MADISON PARK
CAPITAL ADVISORS

Weekly Market Update

September 3, 2019

When Execution Gets Fouled Up by Emotions

Before we dive into our normal commentary, please let us wish all of you students, parents, and teachers a wonderful return to school this week. We are incredibly grateful to each of you educators out there, especially the many that we get to call friends and clients. The work you do is so important, and we also know it is so hard. All the best as you embark on another year.

And now back to our regularly scheduled programming. It's not often we get to quote the great philosopher Mike Tyson (which we have on occasion), but today we do. He once famously said "Everyone has a plan until they get punched in the face." May I say metaphorically that investors have been punched in the face on more than one occasion? So what's the difference between pros and everyone else? When the pros get punched in the face, they regroup and reassess the situation, and then execute their modified plan based on new information (though, I'll add that I remain amazed anyone ever voluntarily regrouped after a Mike Tyson upper cut!). In few places is that more important than in the investment world. Trade wars, border security, slowing corporate profits, massive government spending and deficits – I could go on all day. I can certainly understand why someone would want to bail out of the market based on nothing more than the headlines over the last couple years. We, however, will integrate new information in our model and make adjustments based on the current reality. Sometimes that will mean that our decisions are temporarily uncomfortable if we let emotions rather than facts be the judge of them.

Let's start by looking at this past month, where the emotions and facts may tell differing stories. Below is the chart of the S&P 500 for July (left half) and August (right half). I'm sure you remember the big single day drops last month. I know I do. As it turns out, we had several 2%+ daily drops in the month of August. Emotionally, those declines are much worse and stick with us longer than the up days do. This is a perfect example why we call the daily moves 'noise.' Eventually those daily 'noise' fluctuations will start to affect the model, but notice that even though we had three daily drops of over 2%, the market finished down less than 2% for the month. If you didn't pay attention to the daily swings, the monthly market fluctuation isn't that far out of the norm and, in our opinion, is not enough to warrant dramatic moves in portfolio allocations, yet...

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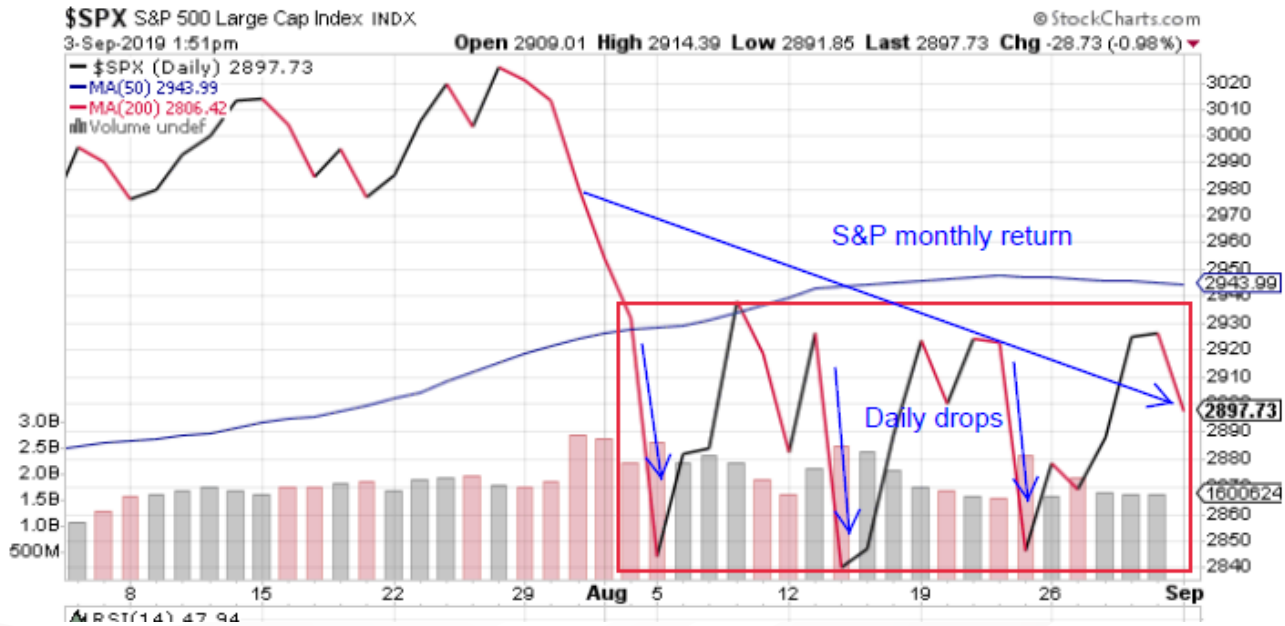
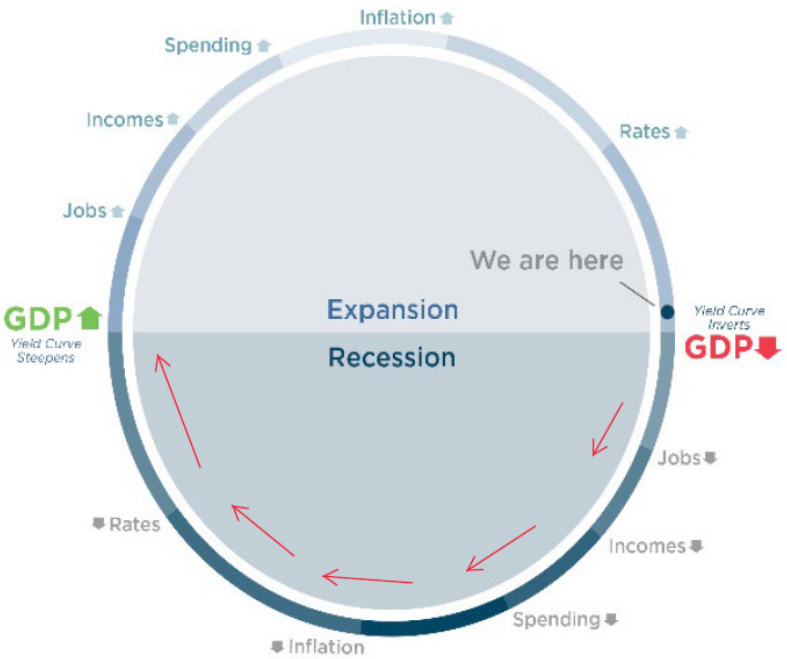


