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My Views from Wall St. to Center St.

"There are essentially two forces influencing returns; growth and inflation. The task, is building a portfolio that can weather any scenario, regardless of what these factors are doing... You should be building a diversified portfolio with assets that are balanced according to their risk rather than their dollar amounts." - Ray Dalio, Founder, Bridgewater Associates, LP

So here we are with less than a month to go in 2017 and the U.S. market continues to set new highs. Despite the aged and overvalued nature of equities and ultra-low bond yields, I find the weight of market evidence continues to lean modestly bullish on equities and high quality fixed income.

Also, this week Washington has moved closer to getting a tax package passed (more on this later).

As I've written over the last several letters, this market has me confused and concerned. I recently participated in a panel discussion where John Mauldin shared the following: "Honestly, I don't think it's possible to make market predictions about leadership in a market that just keeps relentlessly wanting to go up. I think where leadership is actually coming from is the move into passive investments. I mean they're buying these big across-the-board indexes. And not only that, the Bank of Switzerland now owns 4% or more of the S&P 500 and the Bank of Japan is buying the S&P 500. They are buying products that track the indexes, they are not stock picking, they're just saying, we want the whole thing. If there is leadership, it's coming from the move to passive investments." To that I say Amen, brother!

We humans tend to herd, and boy are investors herding. Much like investors did in 1999. Then it was the tech stock craze. More buyers than sellers and prices go up. More buyers into the same few stocks and prices really go up. Until they don't. Minus 75% and 15 years to get back to break even was the cost of that error. Were value plays a better pick then? Yes. Were utilities a better pick then? Yes. Were bonds a better pick? Yes. Was portfolio diversification a better plan? Yes. But everyone wanted that shiny red Ferrari.

So when clients call and want to buy a Ferrari, I point him or her back to their risk assessment and investment strategy. And if goals and risk objectives have changed, then ok consider the Ferrari. But, one can't expect a minivan to drive like a Ferrari or a Ferrari to provide the benefits of a minivan... two different things. As Dalio said, "You should be building a diversified portfolio with assets that are balanced according to their risk rather than their dollar amounts." Tech was the Ferrari of 1999. Passive S&P 500 Index exposure is today's Ferrari. Well, actually FAANGs are today's faster Ferrari but you see the point.

I came across the following quote in a piece from CMG's Stephen Blumenthal that further illustrates today's market mood. "There is always a disposition in people's mind to think that existing conditions will be permanent... when prices are up and the country is prosperous, it is always said that while preceding booms have not lasted, there are circumstances connected with this one which makes it unlike its predecessors and gives assurance of permanency. The one fact pertaining to all conditions is that they will change." - Charles Dow

Dow's quote is from the late 1920's. In 1928, Roger Babson advised investors to get out of the market. People thought he was nuts. He was early on his call as the market went about 40% higher. What was overvalued grew to be more overvalued. He advised again. People thought he was even more nuts.

The market crashed, rallied and went on to ultimately lose nearly 89% of its value by 1932. While I'm not calling for anything near that degree of financial destruction, I can't help but wonder if in a few years from now investors might be looking back asking their advisors how they could have let that happen. I don't intend to let this happen on my watch.

I think there is a better way. I believe Benjamin Graham was right on when he said, "The essence of investment management is the management of risk, not the management of returns."

<u>Bubble, what bubble?</u>

Before I move on to the tax plan, a few other observations about 2017 and whether financial markets are in or entering into a bubble:

- A DaVinci painting sold for $450 million
- Bitcoin has soared over 1000%
- Bank of Japan and the European Central Bank bought over $2 trillion of assets
- Global debt rose above $225 trillion
- The market cap of FAANGs increased by more than $1 trillion
- S&P 500 volatility dropped to 50-year lows and Treasury volatility to 30-year lows
- Money-losing Tesla, Inc. sold 5% bonds with no covenants as it burned over $4 billion in cash and produced very few cars

Michael Lewitt has called this a "joyless bubble", however. It is accompanied by political divisiveness and social turmoil as the mainstream media lectures the populace with fake news. Immoral behavior that was tolerated for years is finally called to account while few brave journalist fight against establishment forces to reveal deep corruption at the core of government. In 2018, a lot of chickens are going to come home to roost in Washington, D.C., on Wall Street, and the media centers of New York and Los Angeles. Icons will be blasted into dust as tides of cheap money, cronyism, complicity, and stupidity recede. Beware entities with too much debt, too much secrecy, too much hype. Beware false idols. Every bubble destroys its idols, and so shall this one.

<u>Tax Reform Plan Grinds Ahead</u>

"I have come to the conclusion that one useless man is a shame, 2 is a law firm, and three or more is a congress." - John Adams

Currently the Republican Tax Plan has moved forward into "conference committee" for fine tuning. What that means in my opinion, is that the tax writers have moved too fast; the bill is still being written and corrected; the numbers don't add up; the lobbyists are likely to win more victories – all sorts of provision have been tucked into the margins of the bill, benefiting banks, oil producers, car dealers to mention a few. Despite the fact that this bill has been hastily written and flawed, I believe it will likely pass and become law. The goal of the conference is to complete the measure by Dec. 20, but congress is resigned to staying in Washington thru Dec. 23 to get the bill to the President's desk.

In summary, I believe the tax plan will pass and everyone will have something to hate about it. I will have more commentary about the bill once we see the final version.

So where do we go from here?

We continue to stay "risk on" in our diversified strategies. That's another way of saying we have more stock market exposure than we do bonds, cash, and other alternative assets. The economic fundamentals are strong in the U.S. and globally. There is no recession in sight in 2018. So, with the passage of the tax plan and solid fundamentals the markets are likely to grind higher. However, I would suspect that the next 12 months will have much more volatility than the last 12 months. We will need to buckle the seats of our "minivan", but it will take the bumps a lot better than a Ferrari.

Personal Note

I have always loved the holidays. From Thanksgiving to New Year's Day, the last 6 weeks of the year are a time we spend more time with family and friends than we do in the previous 46 weeks of the year. On Thanksgiving we get together with family and everyone pitches in with the prepping of the "meal" and even if you don't go through the process of "giving thanks," it is easy to look around the dining room table and see how much we have to be thankful for.

Then it's on to Christmas (my favorite holiday). We start the decoration process the day after Thanksgiving. This happens at home (Julianna is in charge!) and it happens at B&H. B&H was a team effort from Nancy, Cathy, and Sherry, but it's fair to say that Nancy spearheaded the decoration committee. She loves it and is very good at it. If you haven't been in the office to see it decorated, I encourage you to do so. I'm a little biased, but it looks great.

The New Year brings on the expectation of new possibilities. Stop bad habits and start new "healthy" habits. I try to look back at the previous year and evaluate what I did well and what I didn't do well in both my personal and business life. It can be a painful introspection, but if I can incrementally improve each year I will be better for my family, I will be better for my clients and I will be better for myself. I look forward to seeing each of you in the coming year and hearing about your plans for 2018 and beyond.

I'm going to wrap this letter up now, if you have any questions please call me at 423-247-1152 or email me at Jeff@BHRetire.com . As always, I am honored and humbled to be your wealth advisor.

Merry Christmas & Happy New Year!
Jeff