Lassus Wherley ...a View from the Top

Building Better Futures

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Here We Go Again!

We start with our thoughts on recent happenings in the financial markets and end with an answer to some timely questions from clients.

It is quite the roller coaster ride to read headlines these days. Sometimes they pull you into a really interesting story and sometimes they make you want to move on to the next story very quickly. The reality is there are so many things happening in government, in our economy, in life and around the world that it is incredibly challenging to keep up and sometimes tempting to hide under the bed.

Lets start with the financial markets. It seems we have finally started that correction everyone has been talking about recently. This pullback in the financial markets is part of the process. When you reach this point in a long-term bull market volatility does tend to increase and a return to a little more dramatic roller coaster ride is expected. There are many factors involved that may have triggered the quick sell-off including rising interest rates, the continuing trade war with China and the end of accommodative policies. The largest impact from the market drop was related to technology stocks. This makes perfect sense given the continued increase in value these stocks have experienced in being leaders in this market. The worst tech performers in the decline have been some of this year's best performers. We expect to see these growth stocks continue to give back some value in the short term and October may be one of those periods where watching movies will be much more relaxing than watching the news.

The fundamentals of the US economy are still sound so we haven't seen much of a move to what we would classify as safe havens like gold or US Treasuries during this pullback. Typically if investors are taking profits and holding onto cash they may be parking for the short term looking for opportunities. We will

continue to follow this to see where it leads.

The longer-term trend still seems to be up for the US equity markets but many of the financial markets around the world haven't fared quite as well. We will review that in the financial markets performance section. We have been pretty focused on what has been happening in the US lately including the controversy surrounding Brett Kavanaugh and his appointment to the Supreme Court.

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The next breaking news item was that Nikki Haley is leaving her position as UN ambassador at the end of the year. The timing for the announcement was odd given how close to mid-term elections we are, but the attention focused on it was short-lived as other headlines move us on to the next discussion.

The next headline is that the average rate on home mortgages (30-year fixed rate) has risen over 1% in the last year and has just crossed the 5% level. This could start bringing housing prices down or at least slow down price increases in areas where rising mortgage interest rates may slow demand as housing becomes more expensive to finance. It has been a while since we have experienced mortgage rates at or above 5%. Stay tuned to see what impact this may have on the housing markets.

As the Carolinas are still recovering from Hurricane Florence, we have our eyes on Hurricane Michael. As of this morning it appears to have been a direct hit on the Panhandle of Florida with a path that includes Georgia and could impact the Carolinas again. Keeping everyone in our thoughts and prayers to remain safe during this powerful storm.

Another headline revolves around whether China will sell US Treasuries to force US interest rates higher. The consensus at this point seems to be that they won't and that it is more likely that they will continue to buy US treasuries. Of course, right now the primary concern for China is stopping the slide in the value of the yuan. Another country to watch is Brazil. Their presidential election has been a surprise so far with Jair Bolsonaro who has been compared to President Trump taking the lead. He needed a 50% margin to win which he didn't receive. Now we will have to wait for the next round of voting.

Financial Markets Performance

Moving on to the financial markets. The S&P 500 continued to rebound in the third quarter after its performance in the second quarter of this year. The index was up 7.71% as of 9/30/18 for the quarter vs. the second quarter's gain of 3.43%. This

run up in the domestic market can be attributed to continued strength in economic fundamentals, including a historically low unemployment rate, strong consumer sentiment, and the beginnings of wage growth.

Conversely, many investors have continued to have a negative outlook on the international environment. After seeing a significant downturn in the second quarter of this year, it is no surprise that many investors are a bit hesitant to buy back into the international markets. We believe that because of this hesitancy around the international space, many US investors have continued to buy up what seem to be slightly overvalued US equities, pushing valuations higher.

At the end of Q3, the estimated forward 12 month P/E for the S&P 500 was 18.09x vs. the prior quarter's 17.36x and 18.2x in December of 2017 at year end. This P/E has continued to pull away from the 25-year average of 16.1x forward earnings, which the US market has been shy to meet. Contrary to what we expected, even as tariffs have continued to strengthen between China and the US, the market has actually continued upward. We attribute this to an increase in demand for domestic equities over international, and the decline of trade tensions with other countries such as Canada.

