Money Manager Newsletter

March 31, 2018

Investment Consulting Group, Inc.

"If You Are Not Willing To Study, If You Are Not Sufficiently Interested To Investigate And Analyze The Stock Market Yourself, Then I Beg Of You To Become An Outright Long-Pull Investor, To Buy Good Stocks, And Hold On To Them; For Otherwise Your Chances Of Success As a Trader Will Be Nil"
Humphrey B. Neill (Investor, Analyst, Author 1895-1977)

The Technology of Future US Investment Performance

- 35% of workforce is freelance work. i.e. Task Rabbit—The most popular is Ikea Furniture.
- The US is world leader in oil production, larger than Saudi Arabia.
- Maytag Corporation in South Korea has a plan to remove US cities in 48 hours.

Profiting Off Others' Mistakes

There is nothing like the fear of losing money to make people panic. And panic predictably: If people's mistakes were random, they'd average out. Emotionally fueled mistakes often occur due to availability bias, an academic term used to describe how people evaluate the likelihood of an event by taking a mental shortcut to the most readily available example. It is likely a survival mechanism leftover from the development of early man. Joe the Caveman ate that berry and died, so maybe we shouldn't eat it. It's why demand for earthquake insurance rises just after an earthquake. Investors overreact more in volatile markets, which hasn't been the case lately. When people make forecasts, they start at a convenient number and when adjustment is necessary, they move away from it, but not enough. It's similar to a bad first impression when you meet someone and they're a jerk. People overreact to first impressions and underreact to second and third impressions. Crystal Kim—Barron's

When faced without a challenge, make one.

401(k) Fiduciaries Are Breaching Their Duty of Care

Current fiduciary practices in selecting target date funds are a breach of the Duty of Care. Target date funds are the most popular choice of Qualified Default Investment Alternative (QDIA). It's the choice that fiduciaries make on behalf of 401(k) participants who default their investment choice to their plan sponsor. TDF fiduciaries are choosing their bundled service providers (Big3) out of convenience and familiarity. That would be OK if these TDFs were safe at the target date, but they are not. Beneficiaries stand to suffer the most as they near retirement because losses can wipe out a lifetime of savings. Some argue that stocks are a good bet because they deliver positive returns about 75% of the time; they make beneficiaries richer. But would you buy your child a car that breaks down 25% of the time? Fiduciaries are operating on 2 mistaken beliefs that they think protects them: (1) any QDIA will do, and (2) popularity is synonymous with prudence. These beliefs saw 2010 funds lose 30% in 2008. Safer alternatives are available but fiduciaries don't even know they exist because fiduciaries are not performing adequate due diligence.
Ron Surz, President Target Date Solutions

Let's Get Rid of Management

People don't want to be managed. They want to be led. Whoever heard of a world manager? World leader, yes. Educational leader, Political leader, Religious leader, Scout leader, Community leader, Labor leader Business leader, They lead. They don't manage. The carrot always wins over the stick. Ask your horse. You can lead your horse to water, but you can't manage him to drink. If you want to manager somebody, manager yourself. Do that well and you'll be ready to stop managing, and start leading. Wall Street Journal

03/31/2018	Growth Median P/E	Historical Growth Avg.	Value Median P/E	Historical Value Avg.
Royal Blues	29.0x	24.8x	14.3x	11.5x
Large Cap	21.9x	20.0x	12.2x	10.9x
Mid Cap	25.1x	23.6x	13.2x	12.1x
Sm Cap	25.7x	27.6x	13.4x	12.1x

Why the West's Response is Inadequate

The most important lesson is that the Western response has been woefully weak. Mr. Mueller acted because two presidents fell short. Barack Obama agonized over evidence of Russian interference but held back before eventually imposing sanctions, perhaps because he assumed Mr. Trump would lose and that for him to speak out would only feed suspicions that, as a Democrat, he was manipulating the contest. That was a grave misjudgment. Mr. Trump's failing is of a different order. Despite having access to intelligence from the day he was elected, he has treated the Russian scandal purely in terms of his own legitimacy. He should have spoken out against Mr. Putin and protected American against Russian hostility. For democracy to thrive, Western leaders need to find a way to regain the confidence of voters. This starts with transparency. Then comes resilience, which starts at the top. Angela Merkel successfully warned Mr. Putin that there would be consequences if he interfered in German elections. Finland teaches media literacy and the national press works together to purge fake news and correct misinformation. The Economist

The best way to predict the future is to create it yourself.

Panic is a bad investment strategy. Yet that is exactly how many investors reacted when the stock market drops precipitously. Odds are good that they will end up regretting their behavior. Since most scary drops do not lead to major bear markets, it's virtually assured that over the long term selling after every unnerving decline will lead to more losses than gains. If you're not a long term buy and hold investor, therefore, you need an investment system that keeps you from panicking every time the market starts heading south. The Dow Theory is the oldest and perhaps the most popular of such systems. Like any good investment discipline, it provides you with preset rules that try to differentiate between less serious bouts of market volatility and the beginnings of devastating bear markets. The Dow Theory was created in the early part of the last century by William Peter Hamilton. He advised to focus not on the initial pullback from market highs but on the market's attempt to recover from pullback. A bear market signal would be triggered if that recovery were so weak that either the Dow industrials or the Dow transports would fail to close above their previous highs, and then both averages would break below their lows hit in the initial pullback. The Dow Theory isn't designed to catch the exact tops and bottoms of bull and bear markets. The genius of investing is recognizing the direction of the trend, not catching the highs or lows. Mark Hulbert—Columnist, USA Today

Remember the first Law of Economists. For every economist, there's an equal and opposite economist. The second Law, they're both wrong.

How Much Is A Trillion Dollars?

