TRIVETT WEALTH MANAGEMENT

> *"In the short run the market is a voting machine, but in the long run it is a weighing machine."* -Benjamin Graham (1894-1976)

The first half of 2019 has, in my mind, conjured two very distinct observations. First, the market has quite clearly returned to its natural manic-depressive state of volatility. And second, you guys (my clients) have behaved swimmingly in that you refrained from getting too excited on the up and/or too fearful on the down. And this makes me proud. Of my 200+ investment clients, I can't recall a single *please don't jump* conversation following December's bacchanal of panic selling or May's 7% pullback. This means folks stayed invested and didn't fall prey to the false security of going to cash. I'd like to think it's because of good financial coaching, but I'm sure it's also due, at least in part, to a healthy long-term perspective and overall calm temperament—a disposition which I've increasingly sought out in folks with whom we onboard as clients.

In any case, well done, guys. As has typically been the case, you were rewarded, once again, for your patience and long-term focus—this time to the tune of a cumulative 18.5% surge in the S&P 500 from January 1-June 31.

By the Numbers

So, here is where we find ourselves at the 2019 midway point: The flagship S&P 500 is up 18.5% on the year. Foreign stocks have risen 14.5%. Emerging Markets (those of "developing nations") are up 10.8%. Bonds too have risen year-to-date. US Bonds are up 6.1%, while Global Bonds and Municipals are up 5.6% and 5.1% respectively.

The best performing sectors within the S&P 500 are Information Technology (27.1%) and Consumer Discretionary (21.8%). Even the worst-performing sectors have been positive. They are Health Care (8.1%) and Energy (13.1%).

Changes to Certain Advisory Accounts

In early June, I felt it prudent to slightly amend the fixed income portion for some advisory accounts due to the stabilization of interest rates. In Q1, Jerome Powell and the Federal Open Market Committee made it clear that they are uninterested in aggressively raising rates. And now it looks as though we may even see rate cutting. If this holds, it would appear there is some yield to take advantage of as interest rate risk will likely decline.

Essentially, the change resulted in a very small shift from short-duration bonds back to intermediate-term bonds.

Again, this only affected a portion of advisory clients (and did not affect commission-based accounts at all, nor did it impact non-qualified advisory accounts). It ultimately removed the small tactical tilt that I adopted earlier in 2018—which frankly felt good to reverse, as I'm much more of a strategic allocator than a tactical one at heart.

Concerns

Tariffs continue to hold the #1 spot in this category, at least for me. It appeared that the Administration was on track to reach an agreement with Chinese officials. But talks devolved at the eleventh hour, resulting in additional import tariffs. As of this writing, the issue seems to be moving in a more pessimistic direction. However, I remain optimistic in the long term. It's in both nations' interest to reach an agreement. And let's not forget that China has more to lose than the United States if some sort of resolution is not attained. Observe the following excerpt from Brian Westbury:

> ***"Either way, if tariffs nick our economy, China's gets hammered. Last year we exported $180 billion in goods and services to China, which is 0.9% of our GDP. Meanwhile, China exported $559 billion to the US, which is 4.6% of their economy. We have enormous economic leverage that they simply can't match. An extended US-China trade battle means US companies will shift supply chains out of China and toward places like Singapore, Vietnam, Mexico, or 'Made in the USA.' If that happens, the Chinese economy is hurt for decades."***
>
> **-Brian Wesbury, Advisory Council for Federal Reserve Bank of Chicago**

It also bears mentioning that there have been minor trade disputes with Mexico and Canada. It appears that as far as Mexico and Canada are concerned, these will wind up being temporary skirmishes which will likely peter out and have no lasting impact. But the larger point is that it seems the President's rationale for imposing economic tariffs for non-economic reasons is broadening, which I consider somewhat bothersome.

We should also keep in mind that as far as these trade wars go, the US does tend to walk away less scathed than other countries since our exports account for a far less percentage of GDC as compared to other countries (see Mr. Westbury's commentary above). Plus, even if we increase tariffs on $200 billion of Chinese exports from 10% to 25%, that's only 0.2% of GDC, which is manageable. We could probably even withstand a 10% to 25% increase on $325 billion, which is, as Capital Group's Mike Griffen puts it, "*similar to a 25% increase in gas prices, which is not an expansion killer."*

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Either way, the markets do not like the idea of an ongoing trade war. Our entire world has become very integrated, and when you start tinkering with that, the markets don't know how to handle it. And be assured that equity prices will not react well when/if there is an escalation.

Points of Optimism

Companies are still profitable. The impact of the 2018 Tax Cuts & Jobs Act is still pouring its blessings on Corporate America. Companies have indeed used the windfall for hiring, reinvestment in infrastructure, and in some cases, stock buybacks. All three of these provide tailwinds for underlying equity prices.

