| DJ IA | Nasdaq | S & P 500 | Russell 2000 | MSCI EAFE | Crude Oil | Euro | 10 yr Treas. | Fed.Fund Rate | Prime Rate |
|---|---|---|---|---|---|---|---|---|---|
| 26458.31 | 8046.35 | 2913.98 | 1696.57 | 8054.84 | 73.25 | 0.8617 | 3.05 | 2.00-2.25 | 5.25 |

# Money Manager Newsletter

**September 30, 2018**

## Investment Consulting Group, Inc.

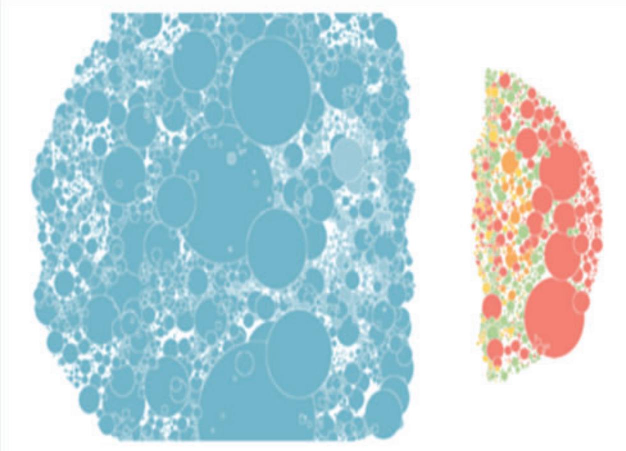
**"Risk Can't Be Quantified. Risk Means That More Things Can Happen Than Will Happen"**
**Howard Marks—The Most Important Thing**

Martin Feldstein warned of a severe recession, on par with the 2008-09 downturn in the WSJ. He posts that the stock market has been overinflated by the long period of very low rates. He warns, losses will be similar to losses when housing prices fell in 2005-11. Feldstein believes the result will be another Great Recession. There are so many mistakes in this analysis it's hard to know where to begin. Here's what we thought upon reading the op-ed:
1.) Consumer reactions to losses of stock-market wealth and housing wealth are very different. Consumers are far more sensitive to declines in housing prices.
2.) Weakness in household spending in reaction to the burst housing bubble was exacerbated by two factors. First, the drop in price was deep enough to prevent refinancing most homes or to sell most homes without a big loss. People were trapped in their homes and in their existing mortgages. Second, an unusually high percentage of loans in 2008 were financed with adjustable mortgages, which, unlike conventional 15 and 30 yr structures, reset alongside increases in the Fed funds rate.
3.) Almost 2% of annual consumer spending growth was financed with loans against home equity right before the Great Recession. There is no comparable borrowing against equities in the US today.
4.) Houses were owned by a broad cross section of Americans before the crisis, including many low-income households.
Stocks might be overvalued today, though there is nothing to suggest they are as overvalued as housing was before the Great Recession.

John Williams once said he does not like to be characterized as a hawk or a dove because he just does not want to be constrained in a monolithic point of view. "It's still a little bit of a puzzle why we haven't seen wage growth pick up even more," he explained. Mystery or not, slow wage growth and low inflation reduce the urgency to raise rates. Bottom Line: NY Fed President Williams just said he not longer thinks it is urgent to raise interest rates given the lack of wage inflation. Yields have dropped a couple of basis points across the entire yield curve as a result. Don't get too carried away however. Williams is fickle, and may decide the economy faces an inflation threat after all the next time he speaks. In the meantime, he is happy with the current pace of tightening, but respects the message of the yield curve. Unless something significant changes on the growth or inflation front, all this suggests he supports another hike or two followed by a pause. Chris Low; Chief Economist — FTN Financial

**The Problem With Passive**
Passive strategies, which are widely popular with individual investors, are often based on Nobel Prize winning portfolio theories about efficient markets and embraced by the banks and brokers that profit from selling the strategies. They are often marketed as "all-weather" strategies to help you meet your financial goals. To be blunt—there is no such thing as an all-weather passive strategy, no matter the IQ of the person who created it. As we have repeated, buy and hold/passive strategies are only as good as your luck. If valuations are cheap when you start passively investing, then you have a decent shot at meeting your financial goals. If, on the other hand, valuations are extreme and rich, you are likely to endure a multi-year period of low to even negative returns which would leave you halfway to retirement without much progress towards that goal. That is not a hypothetical statement. It is simply a function of math. **Lance Roberts and Michael Lebowitz, CFA**

| 09/30/2018 | Growth Median P/E | Historical Growth Avg. | Value Median P/E | Historical Value Avg. |
|---|---|---|---|---|
| Royal Blues | 33.5x | 24.9x | 14.5x | 11.6x |
| Large Cap | 21.4x | 20.0x | 11.7x | 10.9x |
| Mid Cap | 28.9x | 23.7x | 12.1x | 12.1x |
| Sm Cap | 30.7x | 27.7x | 12.6x | 12.1x |



