DJ IA	Nasdaq	S & P 500	Russell 2000	MSCI EAFE	Crude Oil	Euro	10 yr Treas.	Fed.Fund Rate	Prime Rate
24719.22	6903.39	2673.61	1535.51	8104.97	60.42	0.8332	2.40	1.25-1.50	4.50

Money Manager Newsletter

December 31, 2017

Investment Consulting Group, Inc.

"The Most Expensive Mistake Is To Thinking Yourself Smart, When You're Not"
Ross Stanforth

The Economy's Strength

America's economy is in good shape. Business confidence is high and jobs are plentiful. Last month non-farm companies added workers to their payrolls. The unemployment rate is the lowest figure in more than a decade. Wages are growing in real terms with some of the biggest gains going to low-paid workers. As the economy approaches full employment, an astonishing pickup in productivity would be needed to accomplish that. American is not the only economy doing well. For about a year, a synchronized global expansion, including Europe, Asia and the Americas, has been under way. GDP growth in the eurozone, a region until recently synonymous with economic misery, is around 2.5%, despite slower population growth than America's. But America stands out because of where it is in the cycle. If it continues in 2018, this expansion will become the country's second-longest ever. As the business cycle matures, there is more chance that the economy will overheat. Yet the evidence for overheating is thin. Inflation has trended lower this year. Wage growth has picked up a little, thankfully, but shows few signs of accelerating. Pay would have to increase by quite a lot more before rising inflation is a real worry. Nothing Mr. Trump does is likely to have a bigger effect on the economy than his choices to fill Fed vacancies. A mature cycle also has pluses; investment is one. Businesses that have been reluctant to make long-term bets when one or other of the engines of the world economy has been sputtering are now more willing to put their money to work. Investment has also followed a surge in profits, reflecting stronger GDP growth. A second boon of a maturing cycle is higher productivity, which has risen at a snail's pace in all countries since the global financial crisis. More capital spending by businesses will help. All expansions eventually come to an end. Even if America does not inflict a recession on itself, through ill-judged trade policies, a global shock could do the job. The deficits that result will make it politically harder for Congress to agree on fiscal stimulus to combat the next downturn. The immediate outlook is sunny. The global upswing is still young, and has momentum. The Economist—December 16, 2017

Global Economy

Critical Economies will grow moderately:
India 8%, China 6%, Indonesia 5%, Brazil 25%, United States 2%
India is fastest growing economy and will pass China. Jeffery Rosensweig

Concepts of Asset Allocation and Returns

1995 — 100% Fixed Income; 7.5% return with standard dev. of 6%
2005 — 52% Fixed Income/Balance Equities; 7.5% return with standard dev. of 8.9%
2015 — 12% Fixed; 7.5% return with standard dev. of 17.2%
Constant return by increasing volatility, almost 3 times more risk for same return.

Emerging Markets Share of Global GDP

1980 — 25%
2000 — 37%
2017 — 50%
2030 — approximately 65% (22 years)

Expected returns 2017—2026

United States 6/4%
Emerging Markets 12.0%
Long Term Government Bonds 3.0%
Emerging Market Bond 5.9%

Emerging Market Middle Class Facts

Full generation younger — 20-25 years younger
Starting Families and Business
Little Debt
Extremely Optimistic Outlook
1.5 billion strong
Next 20 years — End of baby boomers
Currently 1/2 of world GDP — Emerging Middle Class, soon to be 2/3.

12/31/2017	Growth Median P/E	Historical Growth Avg.	Value Median P/E	Historical Value Avg.
Royal Blues	30.4x	24.8x	16.3x	11.5x
Large Cap	23.9x	20.0x	12.9x	10.8x
Mid Cap	26.2x	23.5x	14.8x	12.0x
Sm Cap	30.0x	27.7x	14.3x	12.1x