US large caps began to catch up with US small caps over the past quarter, with 10.56% and 11.51% YTD gains as of 9/30/18 respectively. As talked about in the last issue of "A View From the Top", small cap stocks have done better due to their resilience to changes in international trade. Large caps have begun to catch up though, as the full effects of the tax cuts earlier this year continue to be seen in strengthening quarterly earnings.

Despite investor avoidance, losses in the third quarter began to slow for the international space. Large cap developed international equities posted a quarterly net gain for the first time in 2018 of 1.35% (MSCI EAFE). Emerging markets still saw a decline in this quarter, although their loss of 1.09% was significantly lower than the 7.68% drop seen in the prior quarter.

Bonds continued their flat to slightly negative trend, as the federal funds rate was raised once again by the Federal Reserve on September 26th to 2.25%. This level has not been met by the Federal Reserve since April of 2008. Tax exempt bonds underperformed taxable bonds for the third quarter by 17 basis points.

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Question: *I read an article recently that talked about a coming financial crisis as bad as 2008. Do you think that will happen and if so should we do something different now?*

Answer: The economy is still strong although we are well into the growth cycle. The financial markets are still reasonably focused on the fundamental health of companies in the current environment with some headline volatility thrown in periodically. We are certainly experiencing a downturn in the financial markets currently but we don't see a financial crisis ahead.

We monitor many different factors that impact the economy and the markets. There are factors that could change our view of the economy and the financial markets. One of these factors would be if we see a continued roll back of consumer protections covered in the Dodd Frank legislation. There has been development of some pretty creative products by the brokerage and insurance industries that we have to keep our eye on. However, we believe that although we are looking at a very volatile market with increasing risk we don't believe we are approaching any type of crisis.

It is always good to review your overall asset allocation and make sure you have cash available to meet your needs. So let us know if anything changes for you or you have concerns we can help you work through.

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Question: *Why is my 1 year return so much lower this quarter than last quarter?*

Answer: We track investment returns on a trailing basis, in either months or years. The most common time periods for trailing returns are 1, 3, and 6 months, and 1, 3, 5, 10, and 15 years. These returns are not calculated based on calendar time periods, but time periods dating back a certain time period from the present. For example, a one-year trailing return would be calculated with data from the end date such as 9/30/2018 to one year prior. Likewise, a 5-year trailing return would be calculated using data with 5 years prior to the end date. As time goes by and the start date is moved forward, to ensure that the same time period is being used, the oldest data is dropped from the calculation. A more intuitive understanding of trailing returns is, "what return would an investor have earned annually on this investment for the past given period of time?"

At the end of last quarter, we would have expected our target asset allocations to have a one-year trailing return between 5.33% and 11.42% based on index returns before fees and expenses. However,

at the end of this most recent quarter, those same portfolios would have had one-year trailing returns of between 4.95% and 9.90%. Why is there such a difference?

It comes as a result of the one year trailing returns dropping one of the best performing quarters in recent years (Q3 of 2017) and adding one of the flattest quarters (Q3 of 2018). In Q3 of 2017, performance for our moderate target asset allocations was 3.45%. In the most recent quarter, this same allocation returned 2.48%. While this difference may not seem significant, it actually has twice the effect on the trailing returns. Not only does adding in the lower return from this past quarter bring down the average, removing the strong performance from Q3 2017 also brings the average down.

Overall, this difference is not a reason for concern and only occurred based on the nature of how trailing returns are calculated. The biggest takeaway from this difference is that 5 years and longer trailing returns are much less affected by monthly or quarterly fluctuations than much shorter time periods. Just as it is important to plan for the long term, it is important to focus on long-term performance versus short-term fluctuations.

We tend to second-guess decisions when the market is up more than our portfolios. Don't make the mistake of comparing your portfolio's performance to just one market index.

Lassus Wherley News

In case you missed it here's an article that just went live on CNBC.com on October 9th talking about not letting emotions control investment decisions, especially in a volatile market.

