Quarterly Newsletter - July 2017

July 15, 2017

Dear Client,

Things in the United States feel very strange just now. On the one hand, the Trump administration is doing and saying things that are remote from any previous American historical precedent. We find this very distressing. The U.S. and world equity markets are, however, doing quite well. This can be seen in your enclosed Twelve Month Managed Asset performance report. All non-real estate equity positions, both U.S. and international, have double digit returns. Many of those returns are over 20%. How can this be happening? And will it continue?

What will happen to the markets if the drip drip of revelations leads down the road to impeachment? Presumably volatility. We do not know how much. We do know that any equity investor needs to be prepared for market volatility. Ten or twenty percent corrections are not uncommon. Thirty percent drops do occur. And we all remember the more than fifty percent drop that happened in 2007 - 2009. We could get any one of these now just as before. Market volatility just comes with the territory.

Thus far, however, the markets have been remarkably quiet, even optimistic. Why? Well, there are a couple of facts that do go some way to explain this.

The first is that we are no longer living in the world of post W.W. II American dominance. America is not as important to the world as we once were. We are big and important but we are no longer the only game in town. No matter what happens here the world is going to move on, with or without us. Europe is doing better. Not only is the European Union not collapsing but the European politicians are looking at the failures of the Euro and seem determined to (slowly) address them. This surely will mean more European unity rather than less. And the European economies are doing surprisingly well. The consequence is that European confidence is returning. Large trade deals are being signed. Environmental commitments are being honored. This confidence is also showing up in the European markets. As we mentioned in our last letter, since the beginning of this year the American markets have slowed a good bit, but the European and emerging markets are doing quite well. As is China. Because we are internationally diversified we are by no means fully dependent on U.S. market returns. We, and you, benefit from the international trends as well.

And then there is the fact of deflation, or at least very low inflation. Worldwide, economies are in recovery mode. This is very helpful to equity markets. America is at full employment now but wage growth remains very slow. Trump mis-diagnoses this, blaming immigrants. The real and persistent causes are automation and monopoly power. If we are going to survive as a political society we are going to have to deal with the huge job losses coming from artificial intelligence and robots. And see the Economist magazine for articles on the rise and corrosive effects of monopoly power in the U.S. It is not a pretty picture. We have the articles should you wish to see them.

But this very low inflation is good for equity markets. Interest rates are low and will remain low so long as inflation does not markedly accelerate. In such an environment anything that can produce growth in income commands a high price. Corporate profits do generally rise and equities rise as earnings rise.

The huge bull market in equities that began at the market low in 2009 has produced a more than tripling in prices. The S&P 500 has gone from 683 at the March 6 2009 low to 2,441 now. That market has been and remains the most hated bull market ever by those investors who missed it. Too bad for them. There are always reasons to buy and reasons to sell. That is what makes up any market. But, as we previously said, the main thing about equity markets is that they are just very unpredictable. The returns to a globally diversified strategy such as ours have, since January 1 2000, been very good, much better than the S&P 500 alone. These returns have often been accompanied by headlines shouting the end of the investment world as we know it. We have ignored these. The price of our good performance has been our willingness to remain invested no matter what the world is saying or doing. We bought equities during the market crash of 2000 and, also of 2007-2009. Should the U. S. or the world markets fall again we will do the same. In our opinion there is simply no other way to do this.

The current U.S. political culture is obviously not stable. Some things are supportive of the markets and some are not. Which of these contrasting trends will in the end dominate no-one knows. In fact, there really never is an end, or a resolution to the puzzles. The markets go along, rising and falling. The best we can do is to ride along and rebalance as we go.

In equity markets activity, market timing, aka guessing, just does not pay off. Not so in politics. In politics activity is all there is. Perhaps one thing any of us could do is to become more active in the political debate now going on. The country is at a crossroads. We are living at an historical hinge moment. We could do worse than to enter into the debate ourselves.

Please take a moment to read the enclosed Fiduciary Acknowledgment. A change in Federal law now requires us to send this to you as an acknowledgement of our role as fiduciaries. This is a role we have always had as S.E.C. registered investment advisors and we are proud to maintain it.

As ever, please feel free to call or email with any questions or comments.

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