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The Intelligent Investor—September 2016

Quick Thoughts:

Having just celebrated my sixth wedding anniversary with both my wife and daughter in Delray Beach, I'm reminded of the importance of our stewardship role. We strive to serve our clients to the best of our ability and welcome the opportunity to go above and beyond for you. We embrace the burden of financial planning and investments so that you don't have to. We work hard to be sure you can enjoy time with your families without financial stress and we are incredibly thankful for that opportunity.

Now on to the commentary…

There is something about the month of October that tends to spook investors. Perhaps it's the approaching Halloween holiday. Maybe it's the market crash of 1929 or the one-day crash that happened in 1987. Further back, almost 20 years ago, the mini-crash of 1997 that was tied to the economic crisis in Asia played out shortly before Halloween. More recently, shares were pummeled in October 2008 after Lehman's collapse roiled global credit markets.

However, October's scary reputation belies reality. Since 1970, the S&P 500 Index has averaged a monthly *advance* of 0.99% (St. Louis Federal Reserve data). So much for October's spooky reputation.

Over the last 45 years, September has registered an average drop of 0.72%, far below August, which is second from the bottom, or an average return of 0.0%. Therefore, on average, the broad-based S&P 500 Index has risen in 10 of the 12 months since 1970. Markets really do rise over time, as the data illustrate, and patience is an investor virtue.

September, for reasons that aren't fully understood, has historically been a tough month for investors. Some explanations seem plausible, though they can't be conclusively proven. According to Investopedia, one theory suggests that summer is usually marked by lighter volume, as investors typically go on vacation and refrain from selling stocks. When they return, they exit shares they had planned to sell.

Another camp puts the blame on mutual funds. Many mutual funds set their fiscal year end in September. Therefore, fund managers, on average, may decide to sell losing positions before the end of the fiscal year, which leads to September's subpar performance.

That theory may hold some water. When the index (in this case the Dow) has been up for the year—as it is now—it usually means the month finishes up, though returns are "still not great," according to Bespoke Investment Group.

In any case, here's the next question that typically comes to mind: "Should I sell in September and re-enter when the long-term averages suggest we'll be in a more favorable climate for stocks?"

First, be careful with averages, as they are just that–averages.

We may consider paring back positions this month, or in any month, but it would have nothing to do with September's historical weakness and everything to do with fundamentals in the market and your personal circumstances.

Attempting to time the market, especially short-term ins and outs...and then back-ins, creates a taxable event in nonretirement accounts. Even if we are LUCKY enough to time it just right, more often than not, it's a net loser and only lengthens the road to your ultimate financial goals.

I'm reminded of a comment made by Peter Lynch, who successfully ran Fidelity's Magellan Fund during a long period of explosive returns. He noted, "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

Boring August

How boring is boring, asks LPL Research Group? We may be near a record high, but using closing prices, the S&P 500 traded in a 1.54% range in August–the smallest monthly range since August 1995. In fact, only six months have had a narrower monthly span, going all the way back to 1928!

Table 1: Key Index Returns

	MTD %	YTD %	3-year* %
Dow Jones Industrial Average	-0.2	+5.6	+7.5
NASDAQ Composite	+1.0	+4.1	+13.2
S&P 500 Index	-0.1	+6.2	+10.0
Russell 2000 Index	+1.6	+9.2	+7.0
MSCI World ex-USA**	-0.2	-0.4	-0.4

MSCI Emerging Markets**	+2.3	+12.5	-1.3

Source: Wall Street Journal, MSCI.com
MTD returns: July 29, 2016—August 31, 2016
YTD returns: December 31, 2015—August 31, 2016
*Annualized
**in US dollars

With August behind us we are entering the so-called "dreaded" month of September. What's in store and what might create a bumpier road, at least in the short term, for investors?

While I won't venture a guess as to where we'll end the month, let me spend a moment reviewing possible events that could awaken the market from its sleepy August.

