

# CA Financial Services

## Client Quarterly

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Compliments of  
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## Record Foreign Holdings in U.S. Stocks

Our media-soaked age bathes us in bitter political battles, persistent tensions across a diverse populace, stark contrasts of wealth and poverty, and the latest natural or man-made disasters. So there seemed to be some surprise over a recent U.S. Treasury report that *foreign* private holdings of U.S. stocks hit a record high of \$7.7 trillion last July, the most recent data available.

As with any single statistic, context is instructive. Foreign *private* holdings excludes sovereign wealth funds and overseas central banks with substantial U.S. investments. Even then, total foreign holdings represent only about 15% of the U.S. equity market's \$60 trillion in asset value – over 50% of global market capitalization. In other words, foreign investors must be strongly tilted to *other* international equity markets, probably over-weighted to their respective home markets.

Foreign presence is relatively larger in U.S. *bond* markets. Total foreign holdings of U.S. Treasury securities peaked at about 60% in 2013 and now stand at just under 50%, or about \$6 trillion. Foreign investment in U.S. corporate bonds and agency obligations adds another

\$5 trillion, about 25% of outstanding issuance for those two sectors.

Foreign money is known more for following than anticipating trends. U.S. equity markets have outperformed other major bourses for much of the past decade. Recent capital inflows have helped fuel the surge to all-time highs for major U.S. indexes, extending the longest bull market on record.

As shown clearly by the accompanying table, mainstream U.S. stocks have delivered that coveted combination of solid upside participation along with downside containment. Quality U.S. bonds have sustained relatively attractive yields as well as their traditional role as a safe haven denominated in the world's reserve currency.

News reports of record private foreign U.S. stock holdings rehashed the self-evident factors noted above, but they missed an obvious point. At the beginning of 2012, foreign private holdings of U.S. stocks stood at \$3.4 trillion. Given the performance of the Standard & Poor's 500, the recent \$7.7 trillion level would not have required the addition of *new* money. Those private foreign investors just needed to have sat tight.

In the end, it looks like our foreign friends share our own time-honored tendencies to favor domestic companies, to trim our exposure when markets sell off, and to jump back in once an uptrend reasserts itself. Yes, we are *all* too human. ■

## Saudi Arabia's Historic Offering

Investors with long memories can't help but be struck by the reordering of global energy markets. In early November, Saudi Arabia announced plans for an initial public offering (IPO) of shares in its state-owned oil firm, Saudi Aramco. On December 5<sup>th</sup> that offering, for just 1.5% of the company, was priced to raise \$25.6 billion, marking the largest public share offering in history and a milestone in an 80-year saga.

Saudi oil was discovered in 1938 and controlled in those early decades by four U.S.-based companies, later consolidated into today's Chevron and Exxon Mobil. In the 1970s, the kingdom asserted its sovereign prerogatives and forced a multi-stage nationalization.

The Saudis had the U.S. over a barrel, so to speak, as global oil consumption continued to grow, and U.S. production entered a relative decline. Rising oil and gas prices, and fear of *much* higher prices, shaped a host of strategic and political exigencies for decades.

Saudi Aramco still boasts huge energy reserves, low costs of production, and very modest debt. Saudi Aramco reported \$111 billion in net income in 2018, more than the world's five largest traded oil companies combined.

However, the world has continued to find lots more oil and gas. The fracking revolution has returned the U.S. to the top echelon of global producers. Adjusted for inflation, today's oil and gas prices are about as cheap as they've been since the mid-1970s. Meanwhile, Saudi Arabia has struggled to translate its petro-wealth into a more diversified national economy with broader par-

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**Tale of the Tape: U.S. Stocks vs. the World**

Year	S&P 500	MSCI World	MSCI World ex-U.S
2010	+ 13 %	+ 10 %	+ 8 %
2011	+ 0	- 9	- 16
2012	+ 13	+ 13	+ 13
2013	+ 30	+ 20	+ 12
2014	+ 11	+ 2	- 6
2015	- 1	- 4	- 8
2016	+ 10	+ 6	+ 2
2017	+ 19	+ 22	+ 24
2018	- 6	- 11	- 16
2019*	+ 23	+ 19	+ 14

\*10 months

Source: BCA Research



## Reconsidering That Traditional Balance

*Moderation in all things* is an adage for the ages. In the investment world, it has been exemplified by the “balanced” portfolio: 60% in stocks and 40% in bonds. But lately, some investment professionals have questioned whether that remains a paragon of prudence.

