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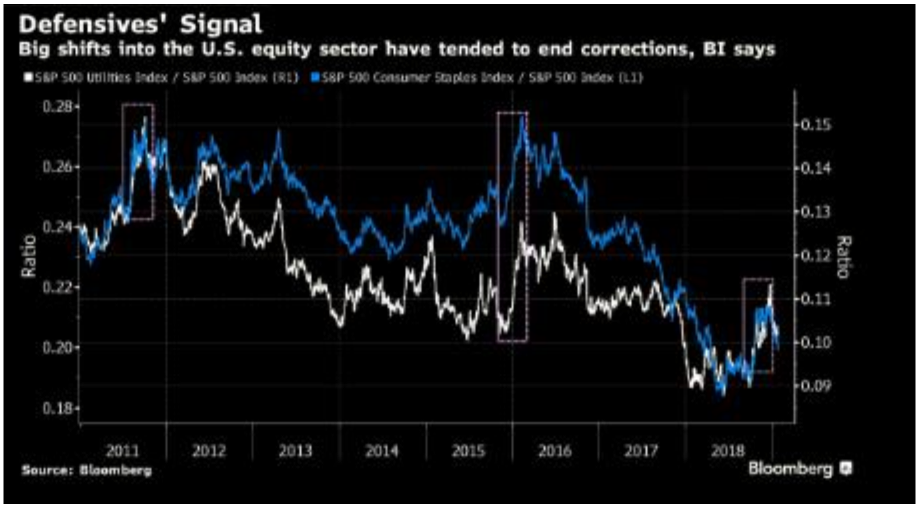
Investor Update

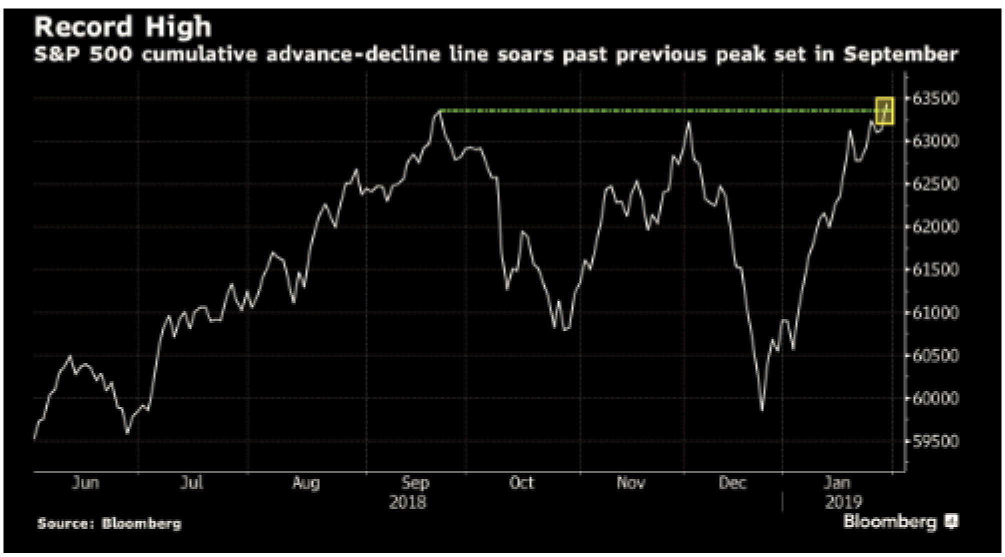
For as bad as December was, January saw the best start to a year since 1987. While 1987 ended up being a bad year, it was a very good year for stocks until October. The interesting thing with January is that economic numbers worsened and earnings expectations came down. This downturn did however put the Federal Reserve on pause as I eluded to in last month's letter. While the market is still well off the all-time highs in September, the last month has really separated the winners and losers from an individual stock perspective.

In our December webinar we discussed that positioning had a lot to do with the downturn and sentiment is a big part of that. Interestingly, when you look at the chart below, investor sentiment was far and away the worst on record. Sentiment was significantly worse than we even saw in 2008. This tells you that a lot of bad information was built into stock prices and that in order for prices to go lower than Dec 24th the news would have to get precipitously worse otherwise you would get a rebound. This is exactly what happened in January as stocks rebounded on bad news.

Additionally a lot of investors either raised cash or rotated to defensive shares in the downturn. As you can see by the chart below, this rotation has marked the bottom of a correction both in 2011 and 2016. More than I have ever seen in my career, the mean reversion of this risk on/risk off positioning from big institutions drives prices in the short term. I do not think this is a coincidence to the proliferation of passive investing and ETF's but I will leave that discussion for another day.



Lastly, if we look at the breadth of the market this “bear market rally” or “dead cat bounce” is much healthier than people will give it credit. In fact, we are hitting a new high for breadth even as the price has not caught up. This type of internal action is indicative of a correction that eventually leads to new highs as opposed to the beginning of a bear market. Interestingly, the last time breadth failed to reach a new high while the stock market was at highs was in 2007 just before the last bear market.



Going forward we continue to believe that we are late in the economic cycle and that volatility will persist on both the upside and the downside. With the Federal Reserve on hold the economic expansion can continue longer than we expected. We still need a trade deal to move the market to all-time highs and the back and forth negotiations can cause some choppiness and maybe even a re-test of the December lows. In any case, our view of a market bound by September highs and December lows remains in place. If you have any questions please contact me at 908-376-3041.

Sincerely,

Mark R. Painter, CFA