While it's true that the S&P 500 P/E ratio has increased to around 21, I still wouldn't classify this as an unhealthy level. Besides, the forward-looking P/E ratio of the S&P 500 (my personal favorite metric for broadly assessing the US equity market) is at 17.2, which is effectively unchanged from this time last year.

Unemployment continues to be jaw-droppingly positive. The unemployment rate as of April was 3.6%, **which is the lowest in fifty years**! Plus, the median duration of unemployment ***fell*** to 9.1 weeks. Add to that the fact that wage growth continues to tick higher, and one can clearly see we have a tightening of the labor market. As if it couldn't get any better, hourly pay earned by the average worker rose sharply in February, pushing the increase in wages to a ten-year high of 3.4%, thereby shrinking the dreaded income inequality.

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A Word on the Bond Rally

I have always held to the principle that most investors, regardless of their aggression level and time horizon, ought to have some portion of their holdings in fixed income (i.e., bonds). Other competent investment professionals may take issue with this, and that's fine. But if you're a client of mine, you very likely own bonds as part of your diversified portfolio.

So far this year we've seen bond funds generate returns better than their historical averages. And that's probably fair since the past few years they have underperformed their historical averages, which has been a function of the continually rising interest rate environment. Remember that bonds are inversely related to interest rates. So, as rates rise, bond prices fall, and vice versa.

But now that you're seeing some gains from your bond holdings, it would seem an appropriate time to remind you of the purpose of having bonds in your portfolio. They are (in order of importance):

1. Diversification from equities
2. Income generation
3. Preservation of capital
4. Inflation protection

Notice, I did not list "growth" as one of the objectives. Growth is the job of stocks. As such, you should not view bonds as a tool for equity-type returns. In other words, don't chase yield. Let bonds do their job. Right now, they are giving you such nice gains. Enjoy the added portfolio alpha while it lasts. But don't get too excited. They aren't stocks, and you should see them as the asset class they are.

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Likely New Law Coming Soon

On May 23 the House of Representatives overwhelmingly passed the SECURE Act. As of this writing, the Senate has yet to vote, but in all likelihood will do so by late summer or fall. From there, President Trump will most likely sign it into law. Here are a few highlights of the SECURE Act:

- Delayed Required Minimum Distributions
- Expansion of eligible expense categories for 529 Plans
- Student loan repayment using 529 Plans
- Allowing IRA contributions at **any age**
- Curtailing "stretch" payout to certain beneficiaries

I will devote an entire whitepaper to the details of the new law if/when it is passed.

A Need for Greater Restraint

As the Market now enters its 11th year following the Great Financial Crisis, it will become increasingly difficult to ignore the Sirens of market timing. Our evolutionary propensity to protect the harvest by "locking in gains" is very understandable. Notwithstanding December's precipitous drop, we've all watched as our statements have arrived bearing great news.

I want to say again, as I have in previous writings, that the fear response, produced by the amygdala, is powerful and unfortunately unavoidable. But it will betray you. It can, and will, cause permanent damage to your financial health if acted upon.

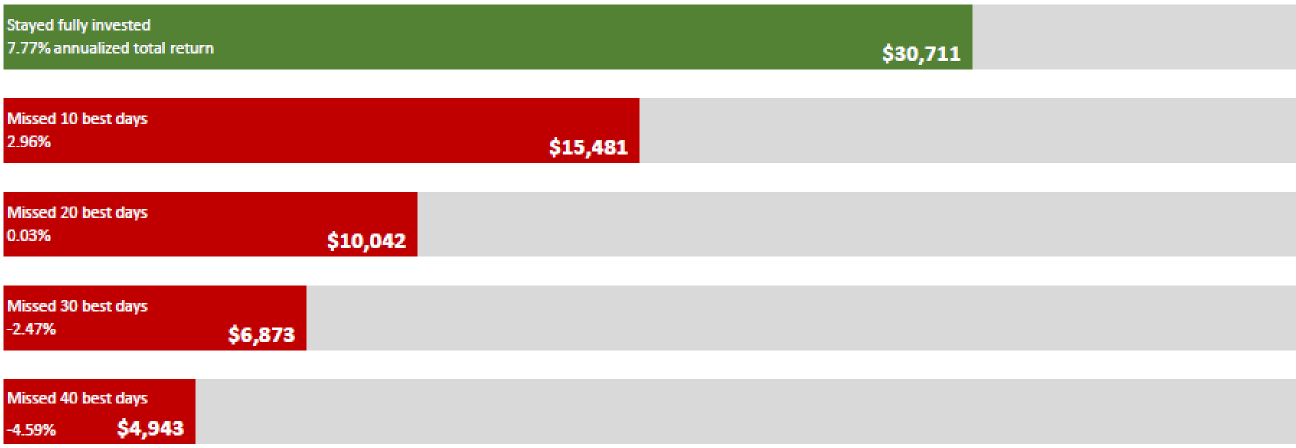
Your portfolio is like a bar of soap: the more you touch it, the smaller it gets.

