MID-CONTINENT CAPITAL

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*advice; judgment; resolution; wisdom

Ten Years On, Worry Continues to Dominate Investor Thinking

The US equity market's sudden and dramatic fourth quarter correction (down 20% at its Christmas Eve lows) was fully reversed by the end of April and the S&P 500 index touched an all-time high on May 1. After pervasive gloom about overly restrictive monetary policy, the Federal Reserve indicated in January that it was prepared to end its rate-hiking cycle. A subsequent dramatic drop in government bond yields (falling from 2.8% to under 2.0% between January and June) -- and an emerging consensus that a shift to easier Fed policy was coming -- was all the fuel the market needed.

But if investors treated the return to market highs as a new all-clear signal, they were rudely reminded that fear and volatility can reappear without warning when the S&P suffered one of its worst Mays on record, down 6.3%. This decline was reversed even more quickly in June (again, on the potential for lower rates) as the market rallied 6.9% (one of the strongest Junes in decades) and again touched an all-time high late in the month.

Investors have had to endure pullbacks of 12% and 20% during a volatile 18-month stretch. This volatility reflects increasing uncertainty about where we are in the economic cycle. On this subject, we say: "It may be late, but it's probably not over."

This was the title of our July 2017 issue of *Consilium,* written at a time when numerous market forecasters were calling for a market "top" and few saw the potential for economic and stock price gains that could extend well into the future. We pushed back against this type of thinking, noting that there was no point in trying to make such a forecast in the first place. Stocks can continue to ratchet higher if the economy has life, and if a recession is coming, we believe appropriate and timely portfolio adjustments can be made with hard data and evidence in hand.

This month we passed the tenth anniversary of the beginning of the economic expansion, which will soon rank as the longest on record. But instead of celebrating, it appears that most investors feel a sense of dread, that conditions have been too good for too long, and that the next downturn and major stock market decline must be just around the corner. However, major market tops in the past have been associated with excesses of confidence, speculation, and ebullient sentiment which are surprisingly absent considering that equities are near their highs. And while we acknowledge that many measures of economic activity are slower than they were a year ago, signs of actual decline are difficult to find.

Major cyclical turning points are rare, by definition; there have been only four of them over the last 40 years! Calling a market "top" is dangerous to an investor's financial well-being, and the odds are inherently against anyone forecasting a recession and a bear market. But we are not reflexively optimistic, either. No economic or market outcome is assured. And, it is understandable to be concerned about the magnitude of the next big market decline, with memories of 2008 still fresh.

We approach the process of market and economic analysis, asset allocation, and portfolio management seriously and with a high degree of humility. Meanwhile, we continue to focus on identifying and owning shares of companies with strong business models and balance sheets, durable growth prospects, and the potential to do well under a range of economic outcomes.

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