



Portfolio Management Memo

December 17, 2018

MARKET ENVIRONMENT

The S&P 500 Index enjoyed a record 12 consecutive months of positive total returns in 2017, as momentum drove the markets to one record high after another. Although 2018 feels quite different than 2017 to date, many of the underlying economic fundamentals have changed very little. In particular, the U.S. continues to benefit from tax reform, solid economic growth, strong corporate earnings, as well as low inflation and unemployment. However, the recent global market sell-off has shed light on a few areas of concern. Worries about a prolonged trade war between the U.S. and China, slowing global growth, the length of the current U.S. expansion, and expectations regarding Federal Reserve rate hikes have played significant roles. It is widely anticipated that the diminishing impact from fiscal stimulus from tax reform coupled with a Federal Reserve set on tightening monetary policy by increasing interest rates is likely to slow economic growth in 2019. U.S. economic growth, which peaked at 4.2% in Q2, has been above average in 2018 and is likely to slow to more historical levels moving forward. Slower economic growth does not necessarily signal an impending recession.

CHANGE IN SENTIMENT?

Although it is too early to tell whether we are at a market inflection point or merely approaching one, shifts in sentiment are often dramatic and difficult to predict. In 2017 and much of 2018, market leadership belonged to the technology sector. However, since the beginning of October, we have seen that leadership deteriorate considerably. There have been reports of slowing demand for Apple products, leadership and privacy concerns with Facebook, and an overall slowing in global semiconductor demand. Most recently, we have seen each of the 5 “FAANG” stocks – Facebook, Amazon, Apple, Netflix and Google – all close in bear market territory (a decline of 20% from their 52-week high). The last bout of volatility felt by investors was during February’s correction, in which the major equity indexes fell by more than 10%. What made this more troubling for investors is that for several years the market had eschewed any wild moves. Indeed, Reuters recently reported that the S&P 500 is on pace for its most volatile year since 2015 according to data from Refinitiv (previously Thomson Reuters Financial & Risk Unit). This has been glaringly evident over the past several weeks where the S&P climbs 5% one week, only to decline 5% the next. In early December, the Dow Jones Industrial Average recorded a 3.14% intraday decline, before ending only down 0.32%.

INVESTOR PSYCHOLOGY

Market downturns have a way of stirring up memories of the Great Recession – the worst financial crisis since the Great Depression. This is known in behavioral finance as the “recency bias,” whereby greater significance is given to events that are vividly remembered. It is important to understand that market corrections, bear markets and recessions are inevitable. However, not every market decline will become the next financial crisis or bear market. Investors became somewhat complacent because volatility over the past few years had been uncharacteristically low. Ultimately, investors may also be subject to what is known as the “loss-aversion bias,” which arises from feeling more pain from a loss than the euphoria from an equal gain. When we see investment losses, our instinct is to halt the pain and simply sell, even if we know that this may negatively impact our long term financial goals. This is exacerbated by the global media that seems to always create a sense of impending doom. Daily market losses are often subtly described as plunges, crashes, or tumbles, even when there is no reason to expect that a downturn of a significant magnitude is right around the corner.

HISTORICAL PERSPECTIVE

From a historical perspective, Chief Investment Strategist at CFRA Research, Sam Stovall reported that since WWII there have been 56 “pullbacks” (declines of 5% to 9.9%), 22 corrections (declines of 10% to 19.9%), and 12 bear markets (declines greater than 20%). On average pullbacks occur once a year, corrections every 2.8 years, and bear markets every 5 years. Stocks recovered within 2 months during pullbacks and within 4 months from a correction, on average. While we’ve had 2 corrections in 2018, we have not had a bear market in 9 years. While losses may be difficult to swallow in the short term, remember that the S&P 500 is still up over 365% from its March 2009 low.

CONCEPTS TO REMEMBER

- **Do not panic** - Equity markets are inherently volatile. The equity markets will rise and fall, but continue to provide the best opportunity for long term returns. Panic selling is never in your best interest.
- **Maintain a long-term focus** – If investors checked their account values less often, they’d notice a lower level of overall volatility. Equity market volatility diminishes over longer periods of time.
- **Ignore the headlines** – Focus on your long-term goals and less on the headlines from the financial media. Every market move does not require you to “re-think” your financial plan.
- **Evaluate your portfolio** – Market volatility presents opportunities to rebalance and tax loss harvest. These are some of the value added services we provide. We will tactically rebalance to take advantage of market pullbacks (buy low & sell high) and harvest losses to offset long term gains (minimizing taxes).
- **Prudent management** – We are here monitoring and adjusting your portfolio to help you accomplish your financial goals. We are here for you and if you have any questions or concerns, please contact us.