October 21, 2016

Dear Clients and Friends,

The third quarter of 2016 was pleasantly uneventful in financial markets. Oftentimes, summer can be a season that sees more market volatility, but not this year. The US stock market was only briefly in the red in the beginning of July and then stayed in positive territory without moving around very much. Did investors finally embrace the wisdom of taking a long-term view and ignoring the short-term noise? Or maybe they unplugged to spend time on the things that matter? I am afraid it is neither of the above and it was just a random pocket of smooth air. It does pose a conundrum for the pundits who must opine on why the market goes up or down and where it goes next: flat lines don't have quite the cache.

How will the upcoming election affect financial markets? Good question, but difficult to answer conclusively. There are some things we know, however. Uncertainty is a headwind for risk taking which puts downward pressure on risky assets such as stocks. To the extent that uncertainty is reduced, markets tend to react favorably. If the market does not appear to be reacting to the upcoming elections, it is perhaps not uncertain about the outcome.

Is the market being complacent? Maybe. However, the margin of error on the Brexit polls allowed for either outcome. The polling gap between the contestants in the US presidential election, leaves less room for doubt. One thing to keep in mind, is that polls are not static. If the gap in the polls narrows and approaches the margin of error, I suspect the market will react to the increased uncertainty.

If the market "gets it wrong" it would be most likely because it cannot factor in the unknown unknowns, i.e. any game changing late October surprises. To close the loop on the topic of elections: the only levers that need to be pulled are in the voting booth and not in one's portfolio, in my view.

I recently was asked by a business colleague "what are you doing to protect your clients against the next downturn?" Though it is a very clear and concise question, I contemplated it for quite some time. The ingredients that comprise the answer are things I have often discussed in my newsletters: diversification, selecting the appropriate risk level for your portfolio, long-term orientation, emphasizing unemotional decision making, being proactive rather than reactive, to name a few.

But more to the point: to prepare for the next downturn, it is important that clients have a plan in place that includes investment goals and cash needs. Having enough low risk assets in your portfolio to meet cash needs will preclude you from having to sell riskier assets at a bad time. Risk and return go hand in hand. It is a good idea to reassess your risk tolerance from time to time, so you know what it means to be 50% or 80% in stock in terms of expected return and possible downside.

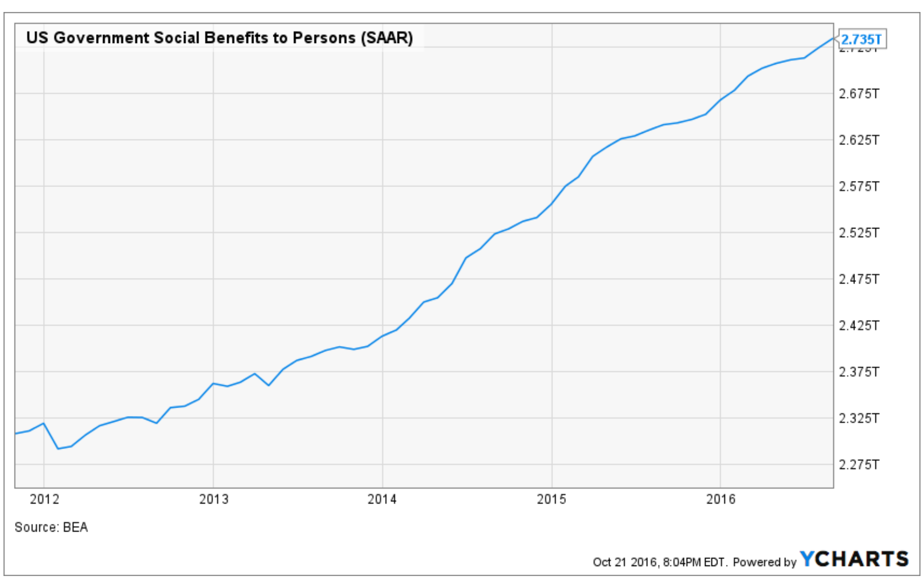
And finally, the conceptionally simplest but practically hardest thing to do is to avoid market timing. No one articulates the futility of market timing better than John Bogle, founder of Vanguard: "Short-term market timing is a loser's game. None of us know what tomorrow holds, not Bogle nor anybody else. And that's why I have never done anything other than [to take] a 10-year reasonable-expectations perspective." It would be so nice to know how to time the market, but any person that has the ability to predict the future with a reasonable degree of certainty and consistency, would have all the world's riches and probably wouldn't bother being in the business of given advice to others.

But the US stock market is expensive, right? Yes. But "expensive" does not mean it is about to get cheap. What "expensive" *does* imply, however, is that over the next 10 years the returns might be muted compared to a "cheap" or a "reasonably priced" US stock market. This knowledge does not help us sidestep a market downturn, but it can help us tilt the portfolio towards other assets that do not look as expensive and are thus likely to have more upside over the next decade.

As you shorten the horizon of your prediction from 10 years to 5 years, to less than 3 year, the accuracy drops precipitously to the point where it becomes somewhat of an arbitrary exercise. Moreover, time spent trying to time the market, can be a distraction from other work that should be done to protect your wealth: implementing a well-designed investment plan and maintaining mental discipline while executing the plan.

As the number of Americans who can rely on a pension plan to fund their retirement is getting ever smaller, more and more reliance is placed on private retirement accounts such as IRAs and 401(k)s and Social Security. One (of the) problems with Social Security is that the cost of living adjustments (COLAs) are based on an inflation rate that does not accurately capture the price increases that seniors face. The inflation rate used, is the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).

The 2017 COLA is 0.3%, which amounts to a $5 (not a typo) per month increase for the average retiree. I don't think anyone with knowledge of retirees' budgets could say with a straight face that $5/month is going to cut it. Why doesn't the government use an inflation measure that more accurately reflects the basket of goods & services that retirees purchase? I will leave that floating out there for everyone to ponder.



What the Social Security and pension reality means for many of our clients is that private investments are increasingly the core pillar upon which the retirement foundation rests. That makes our job both harder and more important. Millennial investors know this reality and have the benefit of time to respond to it. For those with a decade or two left in their careers, savings can still be the saving grace. For retirees, the low interest rates on bonds and miniscule COLAs are clearly more challenging, but we are here to help you meet those challenges and get the most out of your financial assets.

I welcome you to contact me with any questions or to learn more about our investment strategies and financial advisory services.

Wishing you a fall season in beautiful color.

Best Regards,

Jan Schalkwijk, CFA

JPS Global Investments