4th Quarter, 2017

TRIVETT WEALTH MANAGEMENT

> ***"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."*** **Peter Lynch**

It was Christmas morning. I watched intensely with great interest as my almost 2-year-old eagerly ripped into present after present so fast he was unable to enjoy each gift for anticipation of the next. It was like the stream of gifts wouldn't end. Even now in early January he still says, "open pwesents?" He still wants the party to continue. So, what does a toddler and the adult investor have in common? Turns out, a lot. Investors are notorious for jumping onto their own hedonic treadmill, all the while ripping open statement after statement and expecting their money to go up month after month. We become conditioned to expect our quarterly statement to arrive chock-full of presents. But I suppose it's hard not to expect it when the Dow Jones breaks its own record 70 times in a year. After all, you haven't lost money since 2008, so how could that ever change?! Well it can change, and it can happen fast. As 2018 commences let's all remember that the endless gifts will inevitably become not so endless, albeit temporarily.

In my last newsletter I referred to "regression to the mean" as being very real. I attempted to prepare you for the reality that the equity markets will, at some point, cease to generate 15-20% year after year. Well, Q4 showed no signs of slowing. And as I also said in my last newsletter, I make no prediction as to when the reversion will occur.

2017 IN REVIEW

BY THE NUMBERS

Here are the flagship figures: The US stock market as measured by the S&P 500 finished 2017 up 21.8%. Foreign stocks wrapped up the year at 25.6%. US Bonds closed the year up 3.5%. In case you're curious, the worst performing US equity sectors were telecommunication (down 1.3%) and energy (down 1.0%). Inflation as of Nov 30 was holding at 1.7% while unemployment was 4.1%. And as of this writing GDP was 3.2%. I consider these markers very encouraging.

A Year of global growth

2017 was most noteworthy to me in that for the first time in this century, all the major economic basins of the world were growing simultaneously, although at different rates. Before this, at different times, Europe or Japan or the emerging markets dealt with significant headwinds, and growth here at home was plodding and sluggish. It was quite fun for me to watch everything go up. Until now, it's something I haven't witnessed as an investment professional.

The US accelerates – and feels better about it

Steady and unspectacular, hiring has driven the unemployment rate down to 4.1% for two months as of this writing, putting the economy on track for a potential third straight quarter of 3% growth – a breakout of sorts. The consumer, by all important measures, is feeling better about things since the 2008 recession, and retail sales are robust. Household net worth in the fourth quarter looks to have reached $100 trillion, and consumer balance sheets continue to be healthy. Business investment seems to be accelerating with the passage of tax reform (which I plan to discuss at length).

Tax Reform

I'd like to spend a chunk of time on the new tax bill. Of everything that happened in 2017, I believe it carries the greatest long-term effect. Unlike a positive earnings report or a stimulus package, which are acute in nature and pass with time, the tax bill's impact will be felt permanently – well, I should say as long as Congress sees fit. When companies go from paying 35% to 21%, this is nothing short of a windfall.

I freely admit that I could be wrong. But I believe the corporate tax cuts will prove to be the single most significant economic policy since the 1980s. Why do I think this? It's simple. More money in a company's pocket equals potentially greater profits. There are a couple ways that corporations can use the windfall. ***Reinvestment*** – which includes R&D, additional hiring, etc. – or ***dividends and/or stock buybacks***. Both bode well for shareholders. Let's not forget, that long term, the stock market is in its simplest form a reflection of corporate profits. That's it. At its core it is agnostically greedy and can't help itself. You give it money, and it wants to use it to make even more. It is an emotionless machine that runs on dollars, not your or anyone's feelings. Yes, public sentiment will affect markets in shorter spurts, but ultimately stock prices gravitate to their intrinsic value. This new tax bill simply pumps more dollars into US companies' gas tanks. And they can't fight against their nature.

Another positive outcome of the Tax Bill is that some companies will increase wages for existing employees. As I'm writing this, Walmart announced they will increase their base wage to $11/hour along with small bonuses. Other large companies have indicated they will follow suit. A large-scale wage increase is good for markets because more money gets injected into the economy, by virtue of middle-class wage increases.

