November 14, 2018

Re: **<u>Conference Call on Tuesday, November 20 at 6:30 p.m</u>**

Dear Client,

I wanted to write you a quick note to let you know my thoughts on the current stock market rout. Although I am reviewing my reasoning for staying the course, I am also keeping my radar on overtime for any signs to reduce the stock positions. This has been a peculiar year because stocks and bonds have both declined. In some cases, stocks have done better than bonds. Since, in general, we keep our individual bond positions until maturity, we can experience a temporary paper loss on the bonds, not a permanent loss, unless the bond defaults. In my experience, I have never had a bond default. When the bond matures, you will experience no loss as you will receive your principal and interest paid in full. In other words, the fluctuation of the bonds results in price changes not a permanent loss in capital. This is why we favor individual bonds over bond funds. With bond funds, it is another story. As interest rates rise, bond funds lose value and sometimes it can be permanent. Why is this? Bond managers, at times, cannot keep their bonds to maturity like we do because they have to redeem them to pay out customers who leave the fund. I am not too worried about our bond portfolio because all of our bonds are investment grade and, last year, I shortened the maturities of the bond allocation.

It seems that the general market has been in a correction mode since the February 2018 hiccup in which the market took a 10% swoon dive. In actuality, the general market has been correcting ever since. I have spoken in the past about a handful of stocks leading the market which included Facebook, Apple, Amazon, Netflix and Google, all of which are significantly down. We haven't bought any of the FAANG stocks except some customers own some of the FAANGs on their own.

I wish I could give you an explanation of what is going on in the stock market like some of the media pundits are doing. Does anyone really know? That's not reassuring, I know, but I can only speculate that the market valuations were stretched as I have said before and that interest rates are rising. I have also said that the magic number where interest rates might affect the market was around 3.50% on the ten-year U.S. Treasury. We are currently at 3.16%. It could be that the withdrawal of global liquidity and where we are with the current interest rate is too much for the stock market to handle. Political gyrations in the past and certainly going forward will most likely not be helpful either. Maxine Waters is already planning her revenge plots against the banks.

The majority of accounts are less than 60% invested in stocks. I don't see a recession and there has not been a systemic failure of a large institution. Granted, the trade situation with China is starting to bite and I don't see that resolved anytime soon. To me, this warrants that the stock allocation should remain where we are for the time being.

One reason why we shouldn't panic and dump stocks is because of inflation. Currently, the CPI is running at 2.5%. For example, if you have a bond that pays 4% and tax at 50%, you are left with 2% which is below inflation. As you can see, by my illustration, that bonds alone will not keep up with inflation. Americans are living much longer lives and need to have some growth in their assets in order to retire comfortably. Stocks on average have returned 9% annualized from 1928 through 2017. Therefore, on average, over time, a balanced account of 55% stocks and 45% bonds should deliver a return of 6.75%. Of course, future returns cannot be assumed from past returns and there is no guarantee that the future will be the same as the past.

We never advocate an all stock portfolio and we shy away from the popular stocks of the moment. We learned that lesson in the dot-com crash of 2000. However, it is my opinion that a balanced portfolio of stocks and investment grade bonds will produce a very nice return over time.

If I form an opinion that this correction will get much worse then I may reduce the stocks by 5% to 10%, but I'm not there yet. For now, stay the course and quit looking at your account every five minutes. It will drive you crazy.

We are having a conference call on **Tuesday, November 20, 2018 at 6:30 p.m**. and invite you to tune in. To join the conference call, **please dial the toll-free number: 1-800-914-8405. Once prompted, enter the access code: 5486434, followed by the # button**.

All the best,

Steven L. Yamshon
Investment Counsel