Of late, I have noticed clients saying little things like "*let's keep a little more money on the sidelines until there's a drop, and then we'll buy the dip*" or "*let's sell off while our values are high.*" No, let's not, I say! Study after empirical study shows that the more often one enters and exits the equity markets, the lower one's lifetime return will be. Moreover, one will not only likely underperform the markets, but one's own investments. I've heard it said that your portfolio is like a bar of soap: the more you touch it, the smaller it gets.

It also doesn't help that as the 2020 Presidential sweepstakes is, for all intents and purposes, underway, candidates on both sides will make extreme statements regarding whatever "precipice of financial doom" will befall us if we don't cast a vote in their specific direction. In fact, on June 15 our President tweeted "*if anyone but me takes over there will be a Market Crash the likes of which has not been seen before!*" Really!? And you could have found equally pessimistic economic statements from any of the Democratic Presidential candidates during the last set of debates. Bottom line: **<u>Ignore them</u>—all of them. Republicans and Democrats. Their job is to get elected, not to make well informed, data-driven economic prognostications.**

From time to time, we must be reminded that we are ultimately our own worst enemy and that we should resist the urge to exit, or enter, the market at exactly the "right time." This type of mistake can happen to anyone and is completely agnostic in regards to who occupies the White House. **All it takes is one bad decision at the wrong time to miss out on a significant portion of gains**. Consider the following chart, which demonstrates the perils of market timing:

$10,000 invested in the S&P 500 (12/31/03-12/31/18)



Data is historical. Past performance is not a guarantee of future results. The best time to invest assumes shares are bought when the market prices are low.

Source: Putnam Retail Management

A [Closing] Personal Rant

I considered omitting this next section from my newsletter in order to dedicate a separately released article to it. But what the heck. Here's as good of a place as any, I suppose.

I'm struck by this prevailing attitude by many that we find ourselves in a rare and undesirable place historically. Editorials seem to fixate on the *inevitable coming economic collapse* and the *ensuing assured financial destruction of all Americans*. Just google "stock market crash" and watch as your browser fills with terror-filled articles regarding the next Armageddon. Politicians are literally campaigning on the idea that the American dream is no longer attainable. Are you kidding me?!

I want to be super clear on my position here. **If you are alive today, you've won the chronological lottery**. **There is no better time to be alive than right now, right here**. **And how can this be anything but good for the long-term investor?** I am not making a political statement. Really, I'm not. And yes, of course, we have problems. We always will. But consider the following:

- In 1900, the average life expectancy was a dismal forty-seven years. Today that figure is seventy-nine. This means that **life expectancy has increased more over the last 100 years than all of recorded human history combined** *(source: National Vital Statistics Reports)*.

- In 1820, nearly 90% of the world's population lived in "extreme poverty." By 1980, that number had dropped to 40%. As of 2015, it is a mere 10%. For all intents and purposes and certainly by strict definition, extreme poverty in the US is non-existent *(www.ourworldindata.org)*.

- Today, over 80% of the world's population can read. Yet, at the beginning of the 20th century, only one in four could read *(www.ourworldindata.org)*.

- The iPhone that my 3.5-year-old watches his "educational" cartoons on has more technological power than was onboard Neil Armstrong's space shuttle in 1969. Today, even the homeless have smartphones. Moore's Law is alive and well.

- More recently, initial unemployment claims dropped below 200,000. As a percentage of the total population, this is the lowest number ever recorded *(US Department of Labor)*.

- America recently took over the #1 spot as the largest oil-producing country in the world. And in 2020, we're expected to become a net exporter of hydrocarbon energy *(www.instituteofenergyresearch.org)*.

So yeah, I think we live in a pretty darn good place, during a darn good time. And I'm not someone who strolls around with a blind sunny disposition.

And if you're a corporation selling widgets, you must be licking your chops. Because the better technology gets, and the longer people live, and the more educated we become, and the more of us have jobs, the more widgets you're going to sell. Now expand that to an entire global economic ecosystem, and **the only rational conclusion is a syllogistic case for optimism**. If you can't find hope in that, God help you.

The only rational conclusion is a syllogistic case for optimism. If you can't find hope in that, God help you.

As Steven Pinkerton says in his book *Enlightenment Now: The Case for Reason, Science, Humanism, and Progress,* "**There can be no question of which was the greatest era for culture; the answer has to be today, until it is superseded by tomorrow**."

Have a great summer, everyone!

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