FOURTH QUARTER,
DECEMBER 31, 2019

DEIGHAN
WEALTH ADVISORS

Objective, unbiased *advice*

MARKET COMMENTARY

Like biology or chemistry, asset valuation is a science of ratios, formulas, models, and rules of thumb. As with any science, the theories behind asset valuation are based on empirical evidence vetted by academics and practitioners alike. At the same time, however, asset valuation is also a bit of an art. The ratios and formulas only take us so far, and they rely on many assumptions.

For example, the forward price-to-earnings (P/E) ratio is a widely used method to value stocks. A high P/E ratio generally means a stock is expensive, because you're paying a high price per dollar of earnings. Investors, therefore, tend to look for stocks with low P/E ratios. The challenge, however, is that the forward P/E ratio, like most valuation methods, is subjective. In the numerator, we have market price – an objective number determined by buying and selling activity in the marketplace. In the denominator, however, we have future earnings per share, which is based on assumptions for sales, expenses, debt levels, the competitive environment, the economic environment, etc.

Sometimes, a stock's price increases much faster than its earnings, making it all the more difficult to interpret a measure like the P/E ratio. For instance, at the end of 2017, Amazon had a price per share of $1,169.47. Back then, if you had expected Amazon's earnings to stay constant, then you would have calculated a forward P/E of 256.5. If you had expected Amazon to double its earnings, then you would have calculated a forward P/E of 128.3. Triple its earnings? You'd have calculated a forward P/E of 85.5.

In all three cases, you would have calculated a higher number than the P/E ratio for the market overall, which was 22.5 at the time. In other words, even if you had expected Amazon to triple its earnings, you still would have been paying $85.50 for every $1.00 in earnings compared to $22.50 for the average company. According to the P/E ratio, Amazon looked expensive at the time, making it a difficult purchase to justify. Even so, Amazon's stock has increased by 58% since 2017, whereas the stock market has increased 21%. This tells us an expensive investment can still be a good value. It also tells us that the P/E ratio isn't a great measure for valuing high growth companies like Amazon, as it can lead to poor investment decisions.

This is where asset valuation becomes a bit of an art. Which methods should you use, and how many? What do you do when methods give confusing answers? Which methods rely on inputs that are challenging to predict? How can you test your assumptions to be sure they're reasonable?

Like any art that requires practice to master, these questions become easier to answer with time and experience. But they never become easy. For example, of the 46 professional stock analysts who cover Netflix, 29 consider it a buy, 10 consider it a hold, and 7 consider it a sell. Each analyst has spent his or her entire career learning how to value stocks, and yet they don't all agree that Netflix is a good investment. Ask ten painters to paint the same landscape, and you're unlikely to get the same painting twice. Ask ten stock analysts to analyze the same company, and each analyst will develop their own picture of the firm and its outlook. That's the art of valuation.

Now, take this concept, as messy as it is, and apply it to something as complex as the stock market. Are stocks overpriced? Are we due for a correction? Ask ten portfolio managers, and you might just get ten different answers. There is as much artistry in valuing the overall market as there is in valuing an individual stock.

Perhaps the answer is somewhere in between, as with Amazon. It's possible for the entire stock market to be expensive, and yet stocks still might climb for days, or months, or years. We're now ten years into the current bull market, the longest on record, and the S&P 500 Index just returned 31.9% for 2019 – the second-best annual return this cycle. Impressive to be sure, but now stocks are that much more expensive. On the date we wrote this commentary, the P/E ratio for the S&P 500 was 21.7. Compared to its historical average of 16.6, the stock market is roughly 31% more pricey than usual. At the same time, however, the S&P 500 had a P/E ratio as high as 29.8 during the tech boom of

the late 1990's. Today's market is 27% cheaper by comparison. So, is the stock market a buying opportunity, or is it overpriced and ready to crash?

Ultimately, this is the wrong question to ask. On any given day, or throughout any given quarter, stocks could correct significantly for reasons seen or unforeseen, for good reason or for no reason. Risk is always there, and it doesn't go away – in good markets and in bad. We accept that when we purchase stocks and other investments. Information hits markets randomly, and markets therefore react randomly. One cannot predict random events, not with consistency.

