for the account's income have been received from issuers. And, once again, revised statements may be issued to amend previously-issued tax statements, if necessary.

LOCATE THIS SCHEDULE: Schedule of Realized Gains and Losses Year-to-Date

Due to changes mandated by Congress a number of years ago, the burden of reporting taxable transactions has shifted away from individual investors toward securities custodians and clearing firms such as Shareholders Service Group and Pershing. While it's possible that 100% of any gains and losses you are required to report on your 2019 income tax returns will appear on the year-end tax statement(s) you will soon begin receiving, any "cost or other basis" that pertains to securities you acquired ***prior*** to the time the new reporting rules were phased in will not appear on those tax statements. To the extent your income-tax return(s) don't reflect "basis" that appears ***only*** on this schedule, you may falsely conclude your income-tax liability is ***larger*** than it actually is, but the structure of the reporting environment will never induce you falsely conclude that your tax liability is ***less*** than it actually is. In short, ignoring basis information that appears ***only*** on the above-referenced schedule results in an asymmetrical situation where you can only overreport your tax liability.

To help ensure all reportable realized gains and losses are properly reflected on your income tax returns for this year (and for all subsequent years):

1. Locate the December statement for each non-IRA and non-retirement account you hold at Shareholders Service Group.
2. Locate the "Schedule of Realized Gains and Losses Year-to-Date." If this schedule is not included as part of your December statement, it simply means that no gains or losses were realized in that account during the year.
3. If you do not understand my references to "basis" on the previous page or do not understand what "basis" is, consider engaging a professional tax preparer, and then make that tax preparer aware of this additional schedule.

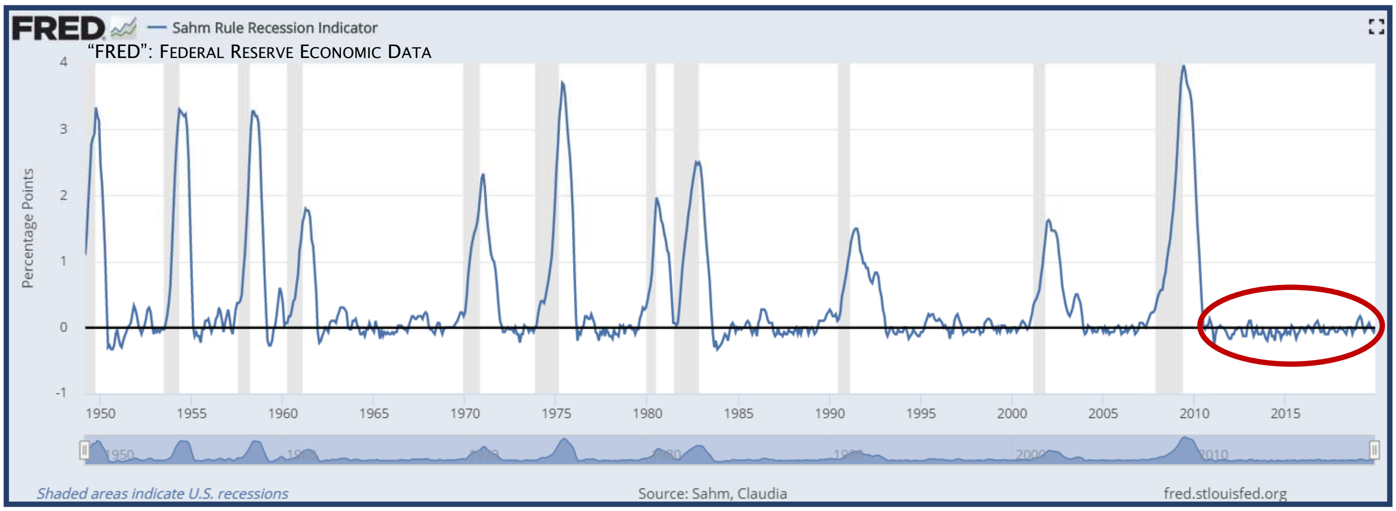
CONSIDER FILING LATER

As previously discussed, securities custodians such as Shareholders Service Group aggregate the tax information they receive for each customer, and then pass that information to their customers and to the relevant income-tax authorities in summarized form. Regardless of the tax-reporting schedule I outlined earlier, securities custodians may receive revised income-tax information from securities issuers well after March 15th of a given year. To the extent they do, they are obligated to share that revised information with all affected customers and tax authorities, regardless of how late in the year those revisions may have been received. Consequently, filing your income-tax returns later in the year may reduce the likelihood of having to endure the hassle and expense associated with needing to amend them, later. To do this, consider paying any income-tax liability you estimate to be due by the mid-April filing deadline while also requesting an automatic, 6-month filing extension. Then, file your actual income-tax returns sometime before mid-October.

