CONWAY • JARVIS LLC
Investment Outlook

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The Market Rides Higher into a Less Than Certain Future

In our year-end letter, we discussed how investors' expectations were driving market returns higher in the post-election period. The post-inaugural period has proved to be no different. DOW 20000 was recorded within days of the inauguration and, following a week of consolidation, coasted through DOW 21000 a short month later. Just like that, Easy Peasy. That advance seemed almost too easily accomplished for those of us who invest in rather than bet on the stock market. Why? Because, aside from all the midnight tweets, a false start on border control, and the various and sundry promises from administration spokespeople, nothing related to fiscal policy has been enacted in the first 60 days of the Trump administration. This rally is all about what *might* happen as the result of the administration's Grand Plan.

The market advance of 6+% thus far in Q1 is more the result of improving investor sentiment regarding the U.S. economy and its markets. That can be attributed to the Trump administration's aggressively communicated *intent* to stimulate the domestic economy. While it has undoubtedly benefitted investors in the short run, we must point out that this does take the market one step closer to the final stage of this second longest bull market on record. One of our favorite market maxims is that of Sir John Templeton: "Bull markets are born on pessimism, grown on skepticism, mature on optimism, and die on euphoria." It looks to us like this bull market has entered the third stage, maturing on optimism about the effects of what will be enacted in terms of fiscal policy for the next decade.

In our economy, optimism raises confidence that translates into action by business and consumers. That likely explains the recent data pointing to a pickup in the rate of expansion of the U.S. economy. We're seeing a stronger labor market with steady, modest gains in household spending and business investment. Hopefully this will translate to higher GDP growth. The Fed apparently shares that optimism and, being data dependent in its approach, has raised key rates in December and again this week. The general consensus is that we could see one or two more key rate adjustments before the year is out. That implies a bullish outlook for both the economy and the stock market.

Be Prepared for the Other Side of Optimism

Inevitably, a later stage advance of a bull market like this one gives rise to speculation about "The End". You know, The Big One, a repeat of 1929 or 2008 or, at the very least, the recessions of 1973 and 2000. The financial media, always selling advertising, routinely swap the giddiness of new market highs for the fear of the next market crash as their hook to keep you watching. Our advice? Change the channel. The drama should be ignored, but not the message. Another maxim: The markets cut both ways and investors should, despite rosy expectations, be prepared for a less than rosy outcome.

We, like other investors, love rising markets. However, what happens when the party's over? Is there a market correction (down 10+%) in our future? Absolutely, a 100% probability. Will there be another recession and bear market (down 20+%)? We guarantee it. These are the realities of markets that investors must acknowledge and for which they must prepare. Any good long-term investment strategy includes a

"Plan B". That's when you break the glass and pull the lever on your backup option, *Liquidity*. It comes in two forms: cash held apart from investment capital, and fixed income investments held in investment portfolios. Those are two ready sources of money that an investors can use to meet their financial needs during a negative market cycle. It's essential to any successful investment strategy since it avoids the liquidation of stocks during one of the above-referenced realities.

What might those realities look like? At these levels, a correction for the DOW 30 would exceed 2000 points. A bear market would exceed 4000 points. Those are large numbers that incite meaningless drama. This is why we encourage clients to A) Focus on percentage changes in the indexes and B) Ignore the DOW 30 as an anachronism that borders on the irrelevant. We suggest focusing instead on more broadly diversified, cap-weighted indices that provide real perspective as to market performance. Stocks continue to flirt with record highs and we've seen the bell ring on almost 110 market sessions without a 1% decline. There is no better time than now to evaluate the asset allocation of your portfolio within the context of a personal budget for the next biennium and to make any needed adjustments to meet your projected liquidity needs.

The stock market advance is pricing in expectations for new fiscal stimulus through less burdensome regulation, a better version of Obamacare, and tax cuts for everyone. Remember, this is speculation, not real information, about how our economy will look under a Trump presidency. The Grand Plan could all come to fruition or not at all. It's highly likely the results will fall somewhere in between. Don't abandon your long-term strategy to speculate on what might happen during the next four years. Sticking with a balanced and diversified portfolio that takes into account your liquidity needs will allow you to ride through the inevitable downturns that will punctuate what could turn out to be the longest bull market in history. Time will tell whether we ride the current wave of Optimism for the next several years or if the excesses of Euphoria set the stage for the next bear market. Either way, address your liquidity needs and you'll be prepared.

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