Quarterly Client Newsletter

1st QUARTER 2018 REFLECTION

BY ALEC BETHURUM
SR. PORTFOLIO MANAGER

This quarter I want to use this space to address two topics. First, we will discuss the pick-up in market volatility experienced in the first quarter. Second, we will address the evolution of our views on ETF's and why we are beginning to use them in a more substantial manner.

First, the market. The experience in both the equity and fixed income markets in Q1 was significantly different then the experience in 2017. However, as we will note, not significantly different from the long-term experience in both markets.

2017 was notable for the relentless and consistent advance in equities. Equity markets set a number of records for the narrowness of the trading range; and the VIX, a measure of volatility, set an all-time low. The first quarter put an end to this trend, and, like a rubber band stretched to extreme, once the volatility broke from its range its movement was rapid and extreme. The change in sentiment was driven by numerous factors including interest rates and tariffs. Interest rates made a sharp upward move at the beginning of the quarter. At its peak, the 10yr pushed through 3% before settling back as the quarter came to a close. This rate volatility was exacerbated by the fact that Q1 also saw a new Fed Chairman take the reins, an event that drives uncertainty.

Q1 also saw the initiation of several defensive tariffs by the US Government. These tariffs led to increased volatility in late March, when our major trading partners, particularly China, responded in kind. By quarter's end, these concerns were further heightened as the press and market participants became worried about what an escalation in tariffs might mean for long-term growth and inflation expectations. Suddenly, the term "trade war" held a prominent place in both newspaper and television headlines.

Despite these events we want to note that the recent volatility, as defined by a 10% pullback in the S&P500, is really more normal then abnormal on a historical basis. In fact, from 1980-2017 the average inter-year drop was 14%. This, despite the fact that 28 out of 37 of those years showed positive returns at year end. The reality is that it was last year's lack of volatility that was more of an anomaly than the declines that we have endured YTD.

Currently we believe the volatility, the concerns about interest rates, and the "trade war" are just noise, and the underlying economy is demonstrating continued strength. Many of the themes which drove the markets higher in December and January (improved regulatory environment, lower corporate tax rates, lower unemployment and improved consumer spending) should drive earnings for the balance of the year. As such, our current position is to take advantage of the equity weakness by adding exposure to this asset class.

The second topic I want to address is one we will discuss in greater detail in coming letters and on our conference call, that being the evolution of our use of ETFs. As many of you know, we have not been big proponents of Index ETF's, believing the abandonment of all fundamental metrics and simply allocating to a stock based on its market cap was a bad idea. However, over recent months, the industry has launched a number of new products in which the stock selection is fundamental in nature and aligns with our views of the market. We have also become very comfortable with any liquidity concerns in ETF's. Finally, in taxable accounts we note the tax efficiency of an ETF. Because of the mechanism by which ETF shares are created, the actual ETF can have infinite turnover inside, but, as long as the client does not sell their ETF shares, no tax liability is incurred. This tax advantage gives ETFs a huge leg up on traditional mutual funds and makes them an important tool for compounding capital in a taxable account. As always, we welcome your questions and appreciate your partnership.

2018 QUARTERLY INVESTOR CALLS

- Tuesday, April 24
- Tuesday, July 24
- Tuesday, October 23

All webinars will begin at 10am CST.

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

WILL YOUR WEALTH BE HANDLED AS INTENDED?

BY ZACH EMSLIE, CFP®

We initiated a review of all accounts to identify situations in which accounts do not have beneficiaries identified. The simplest step is to add beneficiaries to the account. This allows for the quick and efficient transfer of assets upon death. Of course, certain situations may require more complex estate planning.

We plan to incorporate this focus into upcoming client reviews, advise simple solutions when applicable, and discuss more complex needs as the situation dictates.

KEEPING YOUR ASSETS SAFE

BY REGAN ERVIN, CHIEF OPERATING OFFICER

To ensure the safe keeping of assets, TD Ameritrade has modified cash-transfer requirements. Generally, client signatures are now required to move assets between two accounts with differing registration. Meaning, a transfer between John Doe Indiv and John Doe IRA will now require client signatures to execute the request. Further, all wires from a TD account to an external account will require verbal authentication with the client. This must be performed by Sterneck Capital, after receiving a signed wire request. We will try to minimize the impact to clients in cases where standing instructions can be arranged without posing undue security risks.

IS VOLATILITY FRIEND OR FOE?

BY FRANK STERNECK, CO-FOUNDER & CHIEF INVESTMENT OFFICER

As Alec has touched upon, volatility has returned to the equity market this year following an extended hiatus. Common perception is that volatility is a bad thing, and should be feared. This is generally true only if one allows emotion to be a significant driver in making investment decisions. In contrast, we believe volatility can be our friend if we recognize the multitude of factors that move stock prices in the short-run should have little bearing on long-term valuations. As intra-day market swings move stock prices by whole percentage points, often nothing material has changed with the company or economy to justify such a significant repricing. Our preference and opportunity is to take advantage of these fluctuations.

While the media loves to hype big market moves, both up and down, I encourage investors to keep their eye on their individual long-term goals and not let short-term volatility, nor the media, discourage them from participating in an asset class that convincingly has demonstrated attractive returns over time. Appropriate asset allocation and diversification should help reduce overall portfolio volatility, while accepting and even embracing volatility in parts of your portfolio.