TRIVETT WEALTH MANAGEMENT

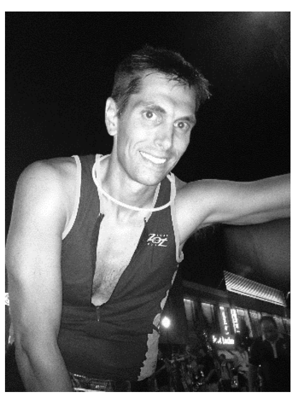
> ***"Only when the tide goes out do you discover who's been swimming naked." -Warren Buffett***

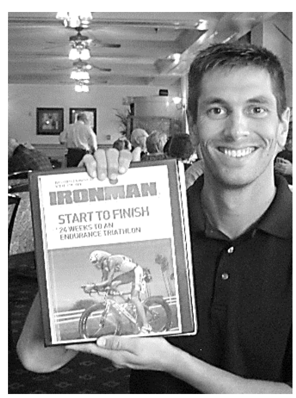
During an oppressively hot August night in 2012, I found myself against a wall in downtown Louisville, Kentucky, weeping uncontrollably. Why such emotion from a guy who, by all accounts, is unemotional? Just minutes earlier I had crossed the finish line of the Ironman Triathlon.

The Ironman is considered to be one of the most grueling one-day sporting events in the world (even more grueling when you're a 200-pound man in his mid-30s). It consists of a 2.4-mile swim, a 112-mile bike ride and finishes with a 26.2-mile run. For nearly 16 hours my body had been in constant motion on a day that temperatures hovered around 90 and the humidity neared 95%.

The reason I was hunched over crying like a baby was twofold: For one, the pain was incredibly intense. During the final six hours of that race I was assaulted by my muscles. Every couple of minutes some unpredictable area of my body would cramp, sending a jolt of pain to the affected area. At times, I had to stop in order to straighten my arm or leg with my hand as the bicep or hamstring would contract uncontrollably. Even worse was the stomach pain, triggering the worst nausea I've ever experienced. And it wouldn't go away. This, in turn caused me not to take in adequate fluids, which resulted in dangerous levels of dehydration. I literally lost nearly 20 pounds on that one single day. Don't believe me? Here is the photographic evidence:

IRONMAN RACE 2012





August 26, 2012 ***24-hours earlier***

The second reason for my tears -- and the reason for my mentioning it in this newsletter -- is everything that the finish line represented. Finishing that race -- which by the way must be done by midnight in order to be recognized as official by the IRONMAN organization -- was the culmination of eight months of intense training, a time when nearly every component of my life had taken a back seat. My work, relationships, and hobbies all played second fiddle to the training regimen. For me, it gave new meaning to the word "sacrifice." I knew leading up to the race that stuff had to be dropped. I quit playing tennis (the sport I'm addicted to). I spent thousands on cycling gear, massage therapy, nutritional supplements, and so on. I made less money at work as my office hours were squeezed. Basically, I made peace with the reality that during those 8 months *I just couldn't have it all*.

And that, in the proverbial nutshell, is what the markets taught us in 2018 . . . **you just can't always have it all**. Although, we had been consistently conditioned over the prior decade to expect it all. But the moment arrived, and we finally experienced the *reversion to the mean* that was referenced in my 2017 mid-year newsletter. The only difference between the Ironman participant and the equity investor is that the latter doesn't have the luxury of selecting when he experiences the painful moments of sacrifice.

2018 IN REVIEW

Here are the flagship figures: The US stock market as measured by the S&P 500 finished 2018 down 4.38%. Foreign stocks, as measured by the MSCI EAFE, wrapped up the year down 13.79%. US Bonds closed the year essentially flat while international bonds were down -1.31%, as indexed by the Bloomberg Barclays Global Aggregate Bond Index. Inflation, as of November 30, was an impressive 2.2%. And unemployment remained historically low at 3.7%.

I must say that 2018 was perhaps one of the strangest years I've experienced in my career as a financial advisor. Most importantly, it was one of the truly great years in the history of the American economy, and by far the best one since the global financial crisis of 2008. Paradoxically, it was also a year in which the equity market could not get out of its own way.