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A better question to ask is, how can I prepare my portfolio for an unpredictable, yet inevitable, downturn in the stock market? The answer is to plan in advance as best you can. Note that "timing the market" is not "planning in advance." It is very difficult, if not downright impossible, to time the market. Those who try usually fail. Those who succeed often mistake their luck for skill and are unable to replicate their past success. To plan in advance, rather, is to properly diversify. This is why we spend so much time working with clients to identify and implement appropriate asset allocations.

An asset allocation is a mixture of investments that ties back to an investor's willingness and ability to take risk. So long as an investor is well diversified with an asset allocation that's correct for their needs, that investor should be able to rest a little easier knowing the portfolio has already been built to withstand shocks. It's a bit like designing a building to withstand an earthquake; you don't know when the quake will hit, and you won't be able to mitigate all the damage, but you can protect against the worst of it.

Think back to conversations you've had with us over the years. We've had these conversations, in part, to identify how much investment risk you're willing to take, to identify upcoming cash needs, to identify long-term financial goals, and so forth. With this information, we've invested your portfolio in such a way that it should be able to absorb reasonable, temporary losses while still meeting your financial goals.

The financial crisis, also known as the Great Recession, was the worst period for stocks since the Great Depression. From top-to-bottom, U.S. stocks lost approximately 50% of their value. It took four years for the S&P 500 Index to regain its prior value, but, guess what? It did regain its value, and a lot more. Today, the S&P 500 Index is worth more than twice its 2007 peak, and that's before dividends. This is what we mean by losses being "temporary," even if the loss at the time was significant.

There is limited value in stressing about the market and when it might fall. Economic cycles are just that – cycles. We've yet to hit the downward swing in this current cycle, but it will happen. However, we can't be so preoccupied with the risk of temporary loss that we panic, exit the market, and endure real opportunity cost should markets instead continue to advance. Such action greatly impairs an investor's ability to meet his or her financial goals. So long as you don't need to sell during the downturn, and so long as your asset allocation is aligned with your goals and risk tolerance, you should be just fine in the long run.

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Of course, that means telling us about changes to your life situation and spending needs. If you'll need a significant amount of cash sometime in the next year, it is important for us to know this as soon as possible so we can raise cash while markets are doing well. We want to avoid raising cash during a market pullback, as that is how you lock in losses of capital.

As a final thought, we also urge you to accept that market declines aren't entirely bad. If properly planned for, they can be a good buying opportunity and a chance to create additional, long-term wealth. After all, who doesn't like to go shopping when things are on sale?

Speaking of shopping, we hope your holidays were bright and full of gifts! As always, please contact us should you have questions about your portfolio. Until next time, best wishes for happy investing.

PLANNING CORNER

SECURE Act Brings Major Changes to Retirement Planning

The SECURE Act became effective on January 1, 2020. This new legislation, which stands for "Setting Every Community Up for Retirement Enhancement," brings big changes to retirement planning.

Annuities in 401(k)s

The SECURE Act allows for annuities in employer 401(k) plans. The new law shifts the fiduciary burden from employers to insurance companies (who often profit from the sale of such products) to ensure that investment product options are appropriate for employee accounts. While annuities may be a good investment option for an individual, they are complex investment assets and should be carefully reviewed by your financial advisor or tax professional before purchase.

Increased Age for Required Minimum Distributions

For years, people have associated the age of 70.5 with the year they receive their first required minimum distribution from their 401(k) or IRA. The SECURE Act raises this magic age to 72. As people are living longer, the life expectancy calculations have been updated to extend the age of first required distribution to age 72.

This change affects ONLY people who have not reached age 70.5 by December 31, 2019. If you reached age 70.5 before December 31, 2019, you are still required to take your minimum distribution in 2020 or face a significant penalty. Those turning 70.5 in 2019 must take their first distribution by April of 2020, and then another RMD by December 31, 2020, and annually by December 31 thereafter. We often recommend clients take their first RMD in the year they turn 70.5 (now 72) to avoid the tax burden that accompanies two RMDs in the same year.

