

# Money Manager Newsletter

December 31, 2016

## Investment Consulting Group, Inc.

**"I Never Thought Ethics Was Something That Could Be Formally Taught. I Thought Ethics Was Something You Learned Growing Up At Home, In School, And In Church"**

**Robert Fomon, Chairman—EF Hutton 10/14/1985**

### America's New Business Model

Mr. Trump promised to drain the Washington swamp of special interests. The costs from this shift may be imperceptible at first, exceeded by the boon from economic stimulus and regulatory reform. And as president of the world's largest economy, Mr. Trump will be able to ride roughshod over firms for longer with impunity than politicians in smaller places ever could. But over time the damage will accumulate: misallocated capital, lower competitiveness and reduced faith in America's institutions. Those who will suffer most are the very workers Mr. Trump is promising to help. That is why, if he really wants to make America great again, Mr. Trump should lay off the protectionism and steer clear of the bullying right now. [The Economist—December 2016](#)

### Good Investment Principals

- Asset Allocation is the most important start
- Adopt a long term goal
- Avoid Human Emotion
- Patience with allocation and managers, active and passive
- Rebalance—Trim winners, add to underperformance

Consumption is 66% of GDP but this can be misleading. Other components of GDP are more volatile and can effect GDP by as much. That 33% covers investment in structures, equipment software, housing, and inventories. All are more volatile therefore its influence on GDP at times can influence consumer spending. Strong growth in consumer spending can encourage investment and weak consumption can discourage. Businesses make investment decisions that go beyond a year and those decisions are the true lifeblood of the US economy. [Gene Epstein—Barrons](#)

There seems to be a notable historical trend of active small-cap managers outperforming the Russell 2000 Index in periods when value stocks lead, while trailing the small-cap index when growth stocks lead. If this pattern holds, it carries a number of important implications for the current market. Our research first compared monthly rolling five-year returns. Morningstar Small Blend category average beat the Russell 2000 in 66% of all rolling five-year periods, it actually outperformed in 83% of value led periods, but in only 21% of growth led periods. Most periods, 72%, were value led which contributed to greater relative success for active management. We think it is likely that we are heading toward a period of outperformance for both value led strategies and active management. [Steve Lipper, The Royce Funds](#)

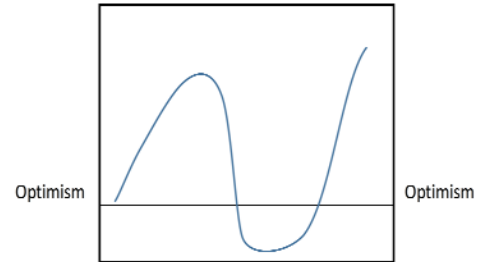
### The key to understanding asset allocation study

- Forecast into the future
- They are an estimate
- Different firms, different returns
- They will be wrong!
- They provide a framework to make educated decisions.

12/31/2016	Growth Median P/E	Value Median P/E	Historical Growth Avg.	Historical Value Avg.
Royal Blues	26.3x	14.6x	24.7x	11.4x
Large Cap	21.3x	12.9x	19.9x	10.8x
Mid Cap	24.2x	14.5x	23.4x	12.0x
Sm Cap	28.7x	15.8x	27.5x	12.0x

### Human Emotion—Cycle of Investment Returns

Optimism  
Excitement  
Thrill  
Euphoria  
Anxiety  
Denial  
Fear  
Desperation  
Panic  
Capitulation  
Despondency  
Depression  
Hope  
Relief  
Optimism



### Outlook—Russia

- Collapse in oil prices and economic sanctions;
- Economy contracted about 4 percent in 2015;
- World Bank: Russia will remain in recession in 2016;
- Russia's ruble down 20 percent;
- Continued decline in investment expected.

### Outlook—China

- Growth at slowest pace in 2 decades;
- World Bank predicts 6.7% economic growth for 2016;
- George Soros: China has a "a major adjustment problem" on its hands;
- Government attempts to stabilize economy only made investors even more wary.

[Anirban Basu—Sage Policy Group, Inc.](#)

Seven years ago, Asia's smaller companies had rallied hard out of the Global Financial Crisis. Earnings momentum was strong and the risk appetite among investors was hearty. Fast forward to today, and interest in Asia's small caps, as well as its performance as an asset class, is decidedly more mixed. Risks are perceived to have risen and skepticism returned with cries of "we can't trust the numbers." So it maybe opportune, therefore, to reassess. What has changed?