That challenge stems from distinctive changes in equity and fixed-income markets. With quality bonds riding the crest of a 35-year secular bull market, there is concern that they no longer offer effective diversification and risk control when paired with stocks also hovering near all-time highs. Some note that the negative correlation between stocks and bonds that has typified the last couple of decades is unusual in the much longer time frame of the past 85 years.

Such concerns come at an interesting time, as balanced and moderate-risk allocation funds have been enjoying a strong year. At this writing, classic balanced funds are ahead about 16% in 2019, with similar results for moderate risk allocation funds and target date portfolios.

Those who question that traditional balanced standard are hardly suggesting radical departures. They primarily cite the further diversification potential of reaching beyond the primary stock and bond indexes.

On the equity side that may include high-dividend stocks and income generators such as energy MLPs and real estate investment trusts. If one subscribes to the notion that all things cycle, a modest increase in foreign stock exposure might be in order. The accompanying table shows what lackluster results those asset categories have produced over the past decade.

For the fixed-income component, higher yield, shorter-term issues and municipal debt could temper the effect of a significant sell-off of Treasury or investment grade corporate bonds. Or not... During the deep bear market and financial crisis 10 years ago, an exceptionally broad range of investment assets sold off

## Advisors Relate Common Investor Biases

It’s no secret that as investors, we are often our own worst enemies. But what are our *most* problematic behaviors?

Charles Schwab Investment Management and the Investments & Wealth Institute recently surveyed advisors regarding the behavioral tendencies that most affect their clients’ investment decisions. The largest number (35%) of advisors cited **recency bias**, being overly influenced by recent news events and experiences. Another 26% of advisors pointed to **loss aversion**, which can steer us to portfolio allocation decisions that unduly limit long-term growth potential.

Three other tendencies were noted by about a fourth of the advisors surveyed. These included **confirmation bias**, favoring information that reinforces our established

perceptions; **familiarity/home bias**, preferring investments we think we know, especially U.S.-based companies; and **anchoring bias**, over-emphasizing a few narrow factors in our decision-making.

Recognizing these tendencies is helpful, but we should note that there are often lines of logic and experience supporting our biases. After all, recent events *can* have a lasting effect on markets. Recovering from risks gone awry *can* be a real challenge. And what’s *wrong* with favoring investments we feel we know and understand?

The key is to temper those biases by staying receptive to new information, taking a broader view of potential market-moving events and conditions, and pursuing a plan of carefully structured diversification. Advisors believe it *can* be done. ■

Investment Performance Review	TOTAL RETURN * (Dividends and capital gains reinvested.)			
	--- Annualized through Dec. 6, 2019 ---			
Selected Mutual Fund Categories *	1 yr.	3 yr.	5 yr.	10 yr.
Large-Cap Stocks (Blend)	17.2 %	12.7 %	9.1 %	11.9 %
Mid-Cap Stocks (Blend)	14.1	8.4	6.7	11.2
Small-Cap Stocks (Blend) †	11.2	6.3	6.9	11.3
Foreign Stocks (Large Blend) †	14.9	8.6	4.1	4.8
Diversified Emerging Markets †	11.1	8.6	3.1	3.2
Specialty Natural Resources †	3.7	1.1	0.1	2.7
Specialty Real Estate †	15.4	9.4	7.1	11.5
Cons. Allocation (30-50% Equity)	10.8	6.1	4.3	6.1
Long-Term Bond	20.4	8.2	5.9	7.3
World Bond †	6.5	3.4	1.5	1.9
High Yield Taxable Bond †	9.1	5.1	4.4	6.5
Long-Term Municipal Bond	8.5	4.9	3.6	4.4

