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FINANCIAL GROUP, LLC

CONTRIBUTORS

- Charles E. Dear, CFP®, AIF®, *Advisor* *
- Steve Worth
- Donald M. "Tripp" Freeman, III, *Advisor* *
- David Callahan

Phone: 203.409.6253 • www.RFGinvest.com

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## *From the desk of…*

Charles E. Dear, CFP®, AIF®, *Advisor* *

**Diversification: Still Needed - Still Works**

2017 ended with stunning gains in large cap momentum stocks, primarily in the domestic and international technology sectors. In context, these gains were even more spectacular when added to the prior seven-year unbroken string of technology gains. So, it was not surprising in early 2018 to hear clients express concern for the mounting risks in the market, ranging from over-valuation in the technology sector, to political rancor, to global security.

While the effects of geo-political events are difficult to handicap in the investment management process, over-valuation is far more actionable. As technology has become far more ubiquitous and deserving of a "premium", there is no question that relying too heavily on this specific asset class, which may be over-bought and over-extended, to drive portfolio returns is a very dangerous approach. The foremost problem with over-concentration in large cap growth stocks is that many of the viable diversifying portfolio alternatives will be much more expensive by the time a growth correction takes a bite out of your portfolio.

Many and most of the widely-held large cap growth stocks, particularly in the technology sector, are found in the S&P 500 Index. In 2018, the S&P 500 Index has experienced three noticeable setbacks; (-10.1%) in late January, (-7.0%) in March, and (-4.3%) in June. From the market's 2018 peak on January 29, to June 29, the S&P 500 is down (-4.3%).

By comparison, during the same 01/29 – 06/29 period, a variety of asset classes experienced better results. The Russell 2000 Index, representing small cap stocks, gained 3.4%. Small cap stocks respond more generously to economic stimulus and a higher U.S. dollar, and defend better against the global trade threats that have been a headwind to large multi-national stocks. The NAREIT Index, which represents Real Estate Investment Trusts (REITs), is up 4.2% - and has gained 12.54% from its February low, having been pressured by the threat of higher interest rates. But REITs represent real assets and tend to flourish in periods of growth stock weakness. In similar fashion, the Dow Jones Utility Index is up 2.2%, and 8.0% from its February low. Both REITs and utilities generate above-average dividends, which also helps to defend against market risk. Investment grade and high yield corporate bonds, most appropriately held in tax-deferred accounts, are a tremendous diversification tool; offering fixed-income, relative (to other bond sectors) protection against higher interest rates, and price stability.

Domestic large cap growth stocks typically hold a dominant position in the average household and institutional portfolio. This is not likely to change, nor should it; Amazon, Alphabet, VISA, Medtronic, and the like deserved to be featured. But when the market's gains disproportionately narrow to these momentum mega-caps, a market correction is almost certainly just around the corner – although the timing is never an easy "call". When a valuation correction does ensue, diversification is your remedy.

It is also important to recognize that diversification is not a call for market timing. A well-balanced portfolio should include portfolio holdings that are not highly correlated to large cap growth stocks at all times – it is simply a matter of degree. When large cap growth valuations are relatively cheap, they should be featured in your portfolio. When large cap growth valuations are uncomfortably high, or other risks such as global trade sanctions threaten the sector, the relative defensiveness of domestic small caps, REITs, utilities, and corporate bonds become more valuable. Don't hesitate to call if you would like to discuss the appropriateness of your current portfolio diversification.

*From the desk of…*

Steve Worth

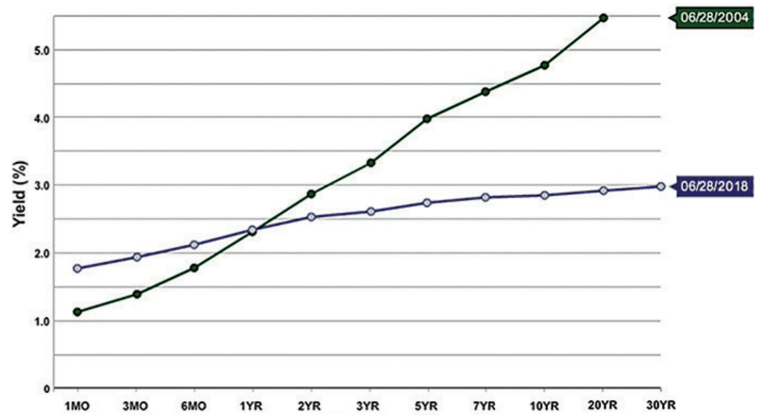
**The Flattening Yield Curve – Should We be Nervous?**

One of the most prevalent market news items of late is the fact that the yield curve is flattening and may be an indicator of a recession. Matt Phillips of the New York Times published a wonderfully digestible article, if not provocatively titled, "What's the Yield Curve? 'A Powerful Signal of Recessions' Has Wall Street's Attention" on this subject on June 25th 2018. Mr Phillips gives a succinct run down so I won't get into another inversion discussion here other than to say yield curve inversion is when short term interest rates are higher than long term rates, which is the opposite of the normal relationship of short and long term rates. No matter what the nerdy specifics of the yield curve may be, we think it is important is to get a realistic perspective on how an inversion will affect our investment process and portfolio values.

And so we offer the following summary points.

- History says yield curve inversion may predict a coming recession but it has yet to give us a level of severity or a point in time when one may occur.
- One could reasonably expect Utilities, Consumer Staples, REITs, and companies with steady well-covered dividends to outperform the broader market in a recession.
- A well diversified portfolio managed by folks looking for companies with wide business moats and strong financials should navigate a recession with more ease than some others.
- One of the reasons longer rates are not higher is because of advancements in technology, which suppress inflation.
- Recessions, like economic expansions, do not last forever. The job of the investor is to invest through the recession to reap the rewards of expansion.

So don't get too nervous. If the Yield Curve does invert and predict a recession, there are ways to create positive returns. Our job as investors is to stay alert, stay diversified, stay invested, and stay on program.




*The steeper Yield curve is from June 2004 as compared to the flatter yield curve from June 2018. Source US Department of Treasury website www.treasury.gov*

**What's a Parent to Do?**

Another year of graduates, another year of new young adults out in the world – how as a parent can you help them on the road to financial security? Here are seven tips to get them started;

- ✓ "Tithe Yourself" – Save ten cents for every dollar earned. This practice will help them better reach their goals as they see their own nest egg growing.
- ✓ "Take it to the Max" – Take full advantage of company-sponsored retirement plans which offer matching contributions. Using other people's money accelerates your savings rate.
- ✓ "Keep it Low" – Build a positive FICO score to lower the cost of future debt. Check it regularly to avoid debt creep. Debt will be needed someday to finance home ownership, large capital purchases, or investment.
- ✓ "Grow, Baby, Grow" – Invest for growth. Take a chance. Be an investment entrepreneur!
- ✓ "Stay Balanced" – Create, and stick to, an annual budget. Lots of online tools to make this happen.
- ✓ "Push Yourself" – Search and strive for promotions at work to achieve higher income. Train yourself for the next step and never stop learning.
- ✓ "Cover Yourself" – Buy life insurance as early an age as you know it's needed. The younger you are, the cheaper it is. Buy it soon!

***Let us know if we can help you support these strategies and practices with your young adults.***