Microcap as an Alternative to Private Equity

Private equity (PE) has become a central component of many institutional and high net worth investment portfolios over the past decade. While private equity offers potential advantages, it also requires taking distinct risks. Investors have changed their asset allocation over the past 18 years. Equities decreased slightly, down 8 percent overall in those 18 years, but the split between private and public equity shifted dramatically, with private equity rising on average from 1.4 percent to 17.0 percent. Private equity offers several advantages, including:
Access to smaller companies—Small companies at the start of their business have higher growth opportunities.
Total return—Returns of private equity look more attractive than public equities. The reason is that investors are capturing an "illiquidity premium."
Microcap equities provide similar advantages but without the baggage of illiquidity. Private equity investments require as much as a 10 year commitment, with an initial up front payment and capital calls over the first several years. For a long-term investor, this seems like a reasonable trade for higher returns. But, low liquidity means private equity is often too restrictive.
While private equity offers the prospect of great returns, the historical results for managers in the asset class have been uneven. Identifying those managers ahead of time is difficult. Perhaps the most notable difference between private equity and microcaps are the fees required to access the market. As John Bogle is fond of saying, "In investing, you get what you don't pay for." Private equity funds can charge capital on three types of assets: committed capital, called capital, and invested assets (including leveraged assets). The Microcap space, which we define as companies having a market cap between $50M and $200M, is $146B, or roughly the same size as The Walt Disney Company's market cap. This means that microcaps are a scarce opportunity, which is good because larger institutional asset managers often neglect them. The real advantage of investing in microcaps is systematically buying stocks with very cheap valuations, high-quality balance sheets and earnings, and strong recent price trends (momentum). These themes—Value, Quality, Financial Strength, and Momentum, have worked even in the largest cap portion of the public equity markets. They are much more effective and predictive in the microcap market, which is neglected and therefore less efficient.
Here is how we measure stock selection:
Value—We favor stocks that trade at cheap multiples. We favor companies with higher shareholder yields.
Momentum — We favor stocks with strong recent price trends.
Financial Strength — We favor stocks with higher-quality balance sheets.
Earnings Quality — We favor stocks with conservative principles in reporting earnings.

Because the total value of all microcaps is small, its market represents a scarce investment opportunity. But, for those who are able to take a position, microcap equities can solve the original goals of private equity. A microcap portfolio can be liquidated in short order — in part or in full. Private equity investments are far less liquid. Chris Meredith, CFA & Patrick O'Shaughnessy, CFA—O'Shaughnessy Asset Management

Goldilocks Scenario for 2018

*Solid Global Growth
*Moderate Inflation
*Still-Easy Central Banks
*Politics/Geopolitics on Back Burner

Or the Three Bears………

Hawkish Central Banks	Unexpected China Slowdown	Politics/Geopolitics
*Inflation rises sharply	*Stronger U.S. dollar fuels	*U.S. midterm elections
*Fixed income and credit	weaker renminbi worries	*Italian election
investors face less liquid	*Commodity prices fall	*"Brexit" challenges
markets as they exit	*Emerging equities hit	*Mideast uncertainties
		*North Korea
		*Trade negotiations

DJ IA	Nasdaq	S & P 500	Russell 2000	MSCI EAFE	Crude Oil	Euro	10 yr Treas.	Fed.Fund Rate	Prime Rate
22405.09	6495.96	2519.36	1490.86	7801.34	60.42	0.8332	2.40	1.00-1.25	4.25

"I was in search of a one-armed economist so that the guy could never make a statement and then say: "on the other hand." Harry S. Truman (33rd U.S. President, 1884-1972)

At a conference in October 2017 our speaker, Jason Dorsey, noted issues regarding millennials

- We don't need benefits, we have parents
- Adulthood is showing up 5 years older
  - I.e. marriage, children, homes
- Millennials are splitting into 2 groups
  - Entitled
  - Hard working—Getting a bad name from the other group
- They are not tech savvy, they are tech dependent
- If you send an email to a millennial they most likely read only the subject line.

Investors who haven't paid much attention to emerging markets since they were last hot in 2009 are taking notice. About $85 billion has poured into emerging market stock funds so far this year, the biggest since 2010.
U. S. microcap market has shrunk from 3,000 companies to 1,700 over 20 years, the number has more than doubled to 4,000 in emerging markets. India, is a phenomenal market for microcaps, with a long track record of profitability and high insider ownership.
Daniel Chace — Wasatch Funds

The worst crime against working people is a company that fails to make a profit.
Samuel Gompers

Financial services and products have become increasingly complex and are more widely accessible to Millennials then they were to previous generations, due to rapid advances in digital technology. As a result, this generation must take on greater responsibility for their own financial decisions, like investing and saving for retirement. However, young adults worldwide demonstrate remarkably low levels of financial knowledge. Lack of knowledge is of great concern because low levels of financial literacy are associated with having greater debt, loans with higher interest rates, less diversified investments, less savings, including retirement savings, and incurring more transaction fees. Annamaria Lusardi and Noemi Oggero — Global Financial Literacy Excellence Center

Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria. Sir John Templeton (Founder Templeton Funds, philanthropist, 1912-2008)

What private companies are going through and why they're hesitant to go public. "The thing you imagine is, all of a sudden, once you become public, everybody only cares about the quarter and everything is going to be run for short-term returns. That's the brand that Wall Street has, for better or worse." But there are learned benefits of public ownership: "There is a way to drive near term performance and long-term strategy and innovation. You just begin to run your company in more disciplined fashion, operationally, organizationally, even culturally. You start to care about a lot of things that when you were private you could be a little bit looser with." Aaron Levie CEO—Barron's

The big sales pitch on Alternative Investments is that they create less standard deviation (volatility) Why? Because pricing is monthly/yearly. Most active stock trade daily which increases volatility.