With this in mind, we go back to the facts, integrate new information, and implement. To put it in terms of flying: aviate, navigate, and communicate. Fly the plane (in aviation parlance, "keep the dirty side down"), make sure that the plane is going in the direction you want it to go (our financial planning), and lastly then communicate what is going on and what you need to do. In flying, many would think the pilot takes direction from Air Traffic Control (ATC), but it's not actually the case. Yes, if there is no conflict with ATC instructions, you follow the instructions, but if you can't do what they say, you inform them of that and ask for different instructions (new plan given updated information).

Before we continue, take a look at the chart to the right showing where **Nationwide Financial** thinks we are in the cycle and what is likely our next direction. The big question is, will the FED try to bail the economy out again, and if they do (which I expect), will it work?

So what is warranted at this juncture? A new plan, some fine tuning, or the status quo? Are we crying out to Air Traffic Control for help or are the skies clear? To help us decide, we continue to look at the economy and the markets as they are and not as we would like them to be. There are many positive signs (mostly in the U.S.) and there is also a building amount of negative data points that cause us concern. That being the case, we believe



the market has mostly priced in the current bad news and one of two things will happen. One is that we will get a resolution of trade negotiations and many of the other issues that plague the world economy. Two is that the bad news will continue to get worse and that will cause consumers to pullback their spending. This will trigger a self-fulfilling prophecy – less spending begets shrinking corporate profits causing stock prices to go down and as profits go down companies look to reduce costs. One way to reduce costs is to reduce employment, leaving consumers with less money. The upside resolution is emotionally preferred and may very well play out. However, at the end of a cycle, the normal cycle is likely to play out before too long. The question is more of a when than an if. With that in mind, we did some fine-tuning last Friday in your portfolios. No major shifts in the overall allocations, but instead some changes that we believe will make your portfolios more resilient as the many unknowns begin to gain clarity (or get murkier).

In our attempt to communicate as clearly as possible, this is not the run for the hills call, but that evidence is mounting to the downside. We will continue to be vigilant. Should it become necessary to make changes prior to our traditional month end, we of course will. We still remain ***cautiously optimistic***, but that optimism is very thin at this point. Be well and keep the dirty side down.

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