Avoid a go-for-broke investing mentality by keeping emotional decisions under control

- We tend to second-guess decisions when the market is up more than our portfolios. Don't make the mistake of comparing your portfolio's performance to just one market index.
- The only accurate way to track performance is based on a basket of indexes comparable to your overall portfolio.
- Educate yourself about investment, maintain portfolio diversification, invest only after careful analysis, consider your overall goals and focus on investment value going forward.

Guest Contributor | Diahann Lassus | @diahannlassus Published 7:55 AM ET Tue, 9 Oct 2018CNBC.com

The simple answer to the question "Should I go all in?" is "Don't do it."

It is very difficult to stay focused on your long-term goals when the market has gone up for an ex-

tended period of time. Most people recognize the feeling they get when they watch the financial markets rally or they review their investments after a really positive couple of months and realize they aren't keeping up with the Dow Jones Industrial Average.

We all seem to second-guess our decisions when the market has gone up more than our portfolios, and have those moments when we start thinking maybe we are doing something wrong.

The reality is that you may not actually be doing anything wrong in your investment portfolio. To that point, tracking your portfolio based on one index is definitely not the way to measure performance.

The reality is that you may not actually be doing anything wrong in your investment portfolio. To that point, tracking your portfolio based on one index is definitely not the way to measure performance.

Remember the Dow is 30 stocks of 30 different companies. It is not a good benchmark for determining if your portfolio is performing well, for two reasons.

First, it includes only 30 stocks out of the thousands traded on other exchanges. Second, because of the way the index is calculated, higher-priced stocks exert a greater influence over the index than lesser-priced ones. If your portfolio is invested in many different asset classes, comparing your overall performance to an index like the Dow isn't very helpful or accurate.

The only accurate way to track your performance is based upon a basket of indexes comparable to your overall portfolio. For example, if you own mutual funds that invest in U.S. small cap stocks, the best index for comparison may be the Russell 2000. If you are looking at U.S. large cap stocks, the S&P 500 is a better measure than the Dow since it is a broader-based index with 500 companies, compared to 30 for the Dow.

I have had many questions from investors about whether they should increase their equity exposure, and consequently the risk in their portfolio.

For many the answer is no, but for some it is a matter of reviewing whether the potential increased return outweighs the increased risk that has to be taken. The best way to view this risk-reward relationship is by looking back at periods of time where we had either a really good market or a really bad one.

Regarding the latter, the two years that come to mind are 2008 and 2009. So if your portfolio lost 20 percent in 2008 but would have

lost 30 percent with an increase in equity exposure, this is a start for determining the extent to which that extra risk impacts a specific portfolio.

The next step is to translate that percentage to real dollars. When we look at a percentage loss of 20 percent or more, we can rationally or intellectually say "Sure, I can deal with that." But once we translate it to real dollars, it has a different feel. So a 20 percent loss may seem OK but, if it represents a $10,000 or more loss in real dollars, it may not be so easy to accept.

Maybe there are things you could do to more effectively manage your portfolio but it is not an all-or-nothing decision. Given the uncertainty surrounding the financial markets these days, now is a great time to take a good look at your portfolio.

Maybe there are things you could do to more effectively manage your portfolio but it is not an all-or-nothing decision. Given the uncertainty surrounding the financial markets these days, now is a great time to take a good look at your portfolio. As you review your overall portfolio and the investments in it keep the following in mind:

- **Think about your overall goals and objectives**. What are you trying to achieve with these dollars? Can you target a higher return and accept higher risk and still reach your objectives? If not, take it slow increasing the risk of your portfolio.
- **If you don't have a financial plan,** this review is a great reason to develop one starting right now. Planning now means a lot less stress and regrets later. Think about what a financial plan could mean to you and your family. A major benefit is that it keeps you focused and on track for the longer term and not just the short term.
- **Make sure you understand the basics of investing,** even if you hire a professional to help you manage your money. You need to understand the reasoning behind how your dollars are managed.
- **Review your overall asset allocation to make sure it makes sense for you.** The overall asset allocation and the asset classes you select are the most important part of building a solid investment portfolio for the long term, and the primary determinant of your portfolio's overall performance over the long term. Make sure you rebalance periodically to bring it back in line with your original asset allocation if there has been no change in your financial situation or investment objectives. If there has been, you need to

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revisit your original asset allocation. If you originally targeted 30 percent in bonds and 70 percent in stocks, is this what you currently have?