1,000,000,000,000 = one trillion
A trillion is equal to a thousand billions (1,000 x 1,000,000,000)

How Long Ago is a Trillion Seconds?
1 trillion seconds = 30,000 B.C. (give or take a decade or two)

How high is a trillion in $1000 bills?
1 trillion dollars = 63 miles high (give or take a foot or two)

If a person's salary is $40,000 per year it would take:
25 Million years to earn $1 Trillion

If you lived to be 80 years of age, to have:
$1 Trillion you would have to save $34 Million each day of your life

A billion dollars ago was only 8 hours and 20 minutes, a the rate our Government is spending it.

DJ IA	Nasdaq	S & P 500	Russell 2000	MSCI EAFE	Crude Oil	Euro	10 yr Treas.	Fed.Fund Rate	Prime Rate
24103.11	7063.44	2640.87	1529.43	8005.97	66.14	0.8115	2.40	1.50-1.75	4.75

Finding Opportunity in Disruptive Change: Retailing and Its Supply Chain

More than 20 major U.S. retail chains declared bankruptcy in 2017, from Sports Authority and Toys 'R' Us to Payless Shoe Source. Thousands of stores closed, more than in either of the recession years of 2001 and 2008. Yet, retail sales are booming, the economy is strong and unemployment is at a low of approximately 4%. What's going on? First, e-commerce is taking an ever increasing share of the $3 trillion in U.S. retail spending. E-commerce already accounts for more than 13% of retail spending and should more than double over the next ten years. E-commerce is also gaining market share by providing next-day and same-day delivery in major metropolitan areas. To provide this convenience, Amazon, Best Buy, and other e-tailers are locating fulfillment centers closer to the customer, typically in higher-cost urban and suburban areas, rather than rural industrial parks.

Investment Implications

Within the theme of next generation automation, many traditional fields and old-line business models are being disrupted. New business models are being created, some existing business models are being reinvented, and others are being subjected to creative destruction.

Here are some conclusions that shape our investment thinking:

1. Emerging markets will lose an advantage over developed markets, as low-cost wages are no longer the determining factor in location of production facilities.
2. Automation utilizing artificial intelligence and sensors will lower prototyping and small batch production costs, facilitating mass customization.
3. Outsourced fulfillment will allow small brands and retailers to do what they do best, create unique products and connect with their customers.
4. Just in time inventory enabled by sensors, software, and local fulfillment will reduce inventory.
5. Mobile and alternative payment systems will continue to gain share as consumers move away from in store cash transactions.
6. These trends are deflationary as production costs decline and labor and real estate are repurposed.
7. Shoppers will make fewer trips to physical stores, but when they do go their intent to purchase will be higher.

Chevy Chase Trust Investment Advisors

When given a choice, take both.

Treasury Market Yields	3/31/2018	12/31/2017	12/31/2016
2 Year	1.27%	1.89%	1.20%
5 Year	2.56%	2.20%	1.93%
10 Year	2.74%	2.40%	2.45%
30 Year	2.97%	2.74%	3.06%
SP 500	1.95%	1.89%	2.07%
Commodities			
Oil ($bal)	$64.94	$60.42	$37.04
Gold ($/oz.)	$1322.80	$1306.30	$1060.30
CRB Index	$195.36	$193.86	$176.27

For the quarter, fixed income now sits ahead of the S&P 500 despite the losses in 30-year maturities. As the final day of the quarter arrives in a deluge of rough weather for every asset class, relative performance is way down the list of portfolio concerns. Re-establishing a better asset allocation across bonds/stocks and within both asset classes will be front and center at some point in April, however. As it was, investors over-decided 2018 strategies in the first quarter, once again too early and relying too much on Q4 trends to forecast the next year.

- Three things popped rates higher. 1) No immediate need to buy more Treasuries out of fear of increasing global tensions. All the problems are still there, they just didn't get worse. 2) A wave of sovereign debt that had to offer enticing yields to be heard above the return of the stock market produced the first average supply week since March 19. 3) A delayed reaction to FOMC minutes the day before.
- The first two items were steepening influences, but the sneaky return of the Fed overpowered them to switch what had been a risk-off flattener to a Fed tightening flattener. Rather than "sometime maybe in the first quarter of 2019," the rate hike to 2.50% is back squarely in the "no later than December or January" position. That's a strong conclusion given the potential disruptions for global growth.
- Portfolio managers now have a clearer vision of market confidence about Fed policy into early 2019. Is that confidence premature or rational? You don't have to make a hard call on that question, but turn it around to ask "does the Fed need to move faster than three hikes in the next 9 months?" Two months ago, the answer based on fundamentals was "perhaps." Now, the better answer is no.
- Once again, the biggest risk of rising rates is the premium required to move supply rather than the risk of central bank policy. Premium risk is still real but it's measured in 5bp increments rather than 10-15bp shifts. Although there's no immediate sign of additional premium in long UST, given 30-yr UST yield at 3.04%.
- Retail sales will color fundamental expectations into early May. Then the Fed returns with a new statement that at worst reinforces the confidence expressed in the minutes.
- Chinese stocks are still sitting out the recovery move in equities, but EU securities are humming once again.
- Most interesting DC story is the NY Times report that hours before federal warrants were exercised on the President's attorney, his legal team was meeting to complete its outline for a Mueller interview with the President. Chris Low—FTN

So Far, So Good, Until……

It's easy to slip into a sense of comfort, enjoying the great ride we've had for the past 9 years, so this quarter's minor disappointments should serve as a cautionary alert. Importantly, nothing that bad has happened, yet, but there are bad things lurking on the horizon. For example, "Extreme weather events" has a high likelihood because hurricanes and firestorms have already decimated several U.S. cities and territories; and the Impact is high because the costs of recovery are enormous. Ron Surz