



My Views from Wall St. to Center St.

“ Difficult Roads often lead to beautiful destinations. ” ~ Author Unknown

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A Bumper 2018, a Return to Normalcy

I hope everyone had a wonderful holiday season. Whether you reached your personal goals in 2018, faced challenges, or are looking for a 2019 reboot, let’s take a moment to hit the key themes from this past year.

After reaching all-time highs in mid-2018, the S&P 500 Total Return Index reached a low for the year on Christmas Eve. December’s 9.0% decline was the worst December on record since 1931.

The idea that “there is always a bull market somewhere” was put to the test in 2018. There wasn’t. A look at major asset classes shows that only cash gained in 2018. Even during the challenging Great Financial Crisis in 2008, several asset classes performed well (bonds and gold).

All Seasons Strategy Summary Statistics for month ending

SUMMARY STATISTICS	1 MTH	YTD	1 YR	5 YR (Annlzd)	10 YR (Annlzd)
All Seasons Strategy	-4.5%	-6.8%	-6.8%	2.5%	6.8%
1 US Large Cap	-9.0%	-4.4%	-4.4%	8.5%	13.1%
2 US Mid Cap	-11.3%	-11.1%	-11.1%	6.0%	13.7%
3 US Small Cap	-12.1%	-8.5%	-8.5%	6.3%	13.6%
4 Intl Developed	-5.2%	-14.4%	-14.4%	1.3%	7.5%
5 Emerging Mkts.	-2.7%	-13.5%	-13.5%	2.6%	8.9%
6 Global REITs	-5.7%	-4.8%	-4.8%	6.4%	11.3%
7 Natural Resources	-5.1%	-12.6%	-12.6%	-0.5%	3.1%
8 Commodities	-6.9%	-11.2%	-11.2%	-8.8%	-3.8%
9 US Bonds	1.8%	0.0%	0.0%	2.5%	3.5%
10 US TIPS	0.5%	-1.0%	-1.0%	1.6%	3.4%
11 Intl Bonds	2.0%	-2.3%	-2.3%	0.2%	1.6%
12 Cash	0.2%	1.8%	1.8%	0.6%	0.3%

Source: S&P Dow Jones Indices

A confluence of events triggered this selloff that also spilled over into commodities and credit. Slowing economic data coming from China and Europe combined with ongoing U.S. China trade disputes, a flattening U.S. Treasury yield curve and plunging oil prices all contributed to worries about slowing global growth. All of this was within the context of the ongoing withdrawal of monetary accommodation.

The real catalyst that ignited the decline seemed to come from the Fed. Chairman Powell's hawkish comments in November that the Fed was a "long way" from getting rates to neutral. This raised the specter of a Fed policy mistake that could and I believe will ultimately push the U.S. economy into a recession. Showing that he was not insensitive to the message the markets seemed to be expressing in December, Chairman Powell walked back his previous comments. The market rallied on his comments and has been on better footing since. In other words, the global glut of liquidity remains intact and the Fed induced market "high" continues. Those that have been reading my "Views" for the past year know that I believe this market is fragile and that the next recessionary "bear" market will be painful and longer in duration than investors have come to expect. More on how to prepare for the next "bear" throughout this letter.

A Peak at 2019

December was a bad month for stock. There is no way to sugarcoat it. Long-term investors recognize the need for a long-term disciplined and diversified approach, but that doesn't mean extreme levels of volatility won't create some degree of concern. I get it.

We touched bottom on Christmas Eve, and shares have extended gains into 2019. In fact, the Wall Street Journal ran an article stating the S&P 500's advance last month was the best start to a year since 1987.

Much of the data suggests the economy continues to expand, but the main reason the bull market is waking up from its late-year slumber is the Federal Reserve.

