Stirling Bridge
Wealth Partners, LLC

MARKET COMMENTARY – AUGUST 1, 2018

Arnold Horshack and 2Q Earnings

Compared to the dizzying options offered for entertainment today, the choices made available in the 1970s were downright scarce. Yet, it is with some fondness that we peer back at the wisecracking *Sweathogs* in Mr. Kotter's remedial class of misfits. Truth be told, we were simply too young and conforming to understand any universal truths plumbed during the sitcom's run. However, as a shrimp-ish child who was eager to please, we were able to immediately identify with the enthusiastic Horshack.

Whether from the back row or front-and-center, when Mr. Kotter asked his class a question, Arnold's arm would extend to the point of dislocation. Then, especially for one so small, hoarse, guttural *Oooh, Oooh, Oooh's* would erupt. *Mr. Kotter! Mr. Kotter! Pick me! Pick me!* Among his tougher compatriots were Vinnie Barbarino and Freddy 'Boom Boom' Washington. They commanded attention more naturally, while Horshack felt compelled to literally shout to be heard.

We are struck by the similarities between Arnold Horshack and the reporting season for 2Q earnings. It is as if corporate managements must resort to Horshackian methods. For, no one in the marketplace seems to notice just how astounding reported results have been. The broad market has yet to reach January highs.

As of this writing, roughly 60% of S&P 500 companies have reported earnings. 72% of them have beaten sales expectations. Even more have beaten on very demanding bottom-line estimates. Operating margins continue to break out higher into record territory. Stock buybacks continue. Dividends increase.

Foul! you cry. Our readers are astute investors. The market, you understand, is a forward-looking, future-cash-flow-discounting mechanism. It is only tangentially interested in what has already happened. You might conclude that we are not telling you the entire story. We must be leaving out the bad news about how managements and analysts are beginning to tamp down expectations for the future.

Let us begin with analysts. If analysts on the whole are doubtful about prospects, then they have forgotten how to convey such information. The stark black and white spreadsheet staring us in the face at this moment demonstrates that the large pack of Wall Street analysts believes earnings will be 18% higher one year hence.

1246 County Road Q, McClure, OH 43534 P: 419-832-1111
www.stirlingbridgewealthpartners.com F: 419-932-1211

Stirling Bridge
Wealth Partners, LLC

You might claim that those analysts are just plain wrong.

Of course they are. Analysts are widely known to be at one time overly optimistic and another exceedingly pessimistic. For argument sake, let us assume that earnings grow *only* 10% from here over the coming twelve months. Such a scenario means that the forward earnings multiple is a reasonable 18 at today's prices.

But what about the men and women closest to the situation – company managements? Business optimism in the US is at its highest level since the 1980s. And guidance for the coming third quarter earnings to be released in October, is running a little ahead of the previous average with technology and real estate bumping up projections on the whole.

Earnings are solid. Interest rates are low (but rising). Unemployment is low. Taxes are low. The S&P 500 has reason to scream upward. Yet it remains range-bound.

Part of the difficulty is that January 2018 was beyond exceptional as far as returns in the market go. The market ran ahead of even rosy projections. So the price action we've experienced since then can't help but underwhelm participants. We also have had the growing specter of a tariff or trade war. Our commentary last month touched on this topic. New information from companies show that 61% have seen no impact from increasing trade friction. Twenty-seven percent have seen a modest negative effect.

In summary, we remain optimistic about near term prospects. Yet, we caution investors to avoid becoming too complacent with taking on additional risk. We don't expect a bear market to come this year. But when the grizzly does eventually return from hibernation, his bite will be just as bad as it has been in the past. In the meantime, we advise investors to take note of the Horshack market. Otherwise, we may be forced to go even deeper into the entertainment archives and discover the parallels between today's stock market and Rodney Dangerfield…

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely

Jason Born, CFA
President

1246 County Road Q, McClure, OH 43534 P: 419-832-1111
www.stirlingbridgewealthpartners.com F: 419-932-1211