TILIA NEWS

INVESTMENT MANAGEMENT | FIDUCIARY ADVICE | RETIREMENT PLANNING

Politics & The Stock Market

With the recent transfer of power in the Executive Branch of the US goverment, we've heard from some clients that have lost optimism about the future path of financial markets.

This is a great time to remind you that historically, the US stock market has been extremely resiliant in the face of all sorts of political & global upheaval. Below are a few great examples:

The US entered World War 2 in 1941. The S&P 500 loses 12.77% that year, but goes on to post gains of 19.17%, 25.06%, 19.03% & 35.82% through the remaining years of the war.

In 1963, President Kennedy was assasinated. The S&P 500 returned 22.61% that year.

In 1968, we had the brutal combination of the Tet Offensive in Vietnam, assasinations of Robert Kennedy & Martin Luther King Jr., and the upheaval at the DNC convention in Chicago. The S&P climbed 10.81% that year.

President Nixon resigned from office in 1974. While the S&P lost 25.9% that year, it rose 37% & 23.83% in the next two years.

The "Black Monday" crash of 1987 was a one-day event where the market lost 22.6%. For the year, the S&P 500 ended up 5.81%.

As the world economy was in tatters and the financial crisis crossed into 2009, optimism was nearly impossible to find. The S&P 500 recovered from a horrendous first quarter to finish the year up 25.94%.

Patience & Time Horizon = Your Investment Edge

"The two most powerful warriors are patience and time." - Leo Tolstoy

Investing is unique in that, often times, inaction is the best action. Ironically, those that save money and are in a position to invest in financial markets in the first place usually get there by doing the opposite. We are bred & educated to take action and get results.

Financial markets are complex organisms, anchored by corporate earnings, but whipsawed by changes in sentiment. Information - both true, false & in-between is relentlessly spilling into the marketplace at a break-neck pace. High-frequency traders & algorithmic programs are attempting to profiting off of minute inefficiencies, and day traders are working to spot short-term trends and take advantage of patterns in price movement.

With all of the sophisticated and well-funded operations out there seeking to profit, how is a "normal" investor expected to succeed?

One answer is by expanding your time horizon - being aware of the past beyond the last year, and looking further out in the future than the next few months. So few market participants seem to do that, and the edge it allows you is enormous. Investors constantly fret over the troubles of the day, whether it's a lawsuit against a company, or a failed product launch, and neglect the long-term trajectory of a business. As long-term investors, that short-term punishment of a great stock gives us the opportunity to buy it at a discount, and look beyond how it may perform over the next 12 months. Just as importantly, looking at the past helps us avoid stocks where sentiment is too positive & far outstrips the fundamentals of the business or industry as a whole.

Another way you can improve your long-term investment performance is through practicing extreme patience. Stocks fall in and out of favor all of the time, sometimes in just a matter of months. Buying or simply holding onto out-of-favor stocks can be a frustrating practice in the short-run. Over time, it is often extremely profitable. If you can think in terms of what changes are occuring with the actual business, and how much of an impact it may have on the long-term outlook, it will help you hold onto or purchase good businesses during times where their stocks are unpopular.

While no one knows what the next four years holds, it's important to remember the past & reflect on the challenges that this nation and our financial markets have overcome. There will be plenty more challenges ahead & some of them may even seem insurmountable at the time. Hopefully some of the examples laid out here will serve as a valuable reminder to keep a level-head & don't let politics or global turmoil slay your optimism about the future of your investments.

Consumer Spending

Bank of America recently released credit card data from 2016, highlighting sales across the major sectors. Looking back over the last 12 months, the biggest increases have flowed to gas stations (+16.1%), cruises (+8%), luxury goods (+5.4%), airlines (+5.2%) & lodging (+4.7%).

On the losing end were sporting goods (-9.0%), department stores (-8.1%) & home goods (-4.7%).

In the middle of the spectrum were home improvement, restaurants, grocery stores, dollar/discount stores & furniture. All of these areas has modest year-over-year growth of 0.5% to 3%.

Setting aside the increase in gasoline prices, there is a very clear trend in place. The average American is placing a higher value on experiences than owning more "stuff". It should come as no surprise that cruise line & hotel stocks have had a nice run, while department stores are in a tailspin. While the data will vary in 2017 & the large % gainers and losers will likely moderate, it wouldn't surprise us to see the trend of experiences over "things" continue.

Tax Documents

By now, most of your 1099 tax documents have been sent out by Charles Schwab, either via email or mail, depending on your communication preference. Please let us know if you cannot locate yours, and we'll be glad to send another copy your way.

It's easy to say that you're a long-term investor. The advantage of it comes when you can truly act like one. Investing is a marathon, and the combination of patience and holding a long-term view will help separate you from the pack.

The Impact of Rising Rates on Bonds

The positive performance of US stocks since the November election has been widely covered in the media. What hasn't received as much attention is the increase in interest rates. Since November 1st, the 10 year US Treasury rate has risen from 1.82% to 2.48%, for an increase of 36%! Over the same time period, the 30 year US Treasury rate has risen 19%. As we alluded to back in our August 2016 newsletter article titled "Bond Bulls Betting on The Greater Fool", the market for long-term bonds had become irrational. Investors in long-term bonds have felt the brunt of this increase in rates. Holders of Pimco's 25+ year zero-coupon bond ETF (symbol: ZROZ) have experienced a decline of roughly 12% since November 1st, & the widely-held iShares 20+ year Treasury Bond ETF (TLT) is down 9% - which equates to 3 years of interest payments from the same investment.

More pain could be on the way for investors in long-dated bonds. As long as the economy continues to grow, and unemployment levels remain low, we'll likely see the Federal Reserve stay on the path towards higher rates. The risks are especially great for investors that hold long-term bonds within mutual funds, as performance can be negatively impacted if other investors in the fund decide to sell.

Even with a clear trend in place towards higher rates, it does not alter our view that most investors should hold a substantial percentage of their net worth in high-quality bonds. It does impact what kinds of bonds we own, and has for some time. With rates low & rising, we want to continue to own bonds that are less than 10 years until maturity, and we want to "ladder" them in a way that you have bonds maturing each year. Owning individual bonds in this manner will ensure that a) the price impact of interest rate increases will be modest and temporary & b) ongoing maturities will allow us to reinvest old bonds into higher rate issues.

Stocks and bonds are always competing for investment dollars, and there is no way to know when the "top" of the interest rate cycle will fall. If & when interest rates rise to the point that we can earn 5-7% on high quality bonds, then all other things being equal, they'll compete well with stocks. At that point, we'll want increase the amount of bonds we own vs. stocks & extend our "ladder" out to 15 or even 20 years until maturity.

Some readers are probably wondering - why own bonds at all when stocks deliver superior returns? It's safe to say that we didn't get this question in 2008 or during the 19.8% decline in the fall of 2011. Bonds will continue to be a valuable mitigator of the violent swings in the stock market, while providing stable income & a source of funds when stocks are depressed.