Source: WSJ Article 7/11/18: How Trump's Trade War Went From 18 Products to 10,000

401 (k) lawsuits show no signs of letting up. "Ultimately, it may be that 401 (k) cases end because sponsors change their practices. That's happening now," attorney Jerry Schlichter says. Mr. Schlichter's optimism may hold true if plan sponsors and their advisers heed the relatively straight forward lessons lawsuits can teach. Three types of fiduciary breach claims dominate in retirement cases: (1) inappropriate investment options, (2) excessive fees and (3) self-dealing. This was affirmed in a May study of over 400 cases conducted by Boston College's Center for Retirement Research. Plan fiduciaries have tended to face this kind of litigation when their funds have experienced persistently poor historical performance compared to similar benchmark funds." Inadequate due diligence and failure to monitor investments and service providers are weaknesses litigators look for. The charge of "excessive fees" is now the most common of the Big Three types of claims. Self-dealing occurs when a plan fiduciary places its own interests above the interests of the plan and the plan's participants and beneficiaries. It's a central claim in the 40 plus cases brought against financial services firms. Plaintiffs typically allege that the company populated its own retirement plan with poorly performing, excessively expensive proprietary funds that do not withstand the scrutiny of thorough and objective due diligence analysis. Blaine F. Aikin—fi360 Inc.

Trustee's will be required to reimburse participants if they don't get lowest share class.

**Bull Markets:**
Average Increase: 377%
Average Duration: 6.989 Years

**Bear Markets:**
Average Decline: -41%
Average Duration: 1.37 Years

**Acceptance Rate**
Applying to college—the process by which we force emotionally volatile minors under an inordinate amount of stress to submit themselves to the judgement of an anonymous and mercurial bureaucracy for the right to make a financially catastrophic commitment as a teenager—somehow got worse since we did that. The overall acceptance rate to a top 50 college in 2006 was 35.9 percent, which has since declined to 22.6 percent. So the kids attending your alma mater right now almost certainly had it rougher than you.
Donald Stanforth, President — Investment Consulting Group, Inc.

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It seems like there are a great many jobs that are best handed off to machines. And yet, there are many other cases where jobs are dehumanized and where livelihoods are needlessly threatened. Debates about issues like why human labor is taxed while machine labor is not (even receives tax benefits) deserve to be heard. The main conclusion should be that—when most everyone has thrown in the towel on active management, it is the best time to embrace it. And, thrown in the towel, they certainly have! We are aware that mankind is the most illogical of creatures, but still, we'll take logic and foresight over superfast data crunchers, any day. Just what is it that they are crunching? Computers haven't eliminated the tendencies of people to take trends to dangerous extremes, they have magnified it. Momentum investing on steroids. The less time people spend doing active research, the easier it is for the remaining practitioners of the trade; the greater the prospective returns will be. As was the case in the three similar eras over the past century—1929, 1972, and 1999, the current environment, momentarily feels like hell for value-investors. And, as was the case following those three kindred markets, the aftermath likely should prove to be more like value-nirvana. Patience is required. Academic theory and economic orthodoxy make horrible masters, and many investors have unwittingly fallen into line behind these unworthy despots. I'll never forget when, feeling quite proud of myself for acing my first upper division economics class, the professor took all the wind out of my sails. He reminded us that back on the first day of class, we had been told that all the theories and equations that we were about to learn, are based on a set of assumptions. Well, in the real world these assumptions don't hold true. Talk about deflating. While economics make a lousy ruler, it can be a useful tool. Now 2018, we firmly believe, is one of those times when paying attention is warranted.
Where to start? Let's begin with money. This subject is perhaps where our topic at hand is most quoted, "Money makes a wonderful servant, but a horrible master." Kopernik couldn't agree more, and we've always subscribed to Charlie Munger's view that, "the best way to earn money is to deserve to earn money." We've always viewed profit as a wholly inappropriate goal, but fortunately we work in an industry where it is a likely outcome of a job well done. We focus on what we can control—our effort, integrity, judgment, and adherence to our time-tested process. The dollar held its value when tied to gold. It lost value when its ties loosened, and it plunged following the scuttling of Bretton Woods. That has been the fate of all currencies that have served political masters. We feel that cryptocurrencies will prove no different; they will be anchored by specie or they will prove to be lousy stores of value. Our advice, if you choose to hold fiat currency or cryptocurrency, insist on a sufficient rate of interest to offset the inevitable loss of purchasing power. Business-wise, intangible values are important. We are old school. We are here to serve our clients and believe in putting their interests ahead of our own. We believe that while doing things right is important, doing the right thing is imperative. We pledge to continue performing our own research, doing rigorous due-diligence, developing our own appraisals of business, risk-adjusting our required margin of safety, and buying values even when doing so is unpopular, especially when doing so is unpopular. We endeavor to always employ independent thought, wisdom, judgment, and integrity. To date, rather than making markets more efficient—robots, formulas, and algorithms have only served to take inefficiency to an extreme level. As a result, the future looks unusually bright for unfettered investing, for active investing, for value investing, and for idiosyncratic investing. David B. Iben, CFA — Kopernik Global Investors