It is almost impossible to cite all the major metrics of the economy which blazed ahead in 2018. Worker productivity, which is the long-run key to economic growth and a higher standard of living, surged. Wage growth accelerated in response to a rapidly falling unemployment rate. Household net worth rose above $100 trillion for the first time, yet household debt relative to net worth remained historically low. Finally—and to me this sums up the entire remarkable year—for the first time in American history**, the number of open job listings exceeded the number of persons seeking employment.**

Earnings of the S&P 500 companies, paced by robust GDP growth and significant corporate tax reform, leaped upward by more than 20%. Cash dividends set a new record, which meant that total cash returned to shareholders from dividends and share repurchases since the trough of the Great Panic reached $7 trillion.

But the stock market had other things on its mind. Having gone straight up without a correction throughout 2017, the S&P 500 came roaring into 2018 at 2,674—probably somewhat ahead of itself, as it seemed to be discounting the entire future effect of corporate tax cuts in one gulp. There ensued in February a 10% correction, followed by several months of consolidation. The advance resumed as summer came to a close, with the Index reaching a new all-time high of 2,931 in late September. It then gave way to a second correction, thereby going into a savage decline, falling to the threshold of bear market territory: S&P 2,351 on Christmas Eve, **off 19.8% from the September high**. A rally in the last week of trading carried it back up to 2,507, but that still represented a solid 6% decline on the year, ignoring dividends**. Thus, 2018 became the tenth year of the last thirty-nine (beginning with 1980) in which the Index closed lower than where it began**, transpiring at the long-term historical rate of one down year in four, which in all actuality is just par for the course.

The major economic and market imponderable as the year turns is trade policy, which in the larger sense is an inquiry into the mind of President Trump. I think it fair to say, as the economist Scott Grannis recently did, that ***"Trump has managed to reduce tax and regulatory burdens in impressive fashion, but his tweets and his tariff threats have created unnecessary distractions and unfortunate uncertainties, not to mention higher prices for an array of imported consumer goods."*** These and other uncertainties—perhaps chief among them being Fed policy and an aging expansion—were weighing heavily on investor psychology as the year drew to a close.

3 Portfolio-level Observations from 2018

1. *Asset allocation worked*. I wasn't unaware of the mild client grumbling earlier in the year as US stocks surged to new record levels, yet client accounts largely remain unchanged. The problem was that no one client of mine *owns* 100% US stocks. They also own bonds and international stocks and commodities and so on. And many of these asset classes were actually losing money. Most folks' portfolios were merely breaking even while the S&P 500 was up nearly 8% at various points. Yep, eating your vegetables is no fun. But then December happened. And the investing community got a stark reminder of what it feels like when the term "risk" goes from theoretical to experiential.
2. *Things can happen quickly*. I've always been amused by the person who claims they will "*get out of the market until things calm down*." The truth is that this is easy to say but nearly impossible to consistently execute. Did you know that the biggest one-day gain last year for the S&P 500 was on December 26? On that day the market jumped +4.96%! Yet the prior four days the market was down a total of approximately -7.9%. Now if Mr. Market Timer had "gotten out" after those four horrendous days to let things "calm down" he would have missed the best day of the year, thereby locking in even more losses than his patient long-term investing counterpart. Never try to catch a falling knife.
3. *Bonds did their job*. Bonds should behave like bonds. This means you shouldn't expect big returns from fixed income. Instead, view your portfolio's bond component as 1) a preservation vehicle and 2) a non-correlating asset class. In other words, when stocks zig, bonds should zag. The best example of this occurring last year was during the two-month selloff where the S&P 500 dropped -9.9% from 9-20-2018 thru 11-23-2018. During that same timeframe US Bonds (as measured by the Bloomberg Barclays U.S. Aggregate Index) dropped only 0.1%.

The Fallacy of Reducing to the Ridiculous

"*But Matt, I've lost 5% of my account value in the last three months*" he said with palpable concern. He continued, "*At this rate, I will have zero dollars in eighteen months! Sarah and I simply can't afford for this to continue*!"

"Jim," I said, "this is like saying that 'Hey! It's snowed two inches in the last hour. At this rate my house will be covered by July!' We both would laugh at the person who utters something so ridiculous."

