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Quarterly Newsletter - January 2018

January 15, 2018

Dear Client,

Somehow it feels like the movie Groundhog Day. It's just the same thing ? over and over. Perhaps we should just re-publish the letter we sent last quarter, or the one before that, or the one before that. As before so now. Over the past 12 months the markets, and therefore your portfolio, have done remarkably well. The 12-month period ending 12/31/17 was, as before, double digit reruns. Upward and onward.

And also as before, the U.S. markets are setting record after record. It's on television all the time.

But what asset classes are really doing well? You might be surprised.

Over the past twelve months the best performing asset class in our portfolios has been the emerging markets. The second best was international small capitalization and third place goes to international large capitalization. All three had double digit returns substantially in excess of the 21.8% returned by the S&P 500.

One needs to recall what the world was like after the 2009 crash to see how remarkable this is. At that time the international stocks, and most especially the emerging markets and the international small and small value stocks, were left for dead. Now they lead the pack. You have participated in this international equity boom because we are internationally diversified. We, of course, are pleased by this and we hope you are as well.

And when might this all stop? If the good economic performance, both US and international, continues then the markets may also do well. That may well be for a good while yet.

Does the Trump tax cut have anything to do with this?

One would imagine that it does. The corporate tax cut will mean, of course, that after-tax corporate profits will be higher than they would have otherwise been. Many people will see their individual taxes reduced in the short-term but these lower taxes have an expiration date. The big permanent tax cuts went to corporate taxes and to the wealthiest individual tax payers. It is likely deficits will increase creating debt that will have to be paid back ? with interest ? by your and our children and grandchildren. That is simply bound to slow the economy. The debt also reduces choices in government spending. And come a recession we may wish we had not used up all that government spending power when we didn't really need to do so.

We are in the largest bull market since 1932, surely this cannot just go on. When will it end? We have no idea of course ? but perhaps both sooner and more violently than most of us might wish.

The temptation, of course, is to try to time the end, to attempt to predict when this market, or all the markets in the world, might decide to reverse direction and go down big time. After all ? nothing can go up forever.

It is hard to describe just how tempting this is. Perhaps you are familiar with it. Let's just sell now, wait for the markets to go down a lot and then buy back in. How hard can that be? But in fact, the financial press recently has been full of tales of woe for this type of market timing. For a vivid description of regret on the part of many investors, regret at missing all or part of one of the most gigantic bull markets in history, we strongly recommend the Wall Street Journal article of Jan 5th 2018 ?Many Investors bailed Out Early?. The detail in the article is fascinating. For example ? since Jan 2012 nearly one trillion dollars has been pulled from U.S. equity mutual funds and in that same time period the S&P is up 116%. The market goes up and up and at the same time money flows

steadily out. This has been called the most hated bull market in history for the simple reason that that is exactly what it is.

We, of course, think there is a better way. You have heard all this before ? but the discipline to follow through is rare. We have a spreadsheet here that displays very nicely the risks and the rewards of both stocks and bonds. Rather than being in and out of the markets as emotions dictate we think investors should diversify and then just accept market risk when it (inevitably) arrives. Put part of the portfolio in stock and part in bonds not by market timing but rather by a conscious choice. Match your equity risk with some percent of the portfolio in bonds. Rebalance back to the desired bond percent as the equity markets soar. Rebalancing will involve selling some of those red-hot asset classes, trimming a bit one might say, but not as a statement of timing. Rather it's just rebalancing.

This should be done in the context of an overall financial plan ? a way of specifying a lifetime income stream that is protected, as far as is reasonably possible, by diversification and rebalancing. And also by reasonable expectations. This is called financial planning and this is what we do. Don't fret. Just recognize that the power of the stock over time comes with risks. These risks need to be accepted while also being ameliorated by diversification and rebalancing.

Happy new year! And may your 2018 be healthy and joyful.

Jim John Richard & Ryan