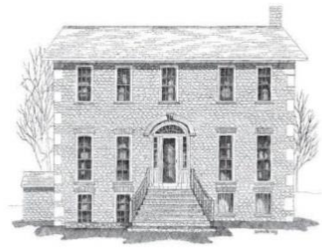

HAPPY NEW YEAR!
DECEMBER 30, 2017

A FRANK DISCUSSION OF RISK AND REWARD: WHERE DO WE GO FROM HERE?

This is the time of year most people take stock of their lives and make resolutions to address issues or concerns that weigh on their minds. As you flip the calendar to 2018 this week, I'd ask you to consider how you feel about your financial life and investments.

Although we give our all at The Horizon Group to provide our clients peace of mind, the truth is that your success is heavily dependent on financial markets we don't control. What we can control is the amount of risk to which your hard-earned money is subjected. Very little risk sounds great, until it's reflected in a statement showing very little return in the midst of a raging bull market. Conversely, adding more risk to generate stellar returns rarely feels like a great idea in hindsight from the depths of an unforeseen correction. So what is the answer?

In short, the answer is laying out a game plan that considers your need for income and safety balanced against your need for growth. It's what we do for each and every one of our clients when we develop their "bucket approach". A key element of this strategy is having regularly scheduled reviews where we monitor your spending, withdrawal rates, and adjust for life events. But the most critical aspect - by far - is that we correctly assess your attitude toward risk and reward. If done with a deft touch, the result is a plan you stick with when the going gets tough.

That is why I am asking everyone to consider where they are mentally for a moment. Over the past month, I have reviewed with clients that are on both ends of the spectrum and every point in between. One extreme is perplexed about the soaring market, scared to death it's going to crash and demanding to be made safer. The other extreme is wondering why we have any fixed income at all and is even mad we keep a minimal level of cash in accounts. Thank goodness the average client is somewhere in the middle – hoping it keeps going up but feeling a bit anxious about the future. As I've outlined in previous notes, making moves based on feelings is a recipe for disaster and rarely ends well. More importantly, I believe much of the unease people are feeling today is social and political in nature rather than economic.

I set out to find a period of time where investors faced similar feelings and circumstances. After speaking with several respected clients who were in their 30's at the time – as well as perusing the annals of history – I'd like to take you back to America in January of 1964. The country was prosperous by all accounts. We'd just come off the thriving decade of the 1950's and were immersed in a boom of new electronics – and the stock market reflected it – having risen another 17% in 1963. Most Americans enjoyed a standard of living that couldn't have been imagined when the war ended just 18 years earlier. But there was great anxiety about the future. Many people were asking themselves if the Kennedy assassination was an ominous sign of something rotten in the country. Race relations were simmering and most citizens felt the will of the people wasn't reflected by their political institutions. On the heels of the Cuban Missile Crisis, "enemies of society" were being locked up with little legal formality and the concept of innocent until proven guilty had little popular support. When *LOOK* magazine hit the newsstands that January, it displayed a centerfold of Norman Rockwell's painting, "The Problem We All Live With". That painting featured 6-year-old Ruby Bridges, in her white dress and holding a ruler, being escorted to school by Federal Marshalls. Our extremely divided country was wrestling with itself, much like it is now.

So how did that period of time play out for investors? Were the people who felt anxious about the future and took chips off the table rewarded? Not really. The market jumped another 14.6% in 1964 and rose 10.9% again in 1965. I'm in no way suggesting that's the most probable scenario you should expect over the coming years. The historical point I'm making is that political issues and social anxiety, although disconcerting, almost never warrant a change in strategy for long term investors. Thirty plus years of experience has led me to the conclusion that only a change in financial circumstance, income needs, tax situation, or health should trigger a change in strategy. Feelings, especially fear, greed, or anxiety, are impediments to successful investing.

In fairness, most clients aren't concerned about the markets from a political or social standpoint; rather, they are truly uneasy about the spectacular returns and are nervous about a correction they feel must be imminent. This is based on experience and common sense, especially since this market has plowed higher since March of 2009 with historically low volatility. Much of this can be explained by the Federal Reserve keeping interest rates artificially low to ensure the health of the financial system and American consumer post crisis. The vast majority of these gains are warranted and the percentage increase is not out of bounds – and most certainly does not preclude further meaningful gains from here.

For historical perspective, consider that in 1982 the S&P 500 index started the year at 122.55. Early in year 2000 it hit 1498 – a *twelvefold* gain in just 18 years! Even with all of our recent gains, this index has yet to even double from that same point 18 years ago. In fact, it would have to gain over 10% to just *double* in the same amount of time it went up over 1,200% in the previous period. Once again, I'm not saying this to predict massive returns from here. I'm simply pointing out that if you expand your holding period, recent gains pale in comparison to others we have experienced.

At this point it would be easy to infer I'm siding with those clients wishing to throw caution to the wind and plow everything into the market. This is not the case. I'm reminding you that you shouldn't act on feelings of nervousness, or that markets don't have to drop simply because they've seen impressive returns. Stock prices follow earnings – and earnings for many companies just got a shot in the arm from tax reform. Consumers are confident and flush with cash. Growth around the globe looks good. No indicators are flashing imminent recession. However, there are no sure bets in investing, and I always have a pile of concerns on my mind.

