July 2017

The Capstone Quarterly

Summer is officially here. We hope you are enjoying quality time with your friends and family. In this newsletter Bryce gives an update on the current state of the markets, Casey shares an inspiring story about women who fought in the American Revolution, and Jon takes a look at the importance of not overreacting to headline events when it comes to your finances.

Bryce's Point of View

-By Bryce Pease, CFP®, Chief Investment Officer

As of the beginning of June 2017, many asset classes and sectors had positive to strong performance over the trailing 12 months. Not everything was up, for example, gold, long term treasuries, commodoties and oil were all down, (with oil being down significantly). But a lot of asset classes did well, especially stocks, with technology stocks, emerging markets, and small US company stocks leading the pack in the 12 months ending in June 8, 2017. (1)

One reason we mention the last 12 months of returns is because we think this timeframe captures a significant period of time in the markets, economy and world. Over the last year, we've gone through one of the most fiercely fought presidential elections with one of the most unpredictable outcomes we have seen in a long time. In the last 12 months, the Federal Reserve has maintained their course of raising interest rates, reversing an unprecedented course of low rates and quantitative easing. And don't forget the Brexit vote in June of 2016 that shocked the world and the financial markets. It's been an interesting 12 months to say the least.

There is a phrase we often say around the office—"the markets don't like uncertainty." Well, we've had plenty of uncertainty over the last year, but you would never know by the positive returns in many sectors and asset classes.

As of the writing of this newsletter the final week of the quarter, the global equity markets are experiencing some volatility, so while it's possible we could be seeing the beginning of a shift in direction for this trend for the markets, we believe there is still a case to be made for positive returns in the US stock markets, which could also bode well for other investment classes to the extent other asset classes follow suit and continue to ride the wave up.

So far this year, the U.S stock market as measured by the S&P 500 has risen in price signficantly higher than it usually does the first 6 months of the year.(2) While it might be easy to assume that the stock market has gotten a little ahead of itself and is due for a pullback, history suggests otherwise. In looking at market returns since 1946, we see that when the market has had a strong performance the first half of the year, there is historically a strong likelihood it will have a strong second half of the year. There is of course no guarantee the marekts will continue up, but historically we think the case can at least be made that a strong first half of the year could serve as tail winds for a strong second half. So, if history is any guide, we might be seeing pullbacks in the stock market as buying opportunities.

Whatever the future performance of the markets, we will be following our strategy of monitoring our individual investments for downside weakness while looking to participate with investments and sectors that appear to be leading the charge.

Speaking of investments that have been doing well, there is one area in the investment world we are beginning to wonder whether or not strong past returns are creating a possible bubble—and that is the real estate market. While, it's been nice to see real estate stage such a recovery since bottoming out in the financial crisis we are beginning to wonder if there might be another bubble in real estate developing on an international level.

One metric we think is worth paying attention to when it comes to real estate is the median home price-to-median income multiple. This multiple is the number times their income (for example "three times" their income) a buyer pays for real estate. In a normal environment we think it seems reasonable to pay 3 to 4 times your income, maybe a little higher. While there are still quite a few places in the U.S. that fall within an affordable range, there are places in the US it appears to be getting a little bubbly. Honolulu, Los Angeles and San Francisco have a median price-to-median income of around 10 times. That means buyers are paying 10 times their income for homes in these areas. We are not sure how sustainable that is.

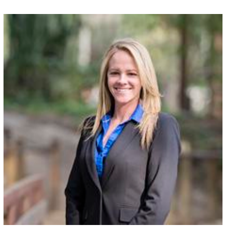
But what really concerns us is what's happening on an international level. Places like Beijing, and Shanghai have a a median price-to-median income level of around 15 times. In Sydney and Vancouver, buyers are paying 12-13 times their income. (3)

Could we be heading into another bubble? We are not trying to predict the future here, we just are pointing out some metrics that are starting to look a little concerning. While places like Beijing and Shanghai are wonderful places to visit, we are not so sure their economy is as stable as our economy. And in our opinion, the global boom in real estate is part of what helped bail out real estate in the US with foreign buyers coming into places like Los Angeles and San Francisco. What could happen when that foreign demand dries up, even for a short period of time?

It seems to us it is easier to spot a bubble than it is to predict what will happen when the bubble pops. So we are not trying to predict the future here, we are just saying this may not be the kind of rising trend you want to go overboard participating in, especially with borrowed money in the form of mortgages and refinancing. Better buying opportunities may be ahead of us than what we are currently seeing in real estate.

Casey's Corner

-By Casey Morris, CFP®



As children, we all learned about the Founding Fathers—those men who either fought for American independence or worked in some other way to achieve it. We learned about names like George Washington, John Adams, Benjamin Franklin, and Thomas Jefferson. As we grew older, their names and stories stayed with us, and it's to them our minds often turn on Independence Day. This got me thinking: what about the women of the American Revolution? Surely there were women who fought and labored for independence. What about the Founding Mothers? Researching this question led me to find an interesting story. So to celebrate Independence Day, I thought it would be fun to look one woman who championed freedom and liberty in her own special way.

