Empowered Future Report

Short term thoughts about long term matters

November 8, 2018

Quote of the Day:

"Investing is about having everyone agree with you….later." **– Jim Grant**

Correction or Bear?

By the end of October, the Nasdaq Composite had already been in correction territory, down more than 12% from its high, but has since recovered about 5%. The other two major indices were in correction, a drop of at least 10%, too. Again, the terms "correction", "bear" and "bull" markets are not always useful regarding a specific portfolio. There is a quantitative element, but these terms are based on unmanaged indexes and measured from a previous high or low point. That said, volatility came back early this year and even more so over the last month. It's always difficult to know what catalyst will make investors become more aware of and change their appetite for risk. This time seems to be a combination of the Fed resolve to continue raising interest rates, tariffs/trade tensions, potential future wage inflation, political vitriol and geopolitical events. More fundamentally, the question is whether companies can continue on the path of record profitability that they've enjoyed in the low interest rate environment of the last decade.

Historically, corrections happen every couple of years and bear markets (20% or more drops) typically occur every 5-6 years. Since we've not had a correction in over seven years, it seemed we were overdue. But, of course, if these events happened like clockwork it would be a lot easier to navigate the investment landscape. Many are now asking the question, "is this the end of the bull market?" but no one really knows.

The US economy continues to show signs of underlying strength with GDP growth rates hovering between 3-4%, double the average growth of the previous nine years. And unemployment numbers, though I think skewed, are at historic lows. The corporate tax cut at the end of last year has clearly helped in the short term and there is also some regulatory relief, even if not accomplished in a lasting way or to the extent that I advocate. On the other side, we have escalating trade tensions with, in my view, extremely misguided tariffs – all tariffs, being a penalty on your own citizens, are a drag on economic growth. The other thing to keep in mind is that in the short to medium term, equity returns show little correlation to broad economic growth rates. This is because intelligent investors are always trying to look forward and anticipate where the economy is heading, not where it's been…or, "trying to skate to where the puck is going".

Most of our portfolios tilt to the defensive side right now as we've been concerned about valuations for some time. This obviously hurts our relative performance if the rest of the market stays bullish but we looked pretty smart over the last few weeks. Sometimes people mistake what we're doing as "timing the market" and in one sense, <u>everyone</u> does this: if you have assets, you put 'em someplace. No matter how passive your approach, you cannot invest in everything all the time – you simply must choose. Even if you "stay in cash", this is a choice, that is to say it's a specific choice of a specific asset class. Or, if you choose to have your nest egg diversified over many "financial" asset classes as opposed to owning hard assets like actual real estate or a small business or gold coins, these are choices. They may be well informed or not so well informed, conscious or not, but you are making both allocation and timing decisions.

The investment philosophy that we adhere to, value investing – or in other words, attempting to do fundamental analysis on business models and the actual price that one would pay for them as a business – has underperformed other approaches recently but these things tend to go in cycles and over long periods, value has been shown to….add value. We are remaining disciplined in evaluating fundamentals. We also put a fraction of each portfolio in hedging asset classes like gold/precious metals exposure, long-short funds, etc. While there is no guarantee that they'll work in every case, this typically gives us some insurance against downside markets and these efforts are functioning how they should in this time of volatility.

"Move Money" Forms Needing Updating

Regulations have changed regarding any custodian's use of "move money" authorizations and so TDAmeritrade is requiring new paperwork be signed. A "move money" form is a convenience we offer clients that, once signed and authorized, allows our clients to call the office and have funds either deposited or withdrawn/transferred between a bank account and their TDAmeritrade portfolio of like kind ownership registration. It's convenient since it doesn't require a new set of paperwork each time you want to transfer money, but the regulatory authorities view it as potentially riskier since you only need to call and that puts a greater burden of trust on the advisor and their staff. So, if you had this convenience set up before and like it/want it to continue, we do need to have you re-authorize it by signing a new form. We're typically doing this as clients come in for their periodic reviews but if you're concerned and want it set up before then, please contact our office.

Year End Planning, Tax Returns, etc.

The end of the year marks the time for holidays and planning for next year. Keep in mind that many decisions around your finances are influenced by tax planning and December 31 is often the deadline to take advantage of opportunities:

- Max out company retirement plan contributions
- Reduce taxable income.
- Review required minimum distributions.
- Do a Roth IRA conversion.
- Defer or accelerate business expenses.
- Prepare charitable donations and planned giving.
- Review health insurance and health savings account.