\* Source: Morningstar. Past performance is NOT indicative of future results.  
 † Small-cap stocks, high-yield (lower rated) bonds, and sector-specific funds may exhibit greater price volatility than the stocks of larger, established companies and/or more broadly diversified funds. Securities of companies based outside the U.S. may be affected by currency fluctuation and/or greater political or social instability.

largely in unison. Treasury securities did represent a significant haven amidst that panic, but they were sporting much higher yields than they offer today.

Prices for those longer-term bonds may well be more volatile

over the next several years, but for retirees who will ultimately spend a significant share of their nest egg, the certainty of a given value at maturity does represent a measure of risk control. Moderation and balance, in all things. ■



## Tax Collections After the Tax Bill

Two years ago, as Congress put the finishing touches on the 2017 Tax Cuts and Jobs Act (TCJA), we asked whether legislation billed as a tax *cut* might actually boost tax *collections*. As often noted in these pages, tax receipts tend to lag both changes in the law and the broad economy. The data below overview the five-year stretch through 2019, essentially the first fiscal year fully reflective of the new law.

Federal Tax Categories	Receipts and Outlays by Fiscal Year (in billions)					
	2015	2016	2017	2018	2019	5-Yr. Change
Indiv. Income	\$1,541	\$1,546	\$1,587	\$1,684	\$1,718	+ 11.5%
Payroll Tax	1,065	1,115	1,162	1,171	1,243	+ 16.7%
Corp. Income	344	300	297	205	230	- 33.1%
Total Taxes	2,950	2,961	3,046	3,060	3,191	+ 8.2%
Federal Outlays	3,688	3,854	3,982	4,108	4,447	+ 20.6%

Source: Congressional Budget Office

Before the TCJA, growth in individual tax receipts was sluggish, and corporate taxes had fallen precipitously. Most recently, total collections rose 4.3% from fiscal 2018 to 2019 with a 12.2% bounce back in corporate taxes. However, that solid gain was offset by an 8.3% jump in spending, sending 2019's deficit to \$984 billion, or 4.6% of gross domestic product.

For the five-year stretch, an overall spending increase of \$759 billion includes \$424 billion more for Social Security, Medicare, Medicaid, and net interest on federal debt, all of which essentially operate outside the annual Congressional appropriations process. So far in this political season, we've heard a lot about tweaking the tax code, but very little about reducing outlays. As one of those amusing auto insurance ads might explain: *You're a politician, it's what you do.* ■

## A Short Piece About a “No-Brainer”

It's often said that insurance isn't bought; it must be sold. But it should be easy to sell the transfer of big risks for a very affordable premium. So, why do so many affluent families with assets to protect overlook or underestimate the need for excess personal liability insurance?

Often called an umbrella policy, excess personal liability extends coverage above that of your homeowner and auto policies. It covers major claims for a wide range of events such as injuries others suffer on your property, damages caused by you or members of your family, claims against you for slander, libel, defamation of character, and more.

Fortunately, only a tiny percentage of people actually fall victim to major liability issues, so expansive coverage can be had for quite modest premiums. Yet, a recent white paper by the Spectrem Group found major coverage shortfalls. A third

of those with homes valued from \$2 million to \$5 million carried less than \$2 million of excess liability coverage. Few families worth over \$1 million carry coverage at least equal to their net worth, and even among those worth \$15 million to \$25 million, almost 30% carried less than \$2 million in excess liability.

A rough rule of thumb is to buy coverage at least equal to your net worth. Those with homes and autos should consider at least a \$1 million even if net worth is less than that. You could be forced to pay a legal judgment from your earnings. A policy can also cover legal defense costs, and with an insurance company's money at risk, it may step in to provide expert legal counsel.