So where do we go from here? While the economy is still growing, albeit at a slower rate and inflation remains low here and across much of the globe, the risks to the economy are numerous—political uncertainties, trade disputes with China, Brexit, government shutdowns to name a few. In each case it is in the best interest of all parties to resolve their differences and to move forward. That said, these risks create the potential for periodic bouts of volatility and perhaps the catalyst for the next recession that I believe will occur either late this year, or possibly into 2020 putting the economy front and center for the next Presidential Election cycle. "We live in interesting times."

Portfolio Construction

The basics of our core portfolios are that they can thrive and survive all 4 seasons. It is broadly diversified with 7 different asset classes - U.S. Stocks, International Stocks, Real Estate, Natural Resources, U.S. Bonds, International Bonds, and Cash. Diversification manages risk and these assets will behave differently from one another (2018 being an exception... 1st time in over 45 years that no asset class was up at least 5% for the year). The wealth management process is about managing risk, not managing return.

I'm very excited that we added the "Mauldin Smart Core" to the investment lineup last year. I have known John Mauldin for many years and respect his opinions and research. It's not only his opinions, but he provides a line-up of experts that are unmatched by another firm. From economists, futurists, geopolitical and anti-aging experts, it is truly a repository of knowledge and insight that I could not get anywhere else.

Last year, he created an investment approach designed to generate upside growth but does so in a way that is also designed to provide downside protection. Unlike our broadly diversified multi-asset strategy, Smart Core diversifies among trading strategies that selectively decode which asset classes to own and for how long.

The Smart Core Program takes to heart Warren Buffet's 2 Rules of Investing:

Rule 1: Never lose money. Rule 2: Never forget Rule 1.

Of course, even Warren has had his share of losses, so please know I'm not suggesting that any investment strategy will not have losing periods. We are just trying to minimize them. Minimizing the loss is important because the larger the loss, the larger the required subsequent return to get back to even.

The Evolution of my "Risk Managed" Investment Philosophy

I have been in this business for almost 30 years. I have seen what "bear" markets can do to wealth. From 2000 to 2009, investors endured two 50% market drawdowns that came with recessions, which required 100% subsequent gain to simply recover your position. As a firm we have always believed in managing downside risk. We were using Marty Zweig's risk strategies in the 1990's when nobody wanted risk management, they just wanted tech stocks. Then tech stocks, i.e. the NASDAQ lost 75% of its value between 2000 and 2002. Then everyone wanted "risk managed" strategies. You however, need "risk management" before you need it—if you catch my drift—not after you need it. The proverbial, "closing the barn door after the horse has bolted".

The challenge as an advisor is to help my clients stay focused on their goals and not returns. Don't get "greedy" in "bull" markets and don't get "fearful" in "bear" markets. I believe with our existing strategies of Multi-Asset, Tactical Fixed Income, etc... and adding Mauldin Smart Core that we will be able to achieve acceptable performance to obtain your goals and we will be more nimble and willing to look at new opportunities.

I do not believe anyone reading my letter wants to sit through another recession with a 40% or more drawdown in the markets. You might ask yourself whether you have the time or desire to go through that again. And if you are one of many retirees in need of distributions to support your retirement during a portfolio drawdown, the math to get back to even gets exponentially harder. I'm always doing everything I can to come up with the solutions that can help you get from where you are to where you want to be. I also believe that we can no longer just rely on diversification, because in today's world, assets tend to move as one as they did in the last crisis.

If you have any questions about any of the topics covered in these "Views", please do not hesitate to contact me. As always, I am honored and humbled that you have chosen me to serve as your financial advisor.

Personal Notes :

Since my last letter, I had another (hopefully last) eye surgery. The good news is my retina is staying attached, but I still really can't see out of the eye yet. My doctor keeps telling me to be patient and it will improve. Patience is a work in progress for me. I'm a lot better at talking about it than I am in the actual practice of it. But, I'm trying, don't have much choice.

I did get a chance to check an item off of my bucket list in January. I'm a big fan of the rock band, Metallica and I got a chance in January to see them in Nashville. They were awesome!

Thanks again from your one-eyed, learning patience wealth advisor...
Jeff

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