Quarterly Client Newsletter

1st QUARTER 2019 REFLECTION

BY ALEC BETHURUM
SR. PORTFOLIO MANAGER

What a difference three months can make! After a rocky finish to 2018, a period when major equity markets saw declines of nearly 20%, the beginning of 2019 witnessed those same markets U-turn and snap back in the other direction. The first quarter of 2019 was the strongest domestic equity quarter in nearly 10 years. Almost all major domestic indexes posted double digit gains. International developed and emerging equity markets also bounced back, posting high single digit gains on a broad basis. By quarter's end, even the bell-weather bond index, the Barclay's Aggregate, was up nearly 3% as the Fed made a U-turn of their own.

What are we to make of this significant turnaround in the markets? In truth, there are a number of lessons to be learned from this volatility, many of which we preach on a regular basis. First, in the short-term (defined by me as anything less then three years) the markets are incredibly unpredictable. Benjamin Graham, Warren Buffet's mentor, often described Mr. Market as having schizophrenic tendencies. One week, month, or year Mr. Market is euphoric with optimism and then, quite suddenly, and without warning or explanation that optimism turns to depression. Unfortunately, these mood swings usually last for longer than observers expect. However, since the long-term mood of the market is generally cheerful the periods of depression are, most often, opportunities to add investments at attractive prices. The most recent bounce in the markets cements a lesson often taught, but usually forgotten in periods of stress, that short-term downturns are most often opportunities to be embraced, not events to illicit fear.

The second take away from the last six months is the value of diversification in allowing clients to maintain their heading when the seas get rocky. It would be impossible for portfolios to have benefited from the Q1 strength if dramatic changes were made during the Q4 weakness. A diversified portfolio reduces the depth of down moves, during periods of stress, making it easier to maintain allocations to the highest returning, but most volatile, parts of our portfolio.

It is true that in owning a diversified portfolio our short-term returns may not equal the results of the highest returning asset class. However, if we make inopportune sales, out of fear, our long-term returns will likely suffer dramatically. Dalbar, an investment research firm, has studied investor returns vs. market returns from 1985-2014 and found that the average equity investor returned 3.8% annualized while the S&P500 returned 11.1%. This wide variance is the result of poor timing decisions based on fear and greed. Our diversified portfolios provide for a smoother ride limiting the dramatic volatility that results in poor decisions.

Our final take away, from recent events, is that an old Wall St. adage, "Don't Fight the Fed", is as relevant as ever. The actions and commentary from the Federal Reserve have recently been the most significant drivers of returns across all major asset classes. The strong down move in Q4 came against a backdrop of a "hawkish" Fed. Chairman Powell indicated that several rate increases were ahead in 2019 and that the Fed would be reducing monetary circulation by eliminating additional bond purchases. However, in Q1'19 following asset price declines, this "hawkish" commentary began to turn "dovish" ultimately culminating in an about face by the Fed. In his news conference, following the board's Q1 meeting, Chairman Powell gave much more conservative guidance for potential rate hikes and balance sheet runoff. This surprise lead to a strong rally in bond prices and that bond bullishness worked its way into the equity markets giving a final boost to an already strong quarter.

As we look forward to the second quarter and Spring we are hopeful for warmer weather and greater price stability in equity and fixed income markets. We will continue to use any volatility to strategically rebalance portfolios, as markets permit, but we also remind clients that most often the best action is no action. As always, we appreciate your trust and your business and invite you to reach out with questions or concerns. We also invite you to join us on our quarterly conference call, Tuesday, April 23, at 10 AM CST.

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Click on "TD Ameritrade" tab on the top right of our website @ sterneckcapital.com

QUARTERLY INVESTOR CALL

Join us April 23, 2019
10am CST

Kc fY[]ghYf3
email info@sterneckcapital.com
or call 816-531-2254

SCM DISCLOSURES

The annual update to our ADV has been posted on our website @ sterneckcapital.com.
Our Privacy Policy is also posted for your convenience.

Papers copies are available upon request.

ACCREDITED INVESTORS

Private placement investments require investors to be accredited. Under Rule 501 of the Securities Act, an individual is an accredited investor if he or she: (i) has a net worth (along with his or her spouse) that exceeds $1,000,000 (excluding the value of his or her primary residence); or (ii) income in excess of $200,000 (or joint income in excess of $300,000 with spouse) in each of the two most recent years with a reasonable expectation of reaching the same income level in the current year.

VIDA & OVATION UPDATE

BY FRANK STERNECK, CO-FOUNDER & CHIEF INVESTMENT OFFICER

As many of you know, one of the differentiating factors of Sterneck Capital is our pursuit of and investment in non-correlated private investments for accredited clients. Of course, our oversight of these investments does not conclude when the investment is made. We continue to closely monitor the investments to ensure the managers are executing as expected and that the original thesis