Folks sometimes resist this strategy on the grounds they prefer to receive their tax-refund as soon as possible. In that case, I encourage people to reduce their estimated income-tax remittances and/or to reduce their income-tax withholding percentages since the receipt of an income-tax refund represents nothing more than the repayment of an interest-free loan to whichever tax authority is issuing the refund.

RECESSION RISK STILL NOT ELEVATED AS PER THE SAHM RECESSION INDICATOR

Last quarter, I discussed an indicator that has a particularly good track record of signaling recession — the Sahm Rule Recession Indicator. Since a recession represents an economic contraction, historical application of this indicator suggests that when the average unemployment rate over the previous three months rises by at least .5% versus its previous 12-month low, the economy is likely to already be in recession.



After a portion of the Treasury yield-curve inverted slightly last summer, recession fears dominated people's minds and headlines. Yet, this indicator remained planted at zero when I checked on it in October, and, as of December, it has remained there.

As you can see in the next graphic, **an indicator of zero (boxed) does *not* equate to a recession risk of zero**. Instead, a reading of zero suggests:

- ⇒ A 2% probability that the U.S. is already in recession,
- ⇒ A 5% probability that the U.S. will experience recession in the next three months,
- ⇒ ... and so on as the boxed data shows.

Notice that when this recession indicator is at or near zero, as it was in December, historical data suggests there *still* remains a 20% probability of a recession developing within the ensuing year. Even in cases where inherent economic cyclicality is not already steering our economy toward recession, exogenous upheavals, whether caused by war, politics, plague, or weather, pose an ever-present risk. Therefore, it is not surprising that the risk of recession occurring within a given 24-month period has approached an almost 2-in-5 probability even when the Sahm indicator has hovered around zero.

