Stirling Bridge
Wealth Partners, LLC

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When Bad Ain't Bad

With each of our rapidly passing years, we become more convinced that one's relative happiness or sadness in life owes much to expectations. For example, when well-meaning friends gush with overflowing glee about a film that we simply must see, our expectations tend to rise. Invariably, the film, once seen, turns out to be quite good. However, given our inflated expectations, we're often left feeling flat. The opposite is equally true. Boot up a movie with absolutely no expectation or preconceived notion, and even a run-of-the-mill romantic comedy may feel inspired.

Expectations for earnings can do an adequate job at partially explaining market movements. With nearly 100% of companies having reported their 1Q 2016 numbers, it is safe to say that earnings declined about 7% year-over-year. To a casual reader, this may sound particularly awful. However, our learned clients and friends know there's more to the story. The expected decline was actually closer to 9%. So when the results were tallied, investors felt a sense of relief.

Going forward, expectations are for a second half recovery in earnings, which is why coming into the second quarter stock prices firmed. China's growth has stabilized, oil prices have bounced to a more sustainably profitable level for energy companies, and U.S. economic data remains steady. With earnings expectations now inching upwards, stock prices have support. The increase only becomes counterproductive when analysts begin seeing only roses in a garden that actually contains both flowers and weeds.

Before we turn to a couple events that are expected to occur this summer, we feel it our duty to discuss bonds and allocation. We have recently seen articles explaining how savers are required to hold less in bonds (i.e. more in risky assets like stocks) in order to achieve a favorable return. As with some arguments, there is an element of truth to this proposition, however, such thinking is likely to lead investors down a path they'd rather not travel.

Interest rates are very low. Yes. An investor could have held 100% bonds in the mid-90's and earned over 7% annually. Today, that number is closer to 4%. But – and we are quite adamant in this – bonds should not be abandoned. Stocks, as a method of income and portfolio stability, are not a suitable replacements for bonds.

First, bonds by their nature provide security in times of trouble. Just because we've experienced a string of years with little market heartburn, does not mean such days are over – as anyone older than eight can tell you. Investors have need for their money, be it income or principal, and bonds are the best way to preserve both. Stocks are simply too volatile to be considered in this light.

Second, inflation and inflation expectations are much lower today than twenty years ago. And, while we would argue interest rates set by the Federal Reserve could afford to be a bit higher, there is no reason to think that an investor requires the same return to keep up with inflation today as he did in 1996.

Our point is that all investors have liabilities of some kind (electric, grocery, vacation, or mortgage bills). It is a rare situation indeed when someone is so well-off that he can accept the risk/volatility inherent in an all-stock portfolio. Bonds are still important!

Whew! Fear not, we've put away the soap box – not in the trash, for we are confident that one day it will again prove useful.

In June or July the Federal Reserve might take another tiny step toward interest rate normalization. The market might react in silly ways surrounding the announcement, but we expect no real damage from such a small hike while rates remain so low. Also in June, Britain votes to remain in or exit the European Union. There are good arguments on both sides, we think. It seems to be a common belief that if Britain leaves, terrible things may happen. Perhaps Britain will not grow as fast as it otherwise would, but the rest of the world is already prepared and will move accordingly. American companies with London operations actually do most of their business on the continent. We see zero long term global effect.

Stirling Bridge Wealth Partners, LLC remains committed to providing customized investment solutions and robust financial planning wrapped in an exceptional service package for our high net worth clients throughout the country. We thank each of you for your dedication to us, for your trust, and for the referrals you've sent our way.

Sincerely
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