Elimination of the Stretch IRA

A major benefit of IRAs has been the ability for non-spouse beneficiaries of deceased IRA owners to stretch minimum distributions over the life expectancy of the beneficiary, deferring tax and providing many years of continued growth. The SECURE Act cuts this benefit significantly, limiting withdrawal of non-spouse

beneficiary IRAs to a maximum of ten years. This change significantly increases the tax burden on beneficiaries, forcing much larger distributions over a much shorter period. While there is no required minimum distribution during the ten year period, the entire amount must be distributed by the end of the tenth year.

This change also affects estate planning for retirement assets. Conduit trusts have been a popular estate planning tool to hold retirement assets after the death of the owner and allow trustees the control to stretch the beneficiary IRA and distribute only minimum distributions to spendthrift beneficiaries. A conduit trust requires the RMD be distributed outright to the individual trust beneficiary, passing the tax liability on to the beneficiary along with the trust distribution. If your estate plan includes a conduit trust, you might consider amending that document to become an accumulation trust, which gives the trustee discretion to hold or distribute the RMD paid to the trust. Because those IRA funds will be coming out of the retirement asset over ten years, you may not want that larger distribution passing directly to an untrustworthy beneficiary. If the RMD is not distributed to the trust beneficiary, the trust will pay the income tax on the retained RMD, but that may be preferable to large sums passing to a young or unsophisticated beneficiary. The funds retained in trust can be managed and invested to provide a longer life for the trust, therein providing longer for the beneficiary.

Other Provisions

The SECURE Act provides additional changes to current law, though perhaps not as momentous as those described above:

- Expands employer opportunities for employer-created funds and creates tax credits for establishments of such funds;
- Expands use of 529 funds for qualified education expenses to include student loans and apprenticeships;
- Allows a mortgage insurance premium deduction;
- Allows a $5000 distribution from a retirement asset for a qualified birth or adoption.

If you are concerned that any of these changes affect your retirement distributions, retirement plan, or estate plan, please contact us at your convenience. We are here to help.

PORTFOLIO CHANGES

Removed

Federal Express (FDX)

We had high expectations for strong global growth from FDX during the nearly five years that we held the shares and were disappointed by the performance of the shares over that time. The discontinued business relationship with global retailer, Amazon.com this past summer was unfortunate, but our concerns were based primarily on the global economic and political environment that we think will hinder the company's growth over the next few years.

Johnson & Johnson (JNJ)

We've held JNJ shares in client portfolios for many years but are concerned that the company's exposure to litigation from claims that their baby powder contained asbestos, questionable marketing practices of opioids and other pharmaceuticals, and several product recalls could prove costly, damage the company's brand, and distract management. While JNJ has been a good holding due to its resilience to economic cycles, we think that there are better opportunities elsewhere.

Added

iShares U.S. Medical Devices ETF (IHI)

We used proceeds from the sale of JNJ to purchase iShares U.S. Medical Devices ETF (IHI). This exchange traded fund seeks to track the performance of the Dow Jones U.S. Select Medical Equipment Index. The shares will serve as a placeholder for JNJ as we search for an attractive replacement in the healthcare sector.

A WARM WELCOME TO MATT SKAVES

At Deighan Wealth Advisors, we have started the New Year off running with the addition of Matthew Skaves as Chief Investment Officer. Matt is a familiar face to many of our clients, having worked with Deighan previously as a portfolio manager, and then as CIO, from 2006 to 2013. Matt has spent the last several years teaching accounting and finance at the University of Maine, Orono, including courses in financial planning, portfolio management, business finance, and business valuation. While at the University of Maine, Matt chaired the Business

SOUNDBYTES

Jean Deighan and Jenifer Butler attended the FPA Northern New England Continuing Education Seminar in Portland, a day-long educational conference for Certified Financial Planning professionals.

Lucie Estabrook and Jen Eastman attended Schwab Impact 2019 in San Diego. Impact is the largest and longest running conference for the investment industry and features thousands of advisors, exhibitors and thought-provoking speakers over three days of educational sessions.

We are proud supporters of the Olympia Snowe Women's Leadership Institute and were thrilled to attend the organization's annual luncheon where we heard inspiring stories from some of the young high school women that have been selected to participate in the OSWLI leadership program. Jelena McWilliams, Chairman of the Federal Deposit Insurance Corporation (FDIC), delivered a dynamic, fascinating and humorous keynote speech.