Also, many of the assumptions we make in your financial plans are based on tax impact so it's very important to get us copies of the most current tax returns. You can do this by bringing them to your reviews or, even better, uploading to your secure vault on your My Empowered Future planning website. If you extended your tax filing, then we likely don't have a copy and would appreciate you getting us these and other important planning documents. As we've discussed in earlier newsletters, the tax law change at the end of last year will impact most investors positively with lower rates. We've also talked about the fact that financial advisory fees are no longer deductible but that could be a net positive as many will use the much higher standard deduction rather than itemize but this is a case by case basis.

Class Action Lawsuits – What to Do

In our litigious society it is frequent that large corporations are sued, and shareholders have to decide how they want to respond, both as owners of stock but also potentially as members of a suit. Some of you may have received notices that you can join or reject being part of a class action lawsuit, specifically with Wells Fargo or Joy Global. You have the following choices:

1. To submit proof of claim becoming part of the class and possibly share in any settlement.

2. Exclude yourself, which means you do not share in this proposed settlement but reserves the right to pursue other legal claims.

3. Object and oppose the settlement but still be a part of the class.

4. Go to a hearing to voice your opinions on the issues.

5. Do nothing and not share in any settlement but still be bound by it.

More often than not, I believe these lawsuits are without merit and mostly benefit the attorneys on both sides. The settlements that are offered don't usually give a small shareholder any incentive to even fill out the paperwork and become part of the class action. While in this communication I'm not making any commentary about either of these organizations, the value of their stock or the validity of the lawsuits, I will say we had positive investment experiences with both stocks. Also, in looking at the documents I believe it would benefit some of our clients to go ahead and file a proof of claim. This obviously is a personal decision on your part - what might constitute "worth the effort" for some, might be considered a waste of time and effort by another. If you owned shares of either/both of these stocks and are eligible, we will communicate with you soon to give perspective on filing a claim.

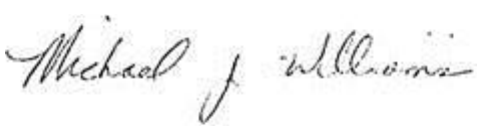
My Take on Midterm Elections

Financial advisors are supposed to avoid politics since there's a risk one could anger one of your clients. I generally take a different approach – since the world we live in and the markets we invest in are affected by politics, I believe our clients want to hear what I genuinely think, even if it differs from their current views. I didn't offer any general recommendations on how or for whom to vote ahead of time…..but I'm never am shy about answering questions or giving my opinions.

Now that the midterms are over, thankfully for most of us, I do want to say that I believe there's a sort of unhealthy co-dependency on the part of politicians and the media right now that feeds the polarization going on. I personally have minority views, often differing from both parties, but I know many of the issues we face today are nuanced and I'm convinced if more people were clear on the proper role of government and our unique founding, we'd actually agree quite often on the solutions. I also feel strongly that we need more - not less - frank and open, yet hopefully civil, conversations. It's tragic if people can't talk to friends, family and co-workers and honestly say what they think without being vilified. It is no time for cheap shots or straw men and it's also no time for political correctness and worrying about hurt feelings.

On how the midterm results will affect the markets, many of you've heard me say that divided government is often better for the economy than one party control, but I believe we'll likely continue to have avoidance of the major issues – deficit spending, out of control entitlements and the long-term problems associated with too much debt. This makes the recovery we are experiencing less robust than it could be. On the Federal level, hopefully we'll see more tempering of the trade war/tariffs but I'm not betting on it. We'll likely see more talk and probably some action on "infrastructure spending" since both parties do seem to agree about the need in this area. In Colorado, I think it's interesting that voters diverged on most ballot issues (mostly rejecting a larger intrusive role of the state) and who they actually voted for, but we'll have to see how they govern. In any case, we'll continue monitoring not just the rhetoric but the actual policies and, of course, how the Federal Reserve responds to economic data.

Lastly, I'd like to remind everyone to celebrate tomorrow, November 9 – on this day in 1989, the German Democratic Republic announced that all citizens of East Germany were free to cross the borders into West Germany and thus began the fall of that wall. Socialism and collectivism had been defeated while individualism and freedom were rightly being celebrated with fireworks and glee.



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