- Volatility has long been a common feature for small companies
- Markets have arguably become more punishing
- The investable universe has grown

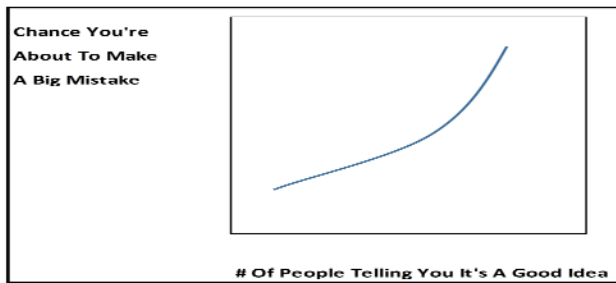
We have made scores of trips into various (and sometimes) obscure cities of china with the aim not just of gathering information and meeting A-share companies but also growing comfort levels to investing in what is a new market to us. We are encouraged to constantly be discovering not only corporate mindsets that are more open to change but also actual rapid change itself in terms of things like automation and industry structures. Given the urgency for firms to offset rising wages, investment in automation has been impressive, particularly in China. A decade ago, abundant and cheap labor coupled with long paybacks was such that Chinese manufacturers were unwilling to invest in automation. By contrast, today, we see the desire to invest in automation, and furthermore, a willingness to pay a premium for the best imported equipment (robots, software, 3D printers etc.). We believe there is still abundant scope for bottom up active investors, even for those with high hurdle requirements, to find compelling opportunities in Asia's smaller companies.

[Jeremy Sutch—Matthews Asia](#)

**Home Ownership Will Come Back With A Vengeance Over The Next 5 Years**  
FTN Chris Low



As adults, we're pretty good at spotting peer pressure among kids. But I think we're a little blind to peer pressure we experience as adults. So what should we do when investors want to make big changes and it's clear the reasons have nothing to do with their values or goals? Start by listening with empathy. Investors may still insist on reacting to what everyone else is doing. But in my experience, listening with empathy and reminding people of their goals almost always stops them from jumping off the proverbial cliff. [Carl Richards—Investment New](#)



When Donald Trump vowed to "Make America Great Again!" he was echoing the campaign of Ronald Reagan in 1980. Back then voters sought renewal after the failures of the Carter presidency. This month they elected Mr. Trump because he, too, promised them a "historic once-in-a-lifetime" change. But there is a difference. On the eve of the vote, Reagan described America as a shining "city on a hill". Listing all that he dreamed of a country that "is not turned inward, but outward toward others." Mr. Trump, by contrast, has sworn to put American First. Demanding respect from a freeloading world that takes leaders in Washington for fools, he says he will "no longer surrender this country or its people to the false song of globalism". Reagan's America was optimistic: Mr. Trump's is angry. [The Economist—November 2016](#)

Numerous government agencies employ tens of thousands of Americans who provide essential paperwork for the government's growing food chain. These regulations quietly feed bureaucracies that in 2014 cost consumers \$1.88 trillion, or \$15,000 per household. Get used to it! Accept the fact government will continue to grow and become increasingly involved in our personal and business lives. It's the unannounced goal of government to control as many resources as possible and to continue expanding with Social Security, education, farm subsidies, Medicare, Medicaid, food programs, mineral and drilling rights, retail and investment banking, public housing, retirement accounts, interest rates, et al. The government believes it can allocate these resources more effectively and fairly than you can. Many criticize the government, claiming we have the worst government in the industrialized world. We might, but it's the best worst government in the world. Winston Churchill said it best: "The inherent vice of capitalism is the unequal sharing of its blessings. The inherent virtue of socialism is the equal sharing of its miseries." Because there are so many uniformed voters, you get the politicians they deserve. [Malcom Berko](#)

An interesting juncture for the robo-advisory space. Robo-advisers are mostly just a fancy interface implementing a low fee indexing strategy that amounts to little more than a target date mutual fund or some version of the Vanguard Tax Managed Balanced Fund. The only reason you would ever open a robo adviser account is if you were unaware of the fact that you were buying something that already exists in a lower fee structure. I know I am harsh on issues like this, but I truly loathe seeing higher management fees where you can buy something identical for far less. [Cullen Roche—Investment News](#)

Free markets don't fail. Bad government policies fail. Every major economic disaster has at its source government error. A global trade war triggered by the U.S. Smooth-Hawley Tariff in 1930, followed by enormous tax increases, gave us the Great Depression. Governments don't create wealth, people do. If governments don't stand in the way, free markets always turn scarcity into abundance and luxuries into commodities. Free market economies will enable more and more people to achieve an ever higher standard of living and a richer quality of life if governments don't get in the way. Think about automobiles. We need commonsense "rules of the road." We don't need government telling us what to drive, when to drive or where to drive. [Steve Forbes](#)

Treasury Market Yields	12/31/2016	12/31/2015	12/31/2014
2 Year	1.20%	1.06%	0.67%
5 Year	1.93%	1.76%	1.65%
10 Year	2.45%	2.27%	2.17%
30 Year	3.06%	3.01%	2.75%
SP 500	2.07%	2.14%	1.92%
Commodities			
Oil (\$/bal)	\$53.72	\$37.04	\$53.27
Gold (\$/oz.)	\$1150.00	\$1060.30	\$1183.90
CRB Index	\$192.51	\$176.27	\$229.96