WHAT DOES 2018 LOOK LIKE?

What I will attempt to do in the following sections is to identify what I see as various factors that may cause concern for the investment landscape.

Stretched Valuations

If I had to name the biggest headwind I see for the US equity market heading into 2018, it would have to be stretched valuations. This isn't to say valuations are astronomically high; just high (The Shiller P/E closed 2017 around 30). A company's valuation is simply what analysts thinks it's worth. Is it overvalued or undervalued? If Starbucks were to raise the price of coffee to $10 a cup, I would consider this overvalued, and therefore predict coffee drinkers would no longer 'buy' the overpriced coffee. You get the idea. Currently the price that the public is paying for stocks is on the high end. Most corrections occur when valuations are above historical averages. Hence, the concern. I would like to add that when compared other interest-rate sensitive asset classes, US equities don't look awful. Plus, some say the liquidity environment still seems accommodative for stocks.

Inflation/Rising Interest Rates

Inflation and rising interest rates also bear watching. The Fed has been very clear on its intention to continue the gradual rising of the Federal Funds Rate. Most experts agree (and so do I) this is a necessary and healthy measure. But if inflation gains steam the Fed may react by hiking rates faster than anticipated, therefore hurting long term bondholders. Aside from my "always diversify" conviction, I continue to believe one should avoid a portfolio too concentrated in high-yield/long term bonds because of inherent interest rate risk.

FINAL THOUGHTS

I mentioned in my last newsletter that this bull market is the least appreciated I've seen in my 16-year career. This seems to continue. Rob Lovelace of Capital Group (AKA: American Funds) describes it "*the most hated bull market that I've seen in my career, just because all the way along, everyone wanted it to end.*" It's good to know that people much smarter than I share sentiments. I also see this underappreciation as a good thing. As long as people remain pessimistic and upset that they've "missed the market" it's unlikely we will reach the greed phase.

The last 12 months spoiled us in terms of stock price capitulation. It would not be surprising to see an increase in volatility in 2018. The VIX decreased nearly 17% over all of 2017 (The VIX measures how much stock prices fluctuate). It seems probable that this will not continue. Let me emphasize something here: volatility is not necessarily bad. It just means that in the short term there are higher highs, and lower lows. So please don't think of volatility as a headwind. In fact, it can be highly useful for the dollar-cost-averager.

An indiscriminate DIY investor could have found any number of ways to generate solid returns in 2017. As I mentioned earlier, the market rise spread across the globe as nearly all of the 47 stock markets comprising the MSCI ACWI posted gains. But now with higher valuations present, one would be wise to exercise greater discrimination.

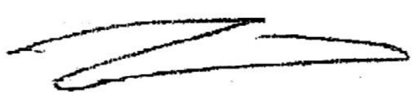
You might be thinking that I am sounding some sort of alarm on how high stocks have risen. I am not. Or maybe I'm telling you that things will continue to soar? You are wrong. There is no hidden message in my commentary; just observation. And to the extent that you, my client, are willing to listen I will refer you to the opening quote by Mr. Lynch. And I will continue to scream as loud as possible "don't try to time the market!" Rebalance? Sure. <u>But please, no bets</u>.

ON A PERSONAL NOTE

I can say without doubt that 2017 will go down as one of the top 5 most memorable years in my life. I'm not referring to the historic run-up in stock prices we've just discussed. I'm talking about venturing out to open Trivett Wealth Management. It was without doubt the most stressful time of my adult life, but quickly turned into the most rewarding. Not knowing if you guys, my clients, would choose to continue our relationship kept me up at night (poor Shawna - my wife - probably felt more like a therapist during those long months instead of a spouse, and I'm sure she's beyond happy to return to her role as stay-at-home mom). But my fears were completely unfounded as I was overwhelmed by your loyalty. I've always heard that in business people trust people, not brands. But now I know that to be true. You demonstrated that you see me as your trusted advisor and words can't express my appreciation. The only way I know how to reciprocate is to continue providing authentic guidance and to tell you the truth about how I see your financial condition. So, as I close 2017, one of the things I'm very thankful for is you, my client.

I pray that your 2018 is full of blessings!!

Sincerely,



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