Probability of a Recession by Sahm Recession Indicator, 1970–2019

Excluding Months Between NBER Announcements of Business Cycle Peaks and Troughs

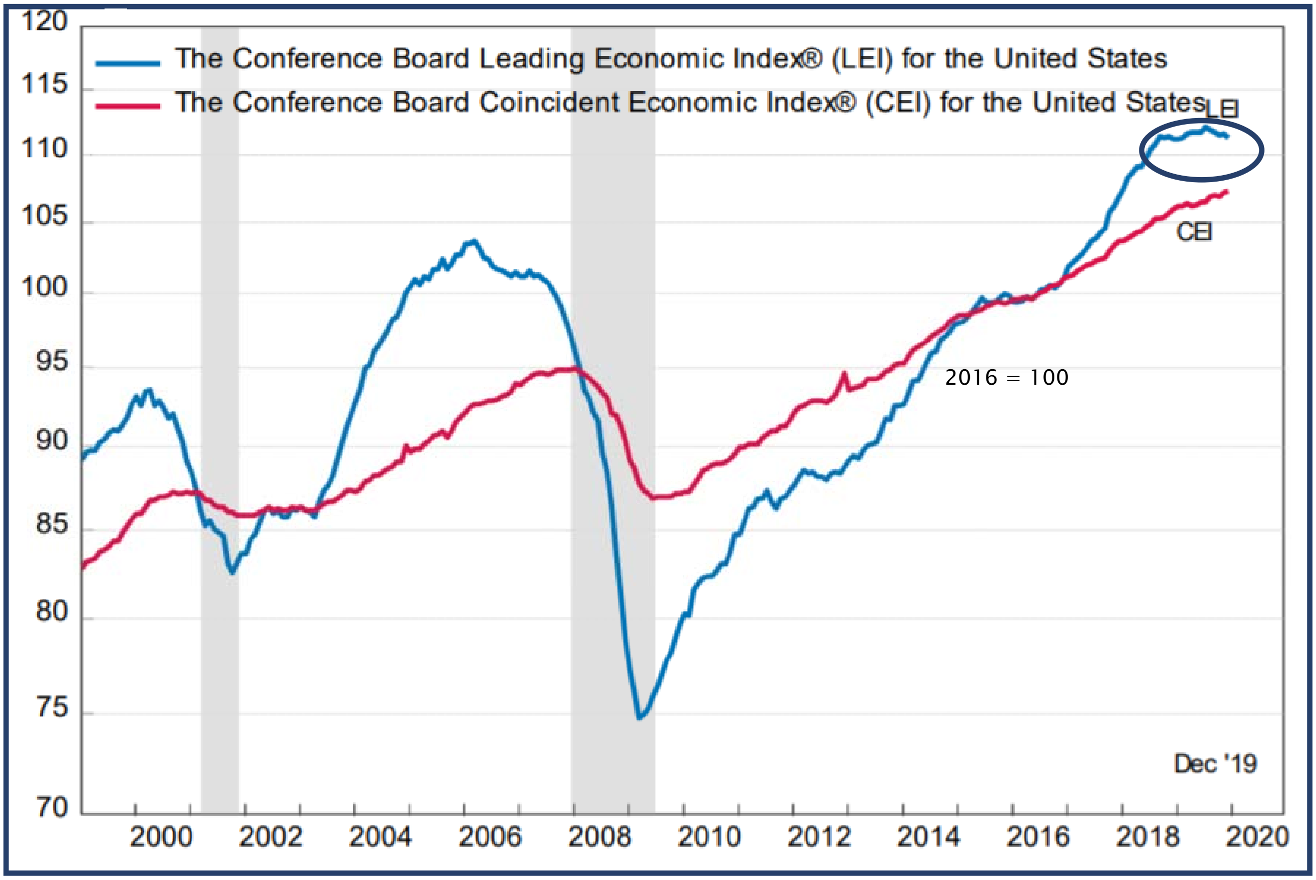
Sahm recession indicator (percentage point increase in unemployment rate)	Recession now	Recession in 3 months	Recession in 6 months	Recession in 12 months	Recession in 24 months	Number of months
Less than 0	1%	2%	5%	10%	25%	203
0 to 0.09	2%	5%	8%	20%	39%	122
0.10 to 0.19	2%	13%	23%	33%	37%	52
0.20 to 0.29	11%	33%	33%	39%	39%	18
0.30 to 0.39	40%	40%	40%	40%	40%	10
0.40 to 0.49	76%	76%	76%	76%	76%	17
Greater than or equal to 0.50	**97%**	**97%**	**97%**	**97%**	**97%**	**30**
Probability of a recession at any unemployment rate	12%	15%	19%	25%	38%	452

LEADING ECONOMIC INDEX® INFLECTS DOWNWARD DURING 4TH QUARTER

The Conference Board's Leading Economic Index® (LEI) for the U.S. declined 0.3 percent in December to 111.2, following a 0.1 percent increase in November, and a 0.2 percent decline in October. As per a January 23rd press release by The Conference Board, "The U.S. LEI declined slightly in December, driven by large negative contributions from rising unemployment insurance claims and a drop in housing permits. The LEI has now declined in four out of the last five months. Its six-month growth rate turned slightly more negative in the final quarter of 2019, with the manufacturing indicators pointing to continued weakness in the sector." The relatively large declines in this index during October and December versus the slight improvement it managed during November would seem to be an unambiguously negative signal.

Shaded areas indicate U.S. recessions Source: International Monetary Fund fred.stlouisfed.org