School's Technology Committee, served on several of the School's hiring and academic committees, and was recognized with the Business School's Excellence in Teaching and Leadership award. Matt also shares our entrepreneurial spirit, having owned his own consulting firm and a photography business. Over the years, we have continued to benefit from Matt's knowledge and talented writing, as he has written the Market Commentary for our newsletters during his academic sabbatical from Deighan Wealth Advisors.

Matt holds a B.A. in English and an M.B.A. in Finance from the University of Maine, Orono, and he is a CFA® charterholder, earning the right to use the CFA designation in 2011. Matt resumes his position as Chief Investment Officer at Deighan Wealth Advisors, where we look forward to sharing in his keen insight and financial acumen.

We asked Matt a few questions upon his return.

What made you decide to return to Deighan?
Deighan is a great company that values and respects its clients and employees. It is unique in its ability to provide comprehensive services, from investment management, to financial planning, to estate planning, and it's a place that just "feels right." It was an easy decision to make.

What do you like to do in Maine?
My wife and I like to spend time enjoying the outdoors with our dog, Finnlay. We travel all throughout the state and love exploring Maine's many and varied landscapes. We also love to support Maine's farmers and artisans, and we're always on the lookout for local crafts, foods, and personal care items.

Tell us about how you participate in your community.
Currently, I serve on the board of directors for the Maine Seacoast Mission and Robinson Ballet. I also serve on the endowment committee for John Bapst Memorial High School, where I'm a former trustee.

What do you most look forward to in re-joining Deighan Wealth Advisors?
I look forward to working with my fantastic colleagues as we continue to provide the highest possible service to our clients and the greater community.

A FOND FAREWELL TO KAREN MITCHELL

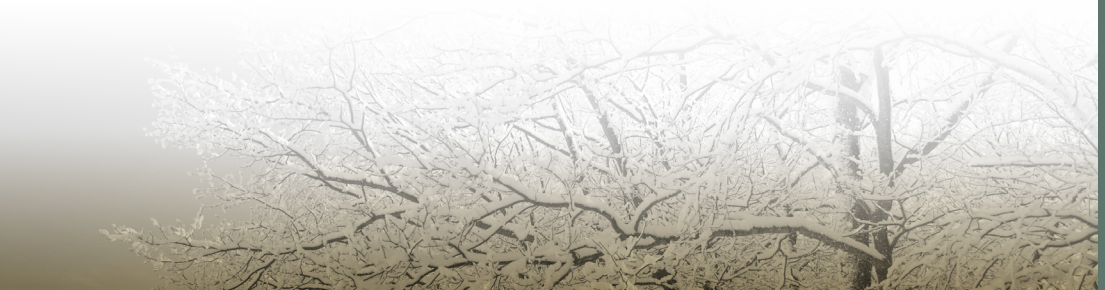
After more than twenty years with Deighan Wealth Advisors, Karen Mitchell retired in December of 2019. We will miss her friendly face and warm greetings in our office, often with a hug, always with a welcoming cup of coffee or tea. We are very grateful to Karen and her years of service to this firm. We wish her the very best in her next adventure!

Do you recall your first day at Deighan Wealth Advisors? What was your initial impression of the firm?
After nearly fifteen years in the horticultural industry, I transitioned to a new career with Deighan Associates in November of 1998. At that time, our offices were located in Jean Deighan's home on Penobscot Street. On my first day, I was greeted with a cup of coffee and Jean's loyal Lakeland Terrier, Hannah. The building was unlike any office I had ever been in; filled with beautiful paintings, antiques, and the sounds of young children. I immediately felt at home.

What is your favorite memory of working with DWA?
I will always cherish the close relationships that I have formed over the years with Deighan Wealth Advisor clients. I have had so many conversations with clients from all over the country, which was always my favorite part of the job. In retirement, this is what I will miss the most.

What plans do you have for retirement?
I have worked at Deighan Wealth Advisors for 21 years, and while I will miss the clients, I am excited for this new chapter in my life. I plan to spend my days volunteering, gardening, and spending more time with family and friends. I am looking forward to spending the summer gardening at my summer home, and traveling with my daughter.

You've developed close relationships with the clients over the years. What message would you like to give them in your retirement?
It has been a pleasure working with each of you. Sharing life experiences through our conversations has been a joy. Thank you for your support and best wishes.



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