Before I jump in, let me remind you that I share Warren Buffett's long-term view. As he said in his 2015 letter to shareholders, "For 240 years, it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs *(Bloomberg – Warren Buffett's 2015 Shareholder letter, Annotated)*."

But in keeping with our theme, let's review potential shorter-term risks that may lie before us. We've been hearing chatter the Federal Reserve might hike interest rates as soon as September.

"I believe the case for an increase in the fed funds rate has strengthened in recent months," Fed Chief Janet Yellen said near the end of August. By itself, the statement really isn't earth-shattering, but it is a signal that Yellen is eyeing a rate hike later this year.

But in an interview on CNBC later in the day, her Number Two at the Fed, Vice Chair Stanley Fischer, surprised investors by saying that her remarks were "consistent" with two rate increases this year. Of course, he was quick to add that it all depends on the economic data.

Nonetheless, an increase at the September 21 meeting could create short-term volatility in shares, even though rates would remain near historically low levels. We saw an example of this volatility on Friday, September 9th, when the DOW fell almost 400 points on a speech given by a voting Fed member. The market has too much idle time on its hands right now, and it is clinging to every word, seemingly searching for volatility.

If not rates, then what? Record highs signal investors aren't fretting over the upcoming election. With the exception of the political junkies, voters historically don't really get engaged until after Labor Day. A tightening in the race could create additional uncertainty as we head toward November.

Then there is the ever-present possibility that international woes could wash up on our shores. Recently, we had a front row seat to the emotional responses wrought by China and Brexit.

Once investors realized overseas worries weren't mucking up the shores of the U.S. economy, cooler heads prevailed.

These are just some of our more recent concerns. I won't belabor the point by lifting up every rock that might provide a September surprise, but now is a good reminder during the market's recent calm that volatility can strike. When it does (note, I say "when" not "if"), our financial plan is designed to reduce overall risk while keeping our focus on the long term.

Economy – Some Good News

I never want to end on a gloomy note. Even during the depths of the Great Recession, we could look up to see the glimmer of distant lights.

A quick review of the economic data reveals an economy that has recently gained a bit of momentum. It's not the fast-paced growth we experienced during the 1980s or the "brimming with confidence" economy of the late 1990s, but the improvements are cautiously encouraging.

Though business spending remains weak, employment growth has accelerated (U.S. Bureau of Labor Statistics), weekly first-time jobless claims are holding at historically low levels (Dept. of Labor), and consumer spending has come out of its winter hibernation (U.S. Bureau of Economic Analysis).

While I'm the first to counsel against taking on needless debt for what are needless purchases, consumer spending accounts for 70% of GDP (U.S. BEA). Therefore, a more engaged consumer helps lift the economy.

Why does this matter? As I've pointed out before, the biggest long-term driver of stock prices is corporate profits, and a growing economy creates a tailwind for profits.

Strategic and Tactical Allocation

You've heard me say this before–stick to the plan. From a behavioral standpoint, it's usually easier to adhere to the financial plan when markets are moving higher. Its human emotion that drives much of the underperformance, and part of our role is to remove harmful emotion from the process. If your goals remain the same, we are comfortable that your strategic allocation is still appropriate; if goals have changed, it's an opportunity to review the planning, and confirm it is synced up with your strategic allocation.

We remain tactically active in this environment, focusing on the relationship of stocks, bonds and real estate in our portfolios. I think we are in a unique period of time, as an increase in rates, and thus a vote of confidence for the economy, would be seen as negative for stocks, when the contrary should be true. I think it may create a "safe haven" trade where bonds go up, when in fact the opposite should happen, as when interest rates go up, bond prices should go down. It's these short term dislocations that create opportunity, and we are focused on being tactical when they do.

I hope you've found this review to be educational and helpful. As I always emphasize, it is my job to assist you. If you have any questions or would like to discuss any matters, please feel free to give me or any of my team members a call.

Thank you very much for the trust and confidence you've placed in me and my team and our firm. As always, I'm honored and humbled that you have given me the opportunity to serve as your advisor.

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