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QUARTERLY MARKETREVIEW

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Mother Nature truly is fascinating- such beauty, power, raw force. It can amaze and humble us. Occasionally, Mother Nature has to remind us who is really in control, especially when man fool-heartedly thinks he has outsmarted nature. The same is true for markets, as the stock market in the first quarter of 2018 turned nasty just when most Punxsutawney Phil-type prognosticators had called for sunny markets with a chance of even brighter days ahead. To be honest, comparing that Pennsylvania-based rodent tasked with calling the end of winter with those of us tasked with calling future market events gives no due-justice to that aforementioned rodent.

The markets were merrily humming along to start the New Year, as January once again saw strong positive returns. The performance through the first month of 2018 allowed the stock market to tie a record for the longest consecutive monthly streak of positive returns at 15. The factors that had made 2017 the least volatile year for markets since 1964 appeared to continue as well. Then February hit-such a cold and nasty month. The stock market suffered its LARGEST point drop EVER!!! Keep in mind that this is the perfect example of the devil lying in the details. Yes, the Dow Jones Index had its largest point drop ever of over 1000 points in a single day. However, this represented a 4% decline in the market. This compares rather favorably to the 500 point drop in 1987 that erased 27% of the markets value or the 30 point drop in 1929 that caused investors to jump from windows and ushered in the Great Depression. Sensationalized and scary headlines have always grabbed the public's attention (a blizzard is now a "snowmeggadon"), so it's only normal to correctly assume media would distort the realities of this situation as well.

Source: S&P 500

Put in historical perspective, the drop was minimal, but it doesn't change the fact it was unexpected. So what happened? It had to be bad news. The economic storm clouds must have unleashed furry upon us, right? No. The skies were sunny. In fact, economic conditions have actually improved. Continuing with the Mother Nature theme, it would be the economic equivalent of that fantastic climactic anomaly when it is raining outside while it is simultaneously sunny. Economic data came out showing the jobs market was even stronger than anticipated. By some measures, it is the strongest jobs market in over 50 years. There are now a record 6.3 million job openings in the United States compared to 6.7 million unemployed workers. This is a problem within itself-the disconnect between skills employers want and the skills job seekers have. Nonetheless, the jobs market is very, very strong. What brought the market rain was the fact wages increased slightly more than anticipated. How terrible that the economy is doing so well wages are finally going up giving consumers more dollars to spend, right? This led to a sharp selloff on the fear that inflation may get out of control. Inflation is the bogey man that scares everyone because it is bad for everything. Essentially run-away inflation is what led to the Nazi's taking over Germany and the Bolsheviks taking over Russia; so yeah, it can be bad!

Luckily, run-away inflation is nowhere to be seen in the economic tarot cards. First, technological improvements continue to suppress wage demands in certain industries– there's a burger flipping robot now, even though I've heard he's no good. Secondly, demographic changes allow employers to replace retiring Baby Boomers with younger, lower paid workers. These two major factors will keep the risks of significant inflation at bay for the time being.

February's volatility subsided only to be supplanted in March by war: specifically, a potential trade war. This is now starting to wade in to political waters, and it is not our intent to provide political opinion, as there are too many outlets for that already. While President Trump's initiative could spark a global trade war, it is important to keep in mind that countries rely on trade with us as much (if not more) than we rely upon trade with them. Therefore, contrary to some news accounts, the President's actions are not guaranteed to result in a global trade war. We don't discount the risks of a trade war escalating, but as of now it does not disrupt our underlying growth forecast.

It's the fundamentals that drive markets over the long term and the fundamentals still are sunny. Beyond the strong jobs market mentioned, a bevy of important economic indicators continue to trend positively. The recently released GDP figure shows the economy expanding at nearly 3%. The last 3 quarters of growth have been the fastest on record since 2005. Manufacturing activity is growing at the fastest rate since 2004. Corporate earnings growth, by far the most important of all the data points mentioned for the markets, is increasing at an annualized rate of 15%. The relevance of mentioning all these data points is that it would be historically unprecedented for the markets to collapse – meaning a 20% or greater decline – with the data still trending as positively as it is. This doesn't mean we believe the markets will march irrevocably higher. Markets could even be down for 2018. We'll never say never but more importantly we don't see markets collapsing. Occasional periods of sideways or even negative volatility can be a good thing. The markets did nothing for 18 months in the midst of 2015 & 2016 before continuing higher. It gives the market time to catch its breath. More importantly, it reminds market participants that the laws of physics still apply (see Bitcoin Mania as the most recent fool's gold).

We've had 11 presidents since the last time the markets were as calm as they were in 2017. The S&P 500 only went up or down by more than 1% seven times in 2017; we've nearly quadrupled that number in the first quarter 2018 alone. This really doesn't highlight how volatile the markets are now but rather just how historically low the volatility was in 2017. There were actually investment instruments created to benefit from (and banking on) market volatility remaining low. When volatility inevitably presented itself, many of these investments lost 100% of their value. Another justification for avoiding the "Hot & New" investments being ever-presently peddled, and just sticking with the stocks and bonds that have forever made up the foundation of a well-structured investment portfolio. Markets are like cooking, if your grandma couldn't make it, it's probably not good for you.

One issue worth noting is the lack of support generated from bonds during this increased bout of volatility. Typically, bonds provide a nice buttress against stock market swoons. However, recent inflation fears and continued interest rate increases from the Federal Reserve have put a dent in bond returns. The broad bond index saw an approximately -2% return for the first quarter of 2018, which is indicative of the much narrower bandwidth of variations in potential returns compared to stock markets. Regardless, we never like seeing the conservative side of our portfolios lag during increased bouts of volatility. Luckily, higher interest rates eventually become a cure within themselves for bonds as the yields generated increase correspondingly. More importantly, interest rates have been too low for too long. The economy has been expanding for 8 years now while interest rates have only started to go up over the last year. Interest rates getting back to a more normal level is good for the economy. We still believe bonds stand at the center of any risk-mitigating strategy designed to avoid the sharp peaks and valleys of inevitable stock market movements.

Moving forward, we believe these moments of increased volatility provide opportunities to uncover value in the markets. This is the beauty behind the consistent and bi-weekly concept of investing in employer sponsored retirement plans. If the market drops by 10%, your next bi-weekly contribution buys you 10% more. While we were more cautious than most market prognosticators to start the year, our investment committee just doesn't see the market clouds turning torrentially dark at the moment. Speaking of clouds, back to that amazing phenomena of rain falling without a cloud in the sky: there actually was a cloud that generated the rain, but it had already passed by the time you felt it raining. Just another reminder not to respond too emotionally to market events, by the time you feel it, the clouds have already moved on. Most importantly, the core of any well-defined investment process - is to build portfolios that are all-weather in nature. No fire sales or knee jerk reactions based upon fear or greed, but rather a prudent course of action that has been systematically analyzed by your dedicated internal investment management team.

As always, thank you for your continued trust, confidence, and support in our investment process, long-term strategy and constant vigilance.