The next financial crisis could be fixed income—banks loan to consumers with credit score of 550.

Treasury Market Yields	12/31/2017	12/31/2016	12/31/2015
2 Year	1.89%	1.20%	1.06%
5 Year	2.20%	1.93%	1.76%
10 Year	2.40%	2.45%	2.27%
30 Year	2.74%	3.06%	3.01%
SP 500	1.89%	2.07%	2.14%
Commodities			
Oil ($bal)	$60.42	$37.04	$53.27
Gold ($/oz.)	$1306.30	$1060.30	$1183.90
CRB Index	$193.86	$176.27	$229.96

"The hardest thing in the world to understand is the income tax." Albert Einstein

Bitcoin, Cryptocurrencies, and Dutch Tulips

Starting somewhere around 1953 in the Netherlands, Tulips were brought north by Ferdinand I, Holy Roman Emperor to the Sultan of Turkey. A virus made its way into the tulip plants and created wild colors that were in heavy demand. People were trading anything and everything for the tulips, with some bulbs costing the equivalent of $400,000 to $550,000 in today's dollars. And that is just a single bulb! The first Bitcoin transaction was 10,000 Bitcoins for 2 large Papa Johns Pizzas; those coins would be worth over $150,000,000 today. You see articles online about people taking out mortgages to buy bitcoin; people are taking out Home Equity Lines of Credit or putting their bitcoin purchases on credit cards. Nearly every day there are new articles about individuals that bought $100 worth of bitcoins now paying off student loans and mortgages with their profits. January 30, 2013 Bitcoin traded at $19.94. Had you bought 5 coins that day your $100 "investment" would be worth over $80,000 today. But what is it really worth? Your guess is as good as anybody's. There are two questions to ask; is there a value, and if so, why is there a value? For gold, there are reasons it has historically been worth something regardless of culture or location. It doesn't degrade, it is relatively easy to divide (it is easy to cut a gold coin in half), and it is aesthetically pleasing. It also makes a good conductor of electricity and, again because it doesn't degrade, it is a good electricity conductor in mobile devices. Historically gold protected against inflation; it acted as a store of value. Today the market value of gold is roughly 8 trillion dollars. With 21 million bitcoins (fully mined by 2140), you could suggest that bitcoin could be worth $381,000 if it became a "gold replacement". Suggesting it could replace the US Dollar as the world currency, with the US Dollar worth about 1.6 trillion dollars, would make each bitcoin worth approximately $76,000 per coin. There is nothing about it that is intrinsically valuable. There are no states that back its use; it is even banned in China (which might be an argument about it being worth something.) Its value is derived completely by the network of people that agree that it is useful (Metcalfe's Law 1) If you lose the private key, there is no way to recover it. Estimates are that we've already lost approximately 3 million bitcoins, which means 14% of every Bitcoin there ever was or ever will be is already gone forever. They can't be recovered. James Howells threw away a laptop with 7500 Bitcoin on it, which means there is a laptop in a dump in Newport, South Wales currently worth over $125,000,000. What do I predict from this endeavor? A bubble worthy of the label. There are 1324 different crypto currencies and, much like their tech counterparts from the late 90's, some will survive, but many more will fail.
Ross Stanforth, VP — Investment Consulting Group, Inc.

1. Metcalfe's law states that the value of a telecommunications network is proportional to the square of the number of connected users of the system (n2). Essentially, the value of the network increases exponentially based on the number of people that use the system. Relating it to the topic at hand, the more people that use bitcoin, the more valuable it becomes. It's adoption becomes a self-fulfilling prophecy.

The power to tax involves the power to destroy. John Marshall (U.S. Supreme Court, 1819)

"Always ask the question 'If not?' Few people have good strategies for when their assumptions are wrong." That's the best business advice I ever got.
John Malone (CEO of cable giant TCI, Fortune 2/16/98)