



Market Mechanics

As fundamental investors, we remain focused on a thorough “bottom-up” research process, analyzing each long-term investment worthy of the commitment of your and our capital. This process demands persistence, patience, and a dedication to long-term thinking. Concerns relating to trade wars, tariffs, and an ever-changing geopolitical landscape can and will continue to weigh heavily on the markets and more specifically, fuel price gyrations. There is no clearer example of this than the last 45 days, where the market shifted from euphoric optimism in September to the fear and skepticism of a full-blown recession lurking just around the corner. The results have been typical October, with the market wiping out all of the returns for the year. The question begs, what exactly prompted this sell-off?

As usual the “experts” have no shortage of reasons for this recent downturn, ranging from the results of tariffs and trade wars, to the Chinese selling Treasuries, to stocks being way over-valued, to corporate earnings peaking, to the assassination of a Saudi reporter at the Turkish Consulate, to the fluctuation in the global currency markets, to President Trump’s tweeting, to the Fed raising interest rates. Despite all the varying reasons for why it happened, all the pundits seem to agree that corporate earnings remain strong as the economy continues to produce good quarter-over-quarter growth. Therefore, isn’t it unusual to have a swift market downturn in such a strong economic environment? Answer: No, as history tells us corrections come in all shapes and sizes, and most often (especially in October it seems) the market does exactly the opposite what people expect of it. Over the last 100 + years the market has regularly seen 10% sell-offs or more in a calendar year, and as painful as it is going through it, we have been historically successful using such sell-offs as an opportunity to acquire additional shares or to add new investments to the portfolios.

As in the case of past corrections, market rebalancing is scary and unpleasant, especially for short-term investors as they often shift from greed to fear. To illustrate the mechanics of this market rebalancing we point to a recent report from our friends at the Goldman Sachs strategy team. Prior to the beginning of this correction the FANGMAN (Facebook, Amazon, Netflix, Google, Microsoft, Apple, Nvidia) stocks had accounted for almost 20% of the value of the market, but represented only 10% of the earnings. The significance of this disparity is best highlighted most specifically by Amazon, which by itself represents 3.6% of the stock market’s (S&P 500) total value, but contributes only 0.2% of the markets earning, a gap of 18 times. If one fundamentally believes that earnings drive stock market performance, then Amazon has some work to do for the earnings to catch up, or conversely, the market can close that gap of 18 times on its own. This is market rebalancing. With the noise of rebalancing ringing loudly in our collective ears, our focus remains centered on working to achieve the appropriate balance of risk and reward individually suited for your investment plan. And while Central Bankers from around the world (led by the Federal Reserve) continue working to restore their respective countries interest rates to historically normalized levels, we expect there will be more bumps along the way.

Despite the volatility, we can take comfort in that we have a customized plan in place for your assets, with discipline and confidence to stay the course. We look forward to speaking with you and touching base as we close out 2018 and set our planning sights on the year ahead.

We continue to be grateful for your trust in the stewardship of your investment assets.

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