



THE RUDD COMPANY  
INVESTMENT MANAGEMENT AND CONSULTING

# The Rudd Commentary

## Market Oddity

From a total return point of view, 2018 has been underwhelming at best. While the S&P 500 index reported gains of 10.5% through 09/30/2018, the Russell 1000 Value index, which more closely resembles our current portfolio strategy, was up only 3.9% over the same period<sup>1</sup>. This large gap between these two indexes is historically uncommon and highlights one of the many unique data points we are evaluating as we manage our client's wealth. Interest rates too, have complicated things as investors with any significant

bond holdings are now experiencing performance drag on their portfolio returns in addition to the already disjointed returns on equity investments.

In this edition of TRC, I would like to give our investors insight into the current financial market environment, share some investor concerns we have received, and provide our outlook for the near-term.

## Floating in a most peculiar way

**The current economic environment is truly unique. There are two very interesting characteristics of this (late cycle) expansion that investors should make a point to understand, one because it explains the disjointed performance returns currently occurring in the U.S. stock markets and two, because it will impact the overall investment performance of most diversified investors in the near-term.**

First, on stock performance. As mentioned earlier, the S&P 500 index returned 10.5% for the nine months ended 09/30/2018 while the Russell 1000 Value returned 3.9% over the same period. While these two indexes are not exactly the same, there is meaningful overlap in holdings, and performance has historically been much closer due to the sheer quantity of stocks held in each index. Recently, however, stock market performance has become much more concentrated to very few names. In fact, the top 5 performing stocks in the S&P 500 Index were responsible for almost half of the total performance of the index<sup>1</sup>. However, opinions regarding traditional value vs. growth investing are similar to those regarding brand superiority in light pick-up trucks. While our firm has historically leaned towards more value-oriented companies, growth has its place in all but our most conservative portfolios.

The second factor affecting investment returns is the change in interest rates that is currently under way. After a roughly three decade-long fall in the price of money in the U.S., we believe the summer of 2016 marked the bottom and that higher rates are in the cards for some time. If this doesn't seem like a big deal, let's put this into just one narrow economic context. Since the recession of 2008, short-term interest rates have been virtually zero, with new car loans (to "credit worthy" borrowers) below 2% and longer-term loans such as mortgages averaging in the 3-4% range. After some reflection, this means that most consumers under the age of 35 have never experienced what most investors and consumers would consider to be "normal" rates. In our opinion this could have a material short-term impact on consumer spending on everything from homes to automobiles, and higher priced consumer purchases.

But, investment performance concentration and rising interest rates have been seen before and are very normal when considered over the long-term. Stock market and interest rate volatility present opportunities to the informed and patient investor. The key for our clients is sticking to a well-planned strategy despite temptations to chase concentrated returns. Even in the years immediately prior and following an investor's retirement (what we consider "The Retirement Red Zone"), a properly diversified portfolio has historically proven to be the most effective solution.

<sup>1</sup> Bloomberg



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## Ground control to Major Don

There are two concerns I believe could have a material impact on investment returns over the long-term. First, is a general concern over political instability across Federal & State governments. While many of our investors have referenced the soap opera quality events in the news recently, our concerns lie with the effectiveness of our elected leaders and their ability to work towards solutions while promoting trust in our system of representative government. Trust is not just a noble goal, it is a self-evident principle that minimizes waste and encourages freedom and innovation. It is essential for long lasting economic growth in a free system. The price of this political warfare may not be apparent now, however, it has the potential to jade an entire generation of entrepreneurs and innovators, which over time, could end up costing more than we can afford.

Second, is the growing level of total U.S. public debt outstanding. As our elected representatives focus on comments written in high school yearbooks, interest payments on our national debt are forecasted to triple over the next decade, eclipsing other expenses such as Defense and Medicaid<sup>2</sup>. With the possibility of increasing interest rates over the long-term, America's primary export may soon fit into an envelope.

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<sup>2</sup> Congressional Budget Office (CBO)

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## Stepping through the door

As we work through the data deluge in the close of the year, investors will likely find what each is looking for, positive or negative. Some of the positive points include strong GDP growth, growing earnings, and the historically tight labor market. These are all signs that America's free market system is incredibly resilient in the face of unprecedented economic policy and political wrangling. Of course, some will choose to anchor on recent stock market volatility, temporary performance drag created by rising interest rates, and just the general feeling that “it's just too high”. Like most things in life, how we choose to see the environment will affect our choices. At RuddCo, we choose to see opportunity in challenges and celebrate our free market. We believe risk is not something to be afraid of. Throughout our history, it is a key ingredient in what has made America truly exceptional.

**Invest Long and Prosper,**

*Josh Rudd*