The primitive propensity of the human brain when dealing with financial matters is of great fascination to me which, incidentally, if you're interested, is covered in great depth in the academic journals of Richard Thaler and Daniel Kahneman.

My favorite question to the innumerable doomsday sayers is "Ok, then what?"

> "I read an article that says the market is going to crash in 2019." **Ok, then what**?
>
> "The Fed is increasing rates. Stock prices are going to plummet." **Ok, then what**?
>
> "The Fed is lowering rates. Money is too cheap. Inflation is going to hurt stocks." **Ok, then what?**

There is always tomorrow, folks. And that's the problem with fatalistic predictions . . . they never address the day after; when the sun does, in fact, rise once again.

Some of the best career advice I've ever received was to understand that there are two types of people: Those who say, "*this time it's different,*" and those who say, "*this, too, shall pass*." I was then taught that any sane advisor will have a more fulfilling career if he/she chooses to work exclusively with the latter.

So please fight your primitive evolutionary instinct. Corporations will continue to make widgets, sell them for a profit, and return such gains to their shareholders. And the brief periods of decline are just that . . . brief. These finite and inevitable times "shall too pass." **And your house won't be covered in snow come July**.

LOOKING TOWARDS 2019

Anticipate Volatility

It seems probable that volatility is here to stay for the foreseeable future. We now have tariffs causing real pain, interest rates rising, and corporate debt levels reaching uncomfortable heights. The confluence of these three factors create an environment conducive to wild intra-day stock swings.

But take note: Volatility is not necessarily bad. In fact, for those systematically contributing it can be your best friend. But what volatility gives in opportunistic discounts, it robs in logic. You see, volatility is notorious for stimulating the hypothalamus and the subsequent release of adrenaline when you see a drop (or rise) of your account value. And this puts one at risk of engaging in destructive behavior. So, please. Know that you're likely going to see bigger swings on your monthly statements. Prepare for this moment. And make the decision now, while you're calm, that despite the feeling of fear (or excitement, depending on the month) you will behave like the long-term investor that you are, **and do nothing**.

Valuations Normalize

From the fundamentalist viewpoint – incidentally my favorite, as a natural born pragmatist – it's simply hard to be excessively pessimistic moving into 2019 when looking at P/E ratios. The December pullback has brought the S&P 500 P/E ratio back to around 19. To put this in perspective, the last time the S&P 500 had a P/E ratio below 20 was in the fall of 2014. Stock prices are far cheaper now than they were a few months ago. And from a valuation standpoint, they look even more attractive as a result of good corporate earnings.

Final Observations

As one scans the economic and investment landscape there doesn't appear to be any doomsday type activity. No apparent "bubbles" seem to be forming on the investment horizon. The economic data remains somewhat robust, as evidenced by the aforementioned unemployment rates. Inflation is still within check. Even though the Fed will likely continue with Quantitative Tightening, it doesn't seem they will get overly aggressive. I anticipate maybe one more rate hike in the Spring - getting us much closer to Jerome Powell's neutral goal. It's possible that this is the only hike we see in 2019.

I don't believe we will see another "2017 style" massive explosion in equity prices. Instead, single digit returns are much more likely in the coming years. We are clearly nearing the end of the business cycle. As such, one should probably temper expectations. But obviously, I could be completely surprised as anything can happen.

For whatever it may be worth, **my experience has been that negative investor sentiment—and the resulting equity price weakness—have usually presented the patient, disciplined long-term investor with enhanced opportunity**. As the witty Sage of Omaha wrote in his 1994 shareholder letter, "*Fear is the foe of the faddist, but the friend of the fundamentalist*."

It is my prayer that your 2018 was prosperous and the new year brings more of the same. **Please take time to enjoy that which you have been entrusted and yet remain aware of opportunities to pay it forward**, as I believe a truer sense of joy comes from providing rather than consuming. If you are reading this newsletter, you are wealthier than 99.5% of the world's population. And in that light, your capacity to make a difference is exponentially greater than most all the remaining global citizenry. Money is not to be merely collected. As Jim Elliott's said, "***<u>He is no fool, who gives what he cannot keep to gain that which he cannot lose</u>***." Now there's a great resolution for 2019!

Happy New Year!

Sincerely,

Matthew J Trivett CFP® CLU® ChFC®