It’s easy to think of American independence as being inevitable. But for the people who actually lived through the Revolution, it was anything but. In fact, the decision whether to join one side or the other was a difficult one. Both patriots (those who favored independence) and loyalists (those who remained loyal to England) probably had good reasons for choosing how they did.

It wasn’t uncommon at the time for women to follow their husbands into battle. Margaret Corbin didn’t just urge her husband to fight in the American Revolution … she joined him. These women were rarely allowed to fight, but they did perform needed tasks like cooking, washing, and tending to the wounded. But on November 16, 1776, Margaret did even more. She and her husband were stationed at Fort Washington in Manhattan. John’s assignment was to fire one of the two available cannons, but when a German mercenary took his life, Margaret knew what she had to do. Despite seeing her husband die, Margaret took his place in an exposed position with only the cannon itself to protect her. Soon a bullet struck her arm … but she kept firing. Next, she took a bullet to the chest … but kept firing. Even a shot to her jaw couldn’t stop her from manning her husband’s post. Margaret never completely recovered from her wounds, but the government took notice of her heroism. In 1779, she became the first woman in United States history to receive a military pension.

American freedom was bought and paid for through the bravery, commitment, and sacrifice of both men and women. This Independence Day, let’s do our best to remember both the men and women who shaped our nation’s history, and also those continuing to serve our great country. On behalf of all of us here at Capstone Pacific, have a happy Independence Day!

The Planning Perspective

-By Jon Teran, CFP®

As Bryce mentioned above, there have been a lot of interesting events and news headlines that have happened over the last year. It seems each time there is a big unexpected news headline that comes out, markets and investors have knee jerk reactions. Rememeber how the US stock markets initially responded to the US presidential elections? When it started to appear Donald Trump was going to be next president of the United States, the stock market plummeted. But if you blinked you might have missed it, because not long after plummeting, the stock markets went on to set new highs in the coming months.

This isn’t a political comment, I’m just pointing out how investors and markets seeem to often have knee jerk reactions to news headlines. While it’s important to keep up on the news and to take into consideration the current direction of the global markets, it’s also important to balance your response to the news, especially when it comes to investing.

Investing guru, Charles Ellis once made an observation about the daily fluctuations in stock prices that offers some perpective on news versus noise. Ellis pointed out that, “The typical stock price changes by at least 4% between its high and low each day. Since there are roughly 250 trading days per year, that implies a total change of price of 1,000% per year. But the price of most stocks actually changes less than 15% per year on average, which means that more than 98% of all movement is just flutter, or noise.” (4)

While it is impossible to tune out all the noise, especially in today's world of social media and round the clock news coverage, we think investors are usually better off focusing on behaviors that could lead to long term financial success rather than panicking over every price drop or news headline that comes out.

Reviwing your budget, your estate plans, your charitable giving, insurance coverage periodically—these are all things that are worth your attention at some point and could help mitigate the impact of the barage of constant news. And if you haven't already, there is one thing we really think is worthy devoting some attention to and that is to automate your investing and savings.

Charles Rotblut, the editor of the *American Association of Individual Invesotrs Journal*, recenty wrote, "One thing I've found incredibly useful is automatic deposit…Given the very small amount of time it took to set them up and the very big impact on future wealth, I consider setting up automatic deposits to be among the smartest financial moves I've ever made."(5)

The next time you are tempted to panic due to news headlines or a sudden drop in prices in the financial markets, maybe turn your attention toward something that could have a long term positive impact on your financial situation, such as automating your investing and savings. It takes a little time and effort, but can be well worth it. And for the accounts you have with Capstone Pacific, we would be more than happy to assist you in setting up automatic deposits. Give us a call or shoot us an email and we'll help you get the process started.

Did You Know?

We are available for remote meetings online. If your schedule is prohibiting you from getting in, or if you are out of the area, we can meet with you online and go over your accounts and/or financial plans.

Finally…

Capstone Pacific is now in the business of providing financial education. If you know of, or are part of a federal agency, company or other group such as non-profits, we can provide financial education for a fee educating employees or group members on their retirement plans and the basics of financial planning. Please contact us if you, or someone you know, has interest in our service of financial education for groups.

Thank you again for your business, we look forward to our next meeting our conversation with you.

Sincerely,

The Team at Capstone Pacific

P.S. If you ever run across anyone who could use our services, we always appreciate it when you pass on our name.

(1) *High RS Newsletter June 2017,* Nasdaq MarketInsite.
(2) "The Risk of Rising Returns", Sam Stovall, *Sam Stovall's Sector Watch: Standard and Poor's Equity Research*, June 27, 2017.
(3) "Real Estate Bubble 2.0: $250 Million is the New Hurdle for Billionaires", Harry Dent, *The Leading Edge*, June 22, 2017.
(4) "Use the News and Tune Out the Noise", Jason Zweig, Money Magazine, July 1998.
(5) "Editor's Note", Charles Rotblut, *AAII Journal*, May 2017