Quarterly Client Newsletter

2nd QUARTER 2017 REFLECTION

BY ALEC BETHURUM
SR. PORTFOLIO MANAGER

As I reviewed the first half of 2017, the two issues most discussed, both in client conversations and through media outlets, were the increasingly vitriolic and sometimes violent nature of political discourse and the strong performance of the tech heavy domestic stock indexes. Interestingly, these issues tend to span the full spectrum of human emotion in relation to how we invest our money. On one hand, we have the pessimists. These individuals often ask how we can even think about investing in this environment, "politics in Washington are beyond repair" and "we are on the cusp of major international military conflagrations." On the other hand, we have the wild-eyed optimists, "why aren't we performing at the level of the S&P 500 or Nasdaq 100 this quarter?" And "why don't we just buy the indexes with low fees?" To address both the dire and optimistic concerns, let's place these views into historical context.

First, consider the political and geopolitical environment. On this front, we have been bombarded with "breaking news" throughout the first half of the year. From the polarizing testimony of James Comey; to the breathless coverage of the Russian interference in our election; to the supposedly imminent impeachment of Donald Trump –it certainly appears we are in uncharted waters. However, if we take a step back and frame this in a historical perspective, we find earth-shattering events rarely occur thus fear concerning political events is rarely good reason to adjust core investment strategy. Warren Buffet has a good quote in regards to concerns about politics and geo politics and their effects on long-term investing. He has said, "In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a fly epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497." Recent history proves this point further. The 1960's and 1980's were likely the two decades, since the end of WW2, where nuclear conflict, with the Soviet Union, seemed most imminent. Yet, both decades generated some of the best economic growth and stock market returns of the century. Fear is rarely a good reason to sell an investment; but other people's fear often gives us an opportunity to find investments at good prices.

The second issue we want to address is the very strong performance of tech heavy indexes and the ETF's, and the questions this performance raises regarding "active" vs. "passive" management. As readers of our previous letters are aware, we are not proponents of broad indexing and previously have pointed to the fallacies indexing presents. This time, though, we want to put the indexing debate in historical context: Wall St. in general is extremely good at providing the public with products they want. With no patents for a given strategy or product, there are low barriers to entry. Once an idea catches the interest of the investing public, Wall St. is happy to churn it out. Wall St. history is littered with products which once were thought to be the holy grail of investing but turned out to be shooting stars.

As an example, few would believe it today, but in the early 1990's Mutual Funds were the ETF's of the time. In previous decades "Stock Brokers" were the kings of investment advice pitching clients stock tips and generating commission revenue. By the 1990's these stock brokers were the "high fee, underperforming" investors. Instead of using a stock broker's prevailing wisdom in the 90's, one was better off giving their money to a mutual fund where experts managed money for a flat fee, rather than commissions. Of course, after a couple decades and a massive expansion, these mutual funds are now the "stock brokers." The truth, of course, is that stock brokers and mutual funds and ETF's are neither good nor bad, instead there are good brokers, good funds and good ETFs and there are bad ones. But the true lesson is that whenever something is so popular that its success is considered inevitable and its practitioners are perceived as infallible that is the time HISTORY has taught us to be concerned.

As a final note, I would like to encourage our clients to call in to our quarterly conference calls. We believe our clients will be best served and achieve the best results when they have a more complete understanding of our philosophical underpinnings and these calls are an excellent opportunity to learn and communicate with us. As always, we encourage questions and comments and we appreciate your business and referrals.

MISSION As a fiduciary we commit to excellence and high standards as we deliver tailored portfolios and financial planning to reduce risk, improving the probability of our clients' success.

CORE VALUES
Client-Centric Stewardship
Integrity
Excellence
Team Work

HISTORICAL PERSPECTIVE ON THE S&P 500

BY REGAN ERVIN, CHIEF OPERATING OFFICER

For the past few years we have reported the S&P 500 has been trading at the 'high-end of fair value,' yet the index continues to set new highs. We feel the case for the S&P 500 being over-valued becomes more pronounced with each consecutive high.

First, we are not predicting an imminent correction or doomsday scenario. We simply want to be mindful of the risk-to-reward when deploying capital, and to convey our views as we give preference to buying companies at attractive valuations.

Consider the S&P 500 is now trading above a 25 Price-to-Earnings (PE). This means, on average, for a company with $1 in earnings, S&P 500 investors are paying $25. Historically, the S&P 500 has traded near a 16 PE, which is to say, historically, investors have been willing to pay $16 for a company with $1 in earnings.

Flipping this around, today, $100,000 of invested capital is buying $4,000 in earnings. Whereas, historically, the same $4,000 in earnings could have been bought for $67,000. If stock prices remain constant, the S&P 500 companies need to see 60% earnings growth to bring the valuations back to the historical average. Do you believe companies will achieve this in the foreseeable future?

Join us on our quarterly conference call as we delve deeper into the historical perspective of the S&P 500 and forward earnings growth.

	PE Ratio
Dec 2011	16
Dec 2012	17
Dec 2013	18
Dec 2014	20
Dec 2015	22
Dec 2016	24
Jun 2017	25.6

**historical average: 16*

QUARTERLY INVESTOR CALLS

Tuesday, July 25th @ 10am CST
Tuesday, October 24th @ 10am CST

To register: 816-531-2254 or *info@sterneckcapital.com*

COMMUNITY STEWARDSHIP

BY ROBIN STERNECK, CO-FOUNDER & PRESIDENT

Years ago Jack Welch, the iconic CEO of GE, vowed to make the company "a good as well as great one". He cascaded that vision through community support via local teams in hundreds of locations throughout the world.

At Sterneck Capital we honor that vision through our collective and individual efforts actively giving back to our communities and the causes that improve them. We believe in doing the right things for the right reasons. It is a natural extension of our fiduciary-based business vision of being good stewards for our clients and communities.

We've committed our time, treasure and skills to make a difference now and in the years ahead. Some of our recent efforts include the organizations listed here.

2017 SCM Outreach Recipients

- Girls on the Run
- Greater KS Sports Foundation
- KC Repertory Theatre
- Metropolitan Organization to Counter Sexual Assault (MOSCA)
- National Multiple Sclerosis Society
- Newhouse
- Operational Breakthrough
- Relay for Life
- Reconciliation Services
- WIN for KC (Women's Intersport Network)
- Women's Employment Network
- Grief's Journey - NE
- Youth Frontiers - NE