- **Review each individual investment**. If you own a stock, is it still a good company? If you own a mutual fund, is it performing like comparable funds? If not, why not? Would you buy it today? Slow down and really think about the investments you currently have. Even if an investment has lost money, it is not necessarily a bad long-term investment. Don't just react to what is going on in the markets today.
- **Maintain that diversification**. Don't let any stock or fund take over your portfolio. Even if an investment has done really well, make sure you take profits and don't let it take over too much of the value of your portfolio. Diversification doesn't mean having many different advisors or many different U.S. large cap stock funds. It means having investments in U.S. large cap stocks, U.S. small cap stocks, fixed income, international, emerging markets and various other asset classes. Investing in asset classes that can help diversify your risk is critical.
- **Purchase new investments only after extensive analysis.** That means don't buy the latest hot investment or buy something on a friend's or neighbor's hot tip, or the one that has gone up the most this week.
- **Focus on the investment value going forward and not just on past performance.** Past performance is only one indicator and not necessarily a predictor of future performance. If you are investing in a mutual fund, all else being equal, stick with the fund with low expenses. Funds with lower expenses have to take less risk for the return.
- **Think about the basics of investing**. You want to buy low and sell high, not the other way around. Don't get caught selling something after it may be close to a bottom, especially if you believe it is still a good company or a good mutual fund. The flip side is, don't fall in love with an investment and hold onto it in spite of continuing poor performance.
- **If you aren't sure what to do, or you find yourself unable to make a decision,**

hire someone to help you. There are many very good financial professionals out there that are capable of helping you work through some of these tough decisions. Don't be afraid to ask for assistance in a difficult market.

The bottom line

The bottom line: Don't make the mistake of moving in and out of investments trying to find the "right answer" in a volatile market. Unless you have a crystal ball, a diversified portfolio is still the right answer to most investment questions.

Remember that many investors lose money not because of bad investments but because of really poor timing of buying and selling investments.

Remember that many investors lose money not because of bad investments but because of really poor timing of buying and selling investments. This happens because by the time they are convinced that the market is going down forever and actually sell may be right before the market does go up. It is also true of rising markets. You cannot time markets no matter how smart you are so invest in a diversified portfolio and keep rebalancing.

"Sooner or later the market will back up. ... Until then, keep that go-for-broke mentality under wraps and don't let emotions control your investment decisions."

This time is not different and the market will not go up forever. The key is to plan your investment program, select individual investments carefully and don't make changes without extensive analysis. And remember that mantra: "I am a long-term investor, I am a long-term investor, I am a long-term investor." You get the idea.

Like any other bull market, this one will not last forever. Sooner or later the market will back up and we will once again experience the fear that is the other part of the equation. Until then keep that go-for-broke mentality under wraps and don't let emotions control your investment decisions.

Diahann LassusCNBC Contributor and President of Lassus Wherley, a subsidiary of Peapack-Gladstone Bank

https://www.cnbc.com/2018/10/09/avoid-go-for-broke-investing-by-keeping-emotions-under-control.html

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Sending our thoughts and prayers to everyone who has been affected by Hurricane Florence and now Hurricane Michael. Please stay safe and know we are thinking about you.

Please keep in touch and remember that you are a long-term investor regardless of what happens in the financial markets in the short term. You know our mantra. We are long-term investors!!!!

Let us know if your cash needs have changed or there is something else we can help with.

There remains much uncertainty in our world today, and we know that the world is changing very quickly. Please let us know if you have any questions. And remember to practice that deep breathing when the world starts to get to you.

We all have those days where we wonder if we have stepped into another dimension but we manage to work our way through and recognize that this too shall pass.

Stay dry and try to enjoy this crazy fall!

Diahann

Compliance Disclosure

If you are a Lassus Wherley (LWA) client, please remember to contact us if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services. Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by LWA, or any non-investment-related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from LWA. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. LWA is not a law firm and no portion of the newsletter content should be construed as legal advice. A copy of LWA's current written disclosure statement discussing our advisory services and fees is available upon request.