Manager's Notes

1st Quarter 2017

As the results of the 2016 presidential election became known and the stock markets plunged in after-hours trading, New York Times economist Paul Krugman was asked when he thought markets would recover. He replied that his “first pass” answer would be “never.” A day later markets would recover and rally to all-time highs and do so without a day with at least a 1% loss for well over 100 days in a row. The last time the market traded that many days in a row without a 1% pullback was in the early 90's.

What is even more remarkable is that this rally began from what we perceive as extremely high equity valuations; what was high just got higher.

Our interpretation of the strength and persistence of US equities as they pass through levels of valuation similar to 1929, 2000, and 2007 is that the US equity markets are adjusting to account for the improved business optimism showing up in many surveys.

We hope it is not too controversial to say that hoping for Donald Trump to be bad for business was not likely to be rewarding. Exactly how good President Trump might be for productivity and employment remains to be seen but the market clearly doesn't want to bet against the new administration. We think clients should keep in mind that every president to gain the White House since 1907 and switch the party of the President's office also had a recession begin between the inauguration and the 6th month of holding office. Of course this doesn't mean it will happen every time in the future but the history is something to be mindful of as the Fed begins to raise rates on the highest rates already available in highest quality bonds.

While US growth appears to have slowed to less than 1% recently there are not enough clear signs that a recession is imminent and make the necessary portfolio adjustments to become more defensive.

The problem remains that, over a long period of time, the current valuations of US equities have proven to be poor times to commit capital. Our Equity Income portfolio continues to hold bonds as we believe they offer the potential to be profitable holdings if stocks fall suddenly. The recent increase in interest rates has not yet, in our view, changed the trend of rates.

In our ETF style, we continue to be very defensive but have recently added exposure to places we feel have changed fundamentals due to the Fed embarking on raising interest rates; Financials and adding yield to the bond position. One holding that has done well for us in the long run but has been very weak for a couple of years is the Biotech holding IBB. We think this industry is particularly well-positioned for a more pro-business atmosphere and we think the rest of the market believes the opposite. For the first time we are aware of this high growth, important industry trades at something less than nose-bleed valuations and everyone now has a full position.

Our view remains; we must manage cautiously through this period of very expensive securities and closely monitor the developments that will eventually lead to the other side of the investment cycle.

Clarke Van Meter   Michael Van Meter