THE BECKMANN MARLOW GROUP

Our Thoughts on 2018

"Your ultimate success or failure will depend on your ability to ignore the worries of the world long enough to allow your investments to succeed."
- Peter Lynch

A Happy New Year?

After wrapping up one of the most volatile Decembers in history, it is safe to say most investors are happy to have 2018 in the rear-view mirror. In retrospect, it was an eventful year with no shortage of headlines. September gave us one of the most memorable Supreme Court nominations in history. After days of dramatic testimony that further exposed our deep-seeded cultural divides, Brett Kavanaugh's confirmed nomination tipped the balance of power in favor of conservatives, 5 to 4. November's midterm elections saw a historic turnout, and brought wins and losses to both ends of the political spectrum. Perhaps most notably, the Democrats regained control of the House of Representatives and gained seven governorships. With Republicans securing victory over the Senate, political gridlock is likely to ensue over the next two years as Donald Trump and Nancy Pelosi search high and low for common ground.

We enter 2019 in the midst of a partial government shutdown and looming immigration crisis. Donald Trump has been firm in his demand of $5 billion for border wall funding. The current debate over the materials involved in the construction of the wall may be viewed as a small (but important, according to some) concession by the GOP. In the meantime, it won't be long before some of the effects of the shutdown are felt on a local level, increasing the pressure to finalize a deal.

Our 2018 mid-year commentary mentioned that we felt current recession risk was relatively low. In spite of all of the observed volatility over the past few months, we still hold this very same opinion. We were highly encouraged by the labor data that was reported on the heels of December. 312,000 jobs were created during the month of December, far exceeding the expectation of 184,000. The average increase over the past three months has been 254,000. Wages are up 3.2% year-over-year. (Trading Economics). Unemployment is still below 4%. Inflation is still under control for the time being. These factors will likely have a positive impact on overall consumption, the most impactful component when gauging the growth of our economy. That is not to say that bouts of volatility cannot continue in the short term.

Let's examine some of the issues at play.

Valuation

September 20th saw a record high on the S&P 500, a broad market indicator for measuring the performance of the US stock market. At this time, overall valuations were stretched considerably beyond historic standards. In this type of scenario, it is not uncommon for us to see a reversion back to a level that is more in line with historic averages. What's more, October gave us our 20th consecutive month of forward earnings growth on the S&P 500. After observing an expansion of this magnitude, it is fair to say that the market was simply due for a pullback.

Capitulation

In volatile times it is often interesting to examine trends in overall fund inflows/outflows. Between the week of December 5th and December 12th, more than $46 billion was redeemed from US stock mutual funds and exchange traded funds. Not only is this the largest weekly redemption on record, it is also nearly twice as high as any other observed week in history. (Lipper) In the wake of these redemptions, investor demand for money markets and short term fixed income has surged. The "take home" from this data is that an alarming number of investors simply threw in the towel during the month of December. Panic selling to this degree can often exacerbate market conditions. In addition, computer and algorithmic traders (which account for a substantial portion of institutional trading) feed on heightened periods of volatility, further intensifying the environment.

Tax Loss Selling

The general timing of this correction should not be overlooked. Historically speaking, November/December is a time when investors will harvest losses currently on the books in an effort to offset any capital gains realized during the year. Given the favorable performance of the stock market earlier this year, the opportunity to harvest losses was especially favorable this year as the calendar year came to a close.

Turmoil in Washington

Recurring signs of unrest within the current administration have not done anything to pacify equity markets. Most recently, the abrupt withdrawal of troops from Syria and the subsequent resignation of James Mattis, a highly regarded General with a distinguished career in the Marine Corps, does little to inspire confidence. The general interpretation of Mattis's comments within his resignation letter was that he was adamantly opposed to the nature of Trump's withdrawal from Syria. Trump's decision to go against the counsel of a General with extensive experience further amplifies the narrative that Trump is often impulsive when it comes to negotiating international affairs.

Additionally, after Trump's meeting with Chinese President Xi Jinping in December, the potential reality of a trade war is still in the forefront. After assigning punitive tariffs to each other's goods last year, the US and China have vowed to have a definitive agreement in place within three months. Continued volatility in the US puts additional pressure on the Trump administration to get a deal done quickly. Once a deal is in place, our team believes this could be a catalyst for some increased stability in the stock market.

Europe

Another issue on the international stage is the looming Brexit deal. Voting took place on January 16th on Theresa May's wildly unpopular plan for separation. Not surprisingly, it was overwhelmingly defeated.

Initially, investors were relatively confident that the terms of the UK's departure would ultimately be carried out with little disruption to trade practices. However, as time continues to pass without clear resolution, the chance of a crisis becomes more of a reality if no clear deal is reached and a "hard" Brexit is carried out. General consensus is that a no-deal Brexit would bring about economic hardship.

A number of UK politicians are touting the idea of a second referendum. With all the tense, and seemingly endless, negotiations surrounding the terms of the Brexit deal, it is thought that a second referendum would give the "Remain" camp another chance to succeed and the UK could still remain part of the European Union.

Federal Reserve

One could argue that this is perhaps the biggest contributor of all to the recent volatility. After nearly a decade of historically low interest rates and a severely bloated money supply, the Federal Reserve has stepped on the gas pedal by raising rates seven times in the past two years. It has long been a concern of many that the Fed would be unable to properly unwind its excessive balance sheet after multiple rounds of quantitative easing post-recession. Even with solid economic data, the market has proven fragile at the outset of every recent move by the Fed. Chairman Jerome Powell recently participated in a panel discussion with former Fed Chairs Ben Bernanke and Janet Yellen. Fortunately, his comments throughout the discussion alluded to an awareness that a continuation along the same path without a pause could put the US economy at risk of a recession. We anticipate further clarity at the next Fed meeting later this month.

Through extraordinary measures, the Fed was able to bring us out of the Financial Crisis in 2008-2009. What remains to be seen is how successful the Fed will be in preventing the next crisis from occurring.

Thoughts on 2019

Unlike this time last year, we are entering into this New Year with valuations at relatively low levels. And while the yield curve has certainly flattened in recent months, it has yet to invert (a general pre-cursor to a recession). Many noteworthy strategists and economists feel a 2.5% level of growth is sustainable from here. If this proves to be true and the economic data remains solid, stocks could be on the precipice of a better-than-average year. That said, if the market doesn't receive clarity on both Brexit and the US/China trade deal in the near future, these could be meaningful headwinds for the stock market. Washington will remain a wild card. Overall, we view the current environment as an opportunity to selectively build long-term positions in quality companies. We will continue to employ both diversification and discipline as we navigate the ebbs and flows of the market. Asset allocation alongside tactical shifts in strategy will ideally make for a smoother ride along the way.

On behalf of everyone involved with the Beckmann Marlow Group, we truly appreciate your business over the past year. We wish you all the best in the year ahead! As always, please contact us with any questions or concerns.

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