"The people that tend to work for me a long time, not only are smart, not only are driven, not only are learners," he tells Money, "but they understand that the greatest value you can offer a boss is to reduce their stress." **Mark Cuban**

Strong economic growth plus a consensus that policy is accommodative makes for easy decisions on rates—but next year could get tricky. He thinks Powell's, Jackson Hole speech, which featured a section praising Greenspan's mid-90's decision to wait and see if inflation materialized before hiking rates suggests Powell too might decide to pause with rates at neutral rather than keep hiking. As Professor Blinder notes, the strategy in 1996 was to wait for inflation and hike if it materialized. It took years to show up back then, but it might come sooner this time. Chris Low; Chief Economist — FTN Financial

I have a friend, let's call him Jason. Jason helps me do what I want to do. Here's how this works.

1. I have an idea.
2. "Somebody Smart" questions the idea.
3. I call Jason.
4. Jason tells me it's a good idea.
5. I say "see, it's a great idea!"
6. I do my great idea.
7. My great idea often turns out to be a bad idea.
8. Oh well, who cares, it was fun anyway.
9. "Somebody Smart" rolls her eyes.
10. Aaaand….repeat. Carl Richards—New York Times

While we remain "cautiously negative" on the market, we'd concede that traditional stock market breadth measures have yet to show a traditional, end-of-cycle thinning of the ranks, in which Mid and Small Caps (and even the "median" Large Cap) lag well behind the blue chip averages. Many equity investors have suggested there's no comparison between today's expensive market and the bubble peak of Y2K, pointing out that today's Technology titans are "real companies" with massive revenue underpinnings. First, the late 1990s' bubble eventually became so concentrated that it left much of the stock market either fairly valued or undervalued; the median S&P 500 price/sales ratio at the march 2000 peak was more than a point below the cap-weighted ratio. How long it would take for some of the S&P 500's bloated valuation metrics to reach more historically-reasonable levels given a sideways market. If it was a market call, we didn't get the "sideways" part correct. The S&P 500 currently trades right back where it was in January and the seven-month break included some of the best top and bottom-line growth rates most of us have ever seen. We found ourselves asking: Did chubby Mr. Market shed any pounds as he pedaled away on his stationary bike? Bottom-line valuations have improved from morbidly obese to pleasantly plump compared to the past 20 years. Phil Segner—Leuthold Group Sept 2018

| Treasury Market Yields | 9/30/2018 | 12/31/2017 | 12/31/2016 |
|---|---|---|---|
| 2 Year | 2.81% | 1.89% | 1.20% |
| 5 Year | 2.94% | 2.20% | 1.93% |
| 10 Year | 3.05% | 2.40% | 2.45% |
| 30 Year | 3.19% | 2.74% | 3.06% |
| SP 500 | 1.80% | 1.89% | 2.07% |
| **Commodities** | | | |
| Oil ($bal) | $73.25 | $60.42 | $37.04 |
| Gold ($/oz.) | $1191.50 | $1306.30 | $1060.30 |
| CRB Index | $195.16 | $193.86 | $176.27 |