YET, THE CONFERENCE BOARD'S OUTLOOK IS STILL CONSTRUCTIVE



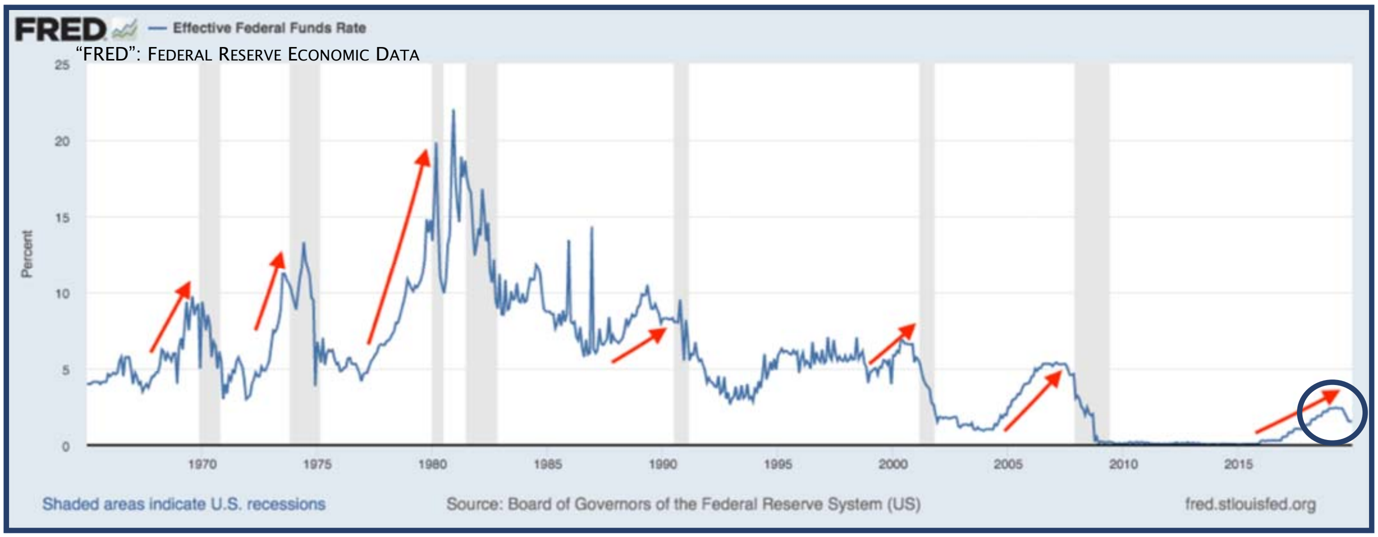
Although the Leading Economic Index has at least plateaued, a spokesman for The Conference Board added, **"However, financial conditions and consumers' outlook for the economy remain positive, which should support growth of about 2 percent through early 2020." Since recession necessarily equates to a shrinking economy, The Conference Board is clearly not expecting a recession to develop within the U.S. this year.**

IMPLICATIONS OF THE FEDERAL FUNDS OVERNIGHT RATE

The federal funds rate is the rate at which financial institutions that are part of the Federal Reserve System lend to each other for various lengths of time. Because lending and borrowing through the Fed is extremely streamlined, it's convenient for institutions to lend and borrow funds for periods as short as a day at a time.

And, because the federal funds market is so active, interest rate changes that may be rippling through our economy are easily discerned by monitoring this market.

Historically, recessions within the U.S. have tended to occur when short-term interest rates, such as the overnight federal funds rate, have risen materially as shown here.



With respect to the rate increase we recently experienced, it was pretty modest by historical standards, and the Fed has already reversed course by reducing its targeted rate for overnight federal funds three times last year. Moreover, the Fed signaled fairly definitively that future rate hikes are on hold for the foreseeable future.

As is the case with many maladies, the onset of a given recession is typically determined well after the fact. While it's possible that it could be retrospectively determined that the U.S. is already in recession, I think it's unlikely.

CORPORATE EARNINGS

To be sure, investors don't fear recession as much as they do collapsing equity valuations. Even if short-term interest rates were to remain low, equity valuations are not necessarily apt to rise further nor are they guaranteed to remain where they now are.

But, if short-term rates were to rise while corporate earnings fell, the result could be something of a perfect storm for equity valuations. As of January 27th, Zacks Investment Research tallied earnings for the 4th quarter of 2019 from 87 of the 500 companies that comprise the S&P 500 (17% of the index's membership). Compared to the 4th quarter results of 2018, total earnings for these 87 companies declined 0.1% on revenues that increased 3.4%. 70% of reporting companies beat Zacks' consensus EPS estimates and an above-average 72% reported positive revenue surprises. While earnings growth has stalled, revenue gains continuing to outpace inflation is a positive. These are not the kind of numbers that cause equity valuations to soar, but other factors matter, too.

Prognosticators seem inclined to anticipate GDP growth of around 2% for the year and they typically expect inflation to remain muted. Over the past two decades, equities have returned a bit more than 10% during years where GDP and inflation both remained between 1.5% – 2.5%. And, don't forget that we now have reached trade agreements with Mexico and (almost) Canada, and Phase I of a deal with China has been finalized. These agreements ostensibly reduce trade-related risk while increasing opportunity, both of which should improve corporate earnings and soothe investors' psyches.

A BIT MORE PERSPECTIVE

Zacks Research analyzed the returns generated by the S&P 500 over various holding periods using data from 1871 through 2019. It found that while the losses occurred in 28% of the 1-year holding periods, the incidence of loss fell to 11% for 5-year holding periods and only 3% for 10-year holding periods.

Unlike Vegas, where gamblers should expect to lose, equities are a positive-sum game where investors have usually won. — Glenn Wessel