Walker & Associates

Year-End 2017 *Market Commentary*

U.S. Stocks

U.S. Stocks continued their relentless march upward in 2017, extending one of the longest bull markets in history. (Only the 1990's bull market lasted longer.) The year began with a lot of market optimism due to the business-friendly Trump administration, and even though dysfunction in Washington ended up tempering many of those expectation, the economy continued to hum along, and corporate earnings were generally solid. The S&P 500 Index gained 21.67% for the year while the tech-heavy NASDAQ Composite Index returned 28.24%. Generally, growth funds outperformed value and, large company stocks outpaced small-caps.

The Year in Bonds

Continued strength in the U.S. economy underpinned a slow but steady shift in the Federal Reserve's monetary policy guidelines, including actions to reduce its balance sheet and to hike interest rates, despite stubbornly low inflation.

The economic optimism, further fueled by serious tax cuts in the U.S. and recovering oil prices across the globe, continued to support credit fundamentals and led to another year of risk-on fervor. The Bloomberg Barclays Aggregate Index, a proxy for expected typical core bond performance, delivered 3.5% for 2017, while the intermediate-term bond Morningstar Category generated 3.7% by comparison.

Global Markets

The exceptional string of month after month gains in 2017 for global stocks raises a concern: have investors become too optimistic about growth? It's hard to predict but it appears unlikely. Global economic growth is also exceptional.

Vanguard's Total International Index Fund returned 27.4% in 2017 while the Vanguard Emerging Markets Index Fund returned an outstanding 32%. Vanguard Developed Markets Index Fund returned 26.4% in 2017.

Every one of the world's 45 major economies tracked by the Organization for Economic Cooperation and Development (OECD) is growing this year and expected to post another year of growth in 2018, per OECD forecasts. It has been a decade since the lift to the world economy was this broad.

Looking Ahead: A Quick Word on the Macro Outlook

- The global economy remains in a synchronized recovery—the strongest since the financial crisis—and it seems almost no one expects a U.S. recession in 2018 at least.
- U.S. stock market prices already reflect this sanguine consensus and few investors will accurately predict the timing of the next recession.
- However, unprecedented central bank policy shifts from stimulus to tightening could be a trigger.

- **Concluding Comments**
- The year 2017 was a very good one for most financial markets and particularly global stocks. But there was one small corner of the investment world that did a bit better than stocks: bitcoin gained 1,518%. We don't own bitcoin (or any other crypto currency) in our portfolios. It doesn't fit within our investment discipline or circle of competence. It's a speculative game we *simply don't need to play* to achieve our clients' investment objectives.
- However, the exponential rise of bitcoin and the questions, emotions, and behaviors it triggers in many investors offers us an opportunity to restate some of the core principles and practices that underlie our investment approach. First, the path to long-term investment success is simple to describe but not easy to achieve. (As Charlie Munger put it in his characteristically blunt way: "It's not supposed to be easy. Anyone who finds it easy is stupid.") Successful long-term investors are disciplined and patient. They are honest with themselves about what they know, what they don't know, and what they can't know (the unknowable). In making investment decisions they focus both on what's knowable (within a reasonable degree of likelihood) and what's important (in terms of portfolio impact). Yet, they are also cognizant of and try to manage their exposure to risks that are important, but unknowable or unpredictable (e.g., geopolitical shocks).
- Successful investors have the humility to know not every decision will turn out to be right and that simply having conviction about something doesn't mean it will actually happen. Their investment process is well defined and repeatable. It requires having a sound basis for each decision, so that if investors consistently implement the process over time they should be right more than wrong and the gains from their winners will more than outweigh their losers.
- Successful investors are willing to challenge their own ideas and admit when they are wrong—whether due to new information and changing circumstances, or an error in their original thesis. They keep their eyes on their long-term financial objectives and on the underlying fundamentals that ultimately drive investment returns. They don't get emotionally caught up in the day-to-day noise of the financial news channels or the zigs and zags of the markets. But when the short-term zigs and zags get meaningfully out of whack with the longer-term fundamentals, they use that price volatility to their advantage—buying lower and selling higher. If the market isn't presenting them with compelling investment

opportunities, they are content to hold their current positions; in other words, they don't confuse activity with progress. (Munger calls it "sit on your ass investing.")

- Successful investors are self-aware about their own risk tolerance and investment temperament. As such, they are invested in a portfolio consistent with those personal attributes, managed by an investment manager aligned with them as well. This enables them to remain disciplined and patient—during the good times as well as the inevitable challenging periods—on the road to achieving their long-term success.

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