10.29.18

RE-VALUATION

We currently remain at close to neutral exposure to the stock market, with our net equity between 3% and 5% of the portfolio. With our ability to move in and out of markets, we made two short-term strategic trades in and out of the SPDR S&P 500 ETF (SPY) and iShares Core S&P Small-Cap ETF (IJR). We made these purchases after the indexes were markedly down from their highs with the goal of capturing a brief intraday bounce or multi-day rally, then quickly selling before they headed lower. With a market as volatile as the current one, it is critical to remain liquid and we exited these trades with minor gains. So far, the Dow Jones Industrial Average has fallen an eye-popping 2,000 points in just 24 trading days, erasing all of this year's gains in the process! At the same time, our portfolios have performed admirably, down only 0.22% (including the fourth quarter fee) while the Dow Jones Industrial Average has lost 8.4% and the S&P 500 lost more than 9%! As you know, we have been trading more frequently this year. While it may be frustrating to see so many trades, as we look back we can see that more than 90% of the funds that were sold have declined further since their sale date, saving losses in your portfolio.

In past eras, declines like this were normal. But, after a decade of monetary policy interventions which led to the highest levels of stock market complacency in history, these normal market cycle corrections now feel catastrophic! Investors have spent the past ten years willfully going unprotected into a casino funhouse built on smoke and mirrors. Many of those investors – if they were smart – would have sold on January 26th of this year and taken the rest of the year off after being up 8% in just a little over three weeks of market action! Instead, these investors ended up with advisors who quickly parked them in a stationary portfolio of 60% stocks and 40% bonds and simply answered their client concerns with a curt "hang in there, it always comes back." Part of our responsibility is to understand what the potential threats are to your portfolio, what indicators/entities/news are moving markets, and what the valuation or intrinsic value of an investment is, and using that information to form a proactive strategy that is able take advantage of changing market conditions. Unfortunately, few advisors think or behave as we do, turning our time-tested experienced strategy literally on its head. Buying the dip worked in the past… Heck, as more and more stock buybacks and artificially low rate corporate loans flooded into the stock market at a greater and faster pace, even buying at the top worked! With this type of a momentum- and liquidity-driven stock market, it actually behooved people to ignore fundamental economics in favor of investing recklessly. And, for a time, it worked – until now! One prudent investor was asked on CNBC if once all the current concerns subside will we be able to go back to normal? The respondent answered in the affirmative, adding "but the problem is that "normal" is still a long way down from here." We couldn't agree more.

So why is "normal" such a long way down from here? It's simple. When the cost or valuation of a stock or bond moves too high above what they are worth, the natural efficiency of reality eventually sets in and knocks what has moved too high without basis back to earth. Markets are currently digesting a deluge of information along with a large question mark about what will be the stimulus for a continued rally into next year. Could it be…

- Midterm elections
- Forward guidance for companies releasing earnings
- Federal Reserve policy
- Administrative actions

- Tariffs with China and Europe
- Inflation concerns
- Direction of interest rates
- U.S. dollar appreciation
- Labor shortages
- Deepening housing slowdown
- Geopolitical risk (Italy) (Brexit)
- Slowdown world's second largest economy (China)

Or… none of the above?

With stock markets not doing their seemingly normal pattern of shallow dips followed by panic buying, more and more investors – both big and small – will move to the sell side of the investment equation. For their clients' sake, the issue that every money manager should understand is that the Federal Reserve's policy of raising rates is making borrowing more difficult. This means that there is less cheap money available for stock buybacks to keep markets on a one-way rocket ship ride upwards. This type of centrally planned policy should have never been "normal." In fact, it has made the unusual look usual – until now.

In our favor is the increase in volatility. With our ability to play both sides – market rallies and market declines – nimble portfolios like ours can capitalize for short periods of time. On Wednesday, we caught a short-term intraday bounce and exited with a small loss before things developed strongly to the downside at the close. From a technical standpoint, major stock indexes are showing a strong buy signal. Unfortunately, the catalyst to spark a monster rally has not yet developed. Earnings certainly have taken on the look of "priced to perfection." When this happens, a company can "beat" their earnings but if they don't signal explosive returns for the future, those companies are savaged with waves of selling. This is where the rubber meets the road because markets are forward-looking mechanisms and in the absence of some type of enormous policy promise (tax cuts) coupled with the headwinds of higher interest rates on borrowing, many market analysts will sell into those topline earnings beats.

Another aspect that is lacking this week is that neither a major voting member or the Federal Reserve Chairman himself has come out and suggested a pause in their interest rate path. It would actually be irresponsible to retract what they have previously acknowledged would be painfully measured/microscopic pace rate hikes – only because they have been so very late in raising rates and they still need more firepower in case we do walk into recession over the next two years. Also lacking is any progress in the tariff crisis with China. Many companies have mentioned higher costs and lower sales in their outlooks. While markets here in the U.S. may not get the desired response from the Fed, other nations (European Union, Japan, China) may still attempt to massage their markets with soothing words of additional stimulus by keeping interest rates low.

The next few weeks will be crucial. Will we continue to see more hopeful words coming from the administration (offering a vague promise of forthcoming middle-class tax cuts and infrastructure packages), midterm mudslinging, earnings season losers and winners, and enough geopolitical drama to choke a horse? Resolving or at least jawboning around these issues could be catalyst for market spikes. But, the fundamental economic reality hasn't changed – stock market valuations remain too high and higher interest rates will continue to act as stock market kryptonite as companies/governments/ municipalities will be hesitant to borrow beyond their normal capabilities to service the mountain of existing debt.

Economic news in the housing market this week was dismal and a sizable detractor to the broad economy. Next week we have Personal Income/Personal Spending, Construction Spending, ISM Manufacturing, Auto/Truck Sales, Factory Orders and the National Jobs Report on Friday.

As always, we will continue posting articles that we believe to be of great informational value on our website, under the "Great Articles" tab, which is linked here:

http://summitplan.com/cgi-bin/htmlos.cgi/great_articles.html.

Additionally, the "Summit Planning Financial Hour" will be live this week on Radio 570-WSYR at 10AM on Saturday. Don't forget to tune in for a recap of the week's events. If you cannot tune in, check out our radio show archive on our website at http://summitplan.com/cgi-bin/htmlos.cgi/radio_shows.html.

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12. The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.
13. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.
14. The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.
15. CBOE Volatility Index is a measure of the implied volatility of S&P 500 index options, calculated and published by the Chicago Board Options Exchange (CBOE).
16. All indices are unmanaged and cannot be invested in directly.