As with most insurance, the reasons for an umbrella policy are not pleasant to discuss. But you might at least be pleasantly surprised by the cost of coverage. ■

## And What About Charitable Giving?

Another question prompted by the Tax Cut and Jobs Act (TCJA) was whether charitable giving would fall off due to that big increase in the standard deduction. It's a little too soon to fully answer that question, but not too early to note some clear planning implications.

First-blush IRS statistics from last spring's tax season did show a 54% drop in charitable deductions claimed on individual returns for 2018. That's not surprising, as the TCJA was expected to relieve up to 25 million households of the need to itemize deductions.

However, those early stats don't include taxpayers who filed extensions, and that cohort usually includes more itemizers with higher incomes. Also, the Chronicle of Philanthropy reports that 2018 charitable gifts from IRAs grew by an average of nearly 74% versus 2017. Those qualified charitable contributions (QCDs) deliver a tax break for seniors (over 70½) without their having to itemize.

Everybody loves a tax deduction, but Americans' charitable inclinations appear to run a little deeper than that. Giving USA estimates donations from individual Americans dropped just 1.1% from 2017 to 2018, while gifts from corporations and foundations rose by 5.4% and 7.3% respectively.

It will take a few years to see how this all shakes out, but one change is already clear. Charitable giving is no longer a last minute, year-end tax-driven scramble. It is a key strategic component of integrated, multi-year financial planning. Reflecting that trend, major sponsors of donor advised funds (DAFs) are reporting record inflows from new accounts as well as record grants flowing out to charities.

DAFs and QCDs are just two of the tools that can help you and your advisor integrate charitable giving with the TCJA's impact on your tax situation and multi-year planning. And there is still a little time left in 2019 to review those options. ■

## The Pilgrims Never Had It This Good

For years, the Federal Reserve has targeted an annual inflation rate of 2% without much success. Disinflation has prevailed, clearly reflected in an interesting, seasonal measure: the cost of Thanksgiving dinner for a gathering of 10.

The American Farm Bureau Federation (AFBF) has tracked that number for 34 years. Its survey of turkey and fixings for 2019's repast indicates that the tab rose just a penny from 2018, to \$48.91, after three

years of slight declines. Research analysts at Evercore ISI report that Thanksgiving dinner now costs less than it did eight years ago, the first such stretch since 1947. The AFBF's chief economist, John Newton, notes that "Americans continue to enjoy the most affordable food supply in the world."

No argument there, but if you did the shopping for your family's feast, \$5 per person may sound a little light. Of course, prices differ

across the country, and some people insist on special touches. For instance, maybe you order your Brussels sprouts from... Brussels.

For the record, the AFBF pegged a 16-pound turkey at \$20.80, down 4% from last year and the lowest price since 2010. Their shopping list also included stuffing, sweet potatoes, rolls with butter, peas, cranberries, veggie tray, pumpkin pie with whipped cream, coffee and milk. As for the Federal Reserve, maybe they should start tracking the price of crow. ■

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icipation and productivity growth.

As with any company, a stock offering forces more detailed disclosures and greater scrutiny. Saudi Aramco's valuation has been hotly debated in recent weeks as analysts picked at their production numbers, reserve estimates, and pricing assumptions, building comparisons to other major oil companies.

Strong share demand from local and regional investors should help counter institutional skepticism influenced by weak oil prices and disappointing results for some recent

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high profile IPOs. Saudi Aramco's offering price implies a \$1.7 trillion value for the *total* enterprise. That's shy of the company's original case for a value above \$2 trillion, but still higher than many analysts were supporting. And it represents an asset worth more than \$50,000 for every Saudi man, woman, and child.

Saudi Aramco's shares will quickly trade to a balance point of opinion on the key factors noted above. It will take a little longer to see if monetizing this slice of a great national treasure can truly help transform Saudi Arabia's economy and society. ■