Market Commentary

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Taking a Look at the Big Picture

We all know by now that the market is in a correction and could be heading for the 20% decline that would usher in the first bear market since 2008. We also statistically know that we can expect the market to have a decline of 20% or more every 10-20 years, so we should be in the realm of not being surprised if it happens.

Going into this correction we knew that the recovery was long though not very deep. The amount of excess GDP growth over the past 10 years was not close to hitting the levels of past recoveries from steep economic declines. We also knew that earnings growth had to slow down from the burst of tax reform. Despite this, earnings were expected to grow at a high single digit clip. We knew the market was a little expensive on a current PE basis but very expensive when using the Shiller PE approach. The Shiller PE had the market expensive several years back and would be coming down just from the passage of time as it ridded itself of the recession year denominators. We also knew we had reached full employment but still had a low labor force participation rate and inflation behaving in line with the Fed's 2% target. We knew the Fed was feeling the euphoric nature of the market and started to signal more conviction in its quest to raise rates. We declared trade wars with almost everyone. We reached resolution in most cases except for China.

Was the catalyst China or the Fed? Or, was the market just anticipating that it had nothing good left to anticipate? Did it wake up and say that the long-term return on US stocks of 6% would no longer cut it and now we investors would demand 7%? Was it a run-up in technology shares that had enticed Millennials the same way Boomers were lulled into 2000?

More importantly what type of downturn do we have? Is this a short blast to revaluation with solid economic fundamentals driving the market back to new highs in a few months or years? Or are we just at the beginning of a prolonged stagnation that bleeds into the economy and creates a self-perpetuating downward bias?

MORE IMPORTANTLY WHAT TYPE OF DOWNTURN DO WE HAVE?

Are we finally paying the price for fiscal imbalances and underfunded long-term promises on pensions and medical care to taxpayers? Or, do we head down a similar path as Europe where structural unemployment and slow growth have not been allayed by loose monetary policy?

Or . . .

Is this the buying opportunity of a lifetime? Real advances are coming like 5G and autonomous vehicles. Will the cost of living drop precipitously as we substitute vehicles, replacing them with greater access to knowledge and entertainment? Will just-in-time manufacturing extend all the way to the consumer with all devices networked through to supply chains allowing for instantaneous recognition of demand and an immediate supply response? Will these advances rocket productivity and lead to real wage growth that drives the economy like we experienced in the industrial age?

The interesting thing about investing is how it tugs at your emotions. When markets are ebullient, we feel better; then when markets are declining, we feel worse. All the same, every issue we face is always present. Nothing happened on October 3rd that changed the long-term risks or opportunities that we face. It would take a social psychologist with a crystal ball to sort out the when and the why.

All we know for sure is that no matter how much you study or how long you consider the options you will never know what the market is going to do in the short-run. In the long-run, the market does not care about the changing dimensions of risk but is quite content to value itself in line with the growth in the economy.

That's why we favor a diversified portfolio every day of the week. At least this way you know you'll participate when times are good and can even celebrate relatively good fortune when times are bad.

Investing is about picking a risk tolerance that aligns with your capacity to take on risk—determining where long-term value is being missed and hedging exposure in case you are not exactly right. It is also minimizing costs where there are lower cost options, avoiding short-term taxable gains, and deferring taxation. It is about putting the right assets in the right registration vehicles and rebalancing the portfolio when risk gets out of balance.

INVESTING IS ABOUT PICKING A RISK TOLERANCE THAT ALIGNS WITH YOUR CAPACITY TO TAKE ON RISK.

It is not about guessing when the next downturn or recovery will occur. This belongs to speculators, and speculators must be willing to risk failing to achieve. Investors need to do everything in their power to achieve and leave the speculative moves to the resources they do not need to fund their retirement and legacy goals.

Our bet: the world has its best days ahead of it. Our second bet: the market will start discounting the brighter future ahead of us, we just don't know when.