Here are the major market concerns shared by our Investment Policy Committee as we start the new year:

Passive Investing. Everyone from the financial press to regulators to product sponsors are enamored with the thought of low-cost index investing. This can be done through mutual funds or exchange traded funds (ETF's). Passive investing – computer assembled funds that mimic an index - now accounts for roughly 42% of all investment in the U.S. market. Vanguard founder Jack Bogle pioneered this movement, as his firm invented the index fund. The theory is that because a computer selects portfolios and trades them, they can do it at a fraction of the cost of active fund managers. Often the cost of active management puts fund managers at a performance disadvantage. Currently in our G7A model portfolios we mathematically mix 5 index funds (for cost) and 14 active ones (for concentration and risk reduction).

There's no doubt indexing is tremendously useful and cost effective – especially for small accounts. However, there is always a risk of *unintended consequences* when everyone adopts a strategy. Consider that in the first six months of 2017 nearly $500 million left active fund managers in favor of index funds, and that trend is gaining momentum. When that cash hit those computers in an index 500 fund, it spread that cash over 500 stocks according to their weighting in an index, without regard to whether they were a good stock or not. Fundamentally, indexing is propping up all stocks – and some don't deserve it! This has the potential to end badly and is a situation we are watching closely and discussing often.

This concern comes from personal experience. In October 1987 – five years into that 1,200% market run mentioned previously - I was just finishing my first year in the investment business. So many people were piling into the market for the first time "portfolio insurance" was invented. It was a way to computer trade stock index futures to limit downside losses. It worked well when few people were using the system. But on October 19th, also known as Black Monday, everybody headed for the door at once. The computers sold and sold and when the smoke cleared the market had dropped 22.61% in a single day! The strategy failed – along with limit orders and other protections investors had in place. I still have a fairly healthy skepticism of computer strategies and the market dislocations that can occur when everyone wants out at once. That most certainly includes this passive management craze we're currently experiencing. And don't get me started on Bitcoin – which I emphatically contend is speculation, not investment.

Interest Rates. The Federal Reserve raised interest rates three times in 2017. The reason bond markets stood their ground and acted well in the face of rising rates is that longer rates didn't rise accordingly. In fact, the 10-year treasury started the year at 2.43% and ended at 2.41%. We expect much the same this year – 2 or 3 interest rate hikes from the Fed, but this time with longer rates reacting by creeping higher. If the 10-year treasury climbs steadily up to the 3% level, that should be a benign event for both stock and bond markets again this year. However, the real risk with interest rates is if the economy starts overheating or shows dramatic signs of inflation. Although that might be a positive for corporate profits and stocks, it could force the Fed to aggressively raise rates which could in turn spike longer rates. A jump in the 10-year rate above 3.5% could mean trouble for bonds. Higher bond yields will also present a competitive return when compared to stock dividends at some point as well. Stocks typically fall when bonds become an attractive alternative. This is why we are concerned with interest rates - and intently monitor all inflation data for clues on the timing and severity of rate increases.

A "Black Swan" Event. Over the course of history there have been a number of market setbacks and crashes. Typically, a recession is the most likely cause of a market correction. We have many indicators to signal a recession and can act accordingly. On the other hand, events out of the clear blue that throw the market into a panic can happen at any time and are virtually impossible to predict. These "Black Swan" type events can be set in motion by computer malfunctions, political posturing, regulatory actions, wars, terrorism, natural disasters, and any other condition that can cause people to panic.

The purpose of this newsletter – aside from wishing you a healthy and prosperous New Year – is to have you think for a moment about your investments, your strategy, and the risks inherent to investing your hard earned money. Have you thought about the tradeoff between safety and return? Are you comfortable with your long-term strategy? I ask this not because I'm expecting a market drop, but because we've had a good run and it's always better to consider these issues from a position of strength. Although the market positives far outweigh the sum of my fears at this point, nobody knows what the future holds. Now would be a perfect time to revisit the lifeboat drills we do occasionally at client reviews. Are you prepared should the market hit an air pocket and drop 40%? Take a good look at every asset you own. Tally them in three columns: cash-bonds-fixed investments, market investments, and real estate. Take 40% off the market investments and add it up. Would you hold to our strategy? The answer should be yes.

Once you're comfortable with the "what if" scenarios, I'd encourage you to focus on enjoying every other aspect of your life and ignore the hysterical financial press and pundits. It will be perfectly natural in times of stress or uncertainty to feel like you should move investments around, or "do something"! The fact of the matter is that you've already done it. You've partnered with a firm that has assessed your needs and implemented a strategy that will work for you in every type of market. Behind the scenes a very knowledgeable and proactive Investment Policy Committee is researching trends, theories, and investments while continuously monitoring portfolios and market conditions for you. (They'll be sharing our 2018 outlook and strategy by conference call January 24th at 1 p.m.). On top of all that, we're meeting regularly to review your progress and focus on issues as they arise. You can rest assured the heavy lifting has been – and is continuously being - done.

It is an honor and privilege to serve as your trusted advisor. Your continued confidence means everything to the talented team here at The Horizon Group. They are here for your needs anywhere money touches life – and truly enjoy serving you. And I do as well. As I set out to visit the majority of the 101 clients that now live out-of-state over the coming months, I find it hard to believe 2018 will mark the 25th anniversary of the firm I started in June of 1993. Please mark your calendar now for Friday, September 14th to take part in our 25th anniversary celebration back in Letchworth State Park. I have a hunch it will be an epic party as we bring back some of our favorite events from years gone by! Happy New Year!

Mark

Past performance is not indicative of future results.
Securities offered through Securities Service Network, Inc., Member FINRA/SIPC
2018Fee Based advisor services offered through SSN Advisory, Inc., a registered investment advisor
Data sources include the Wall Street Journal, Bloomberg, FactSet, and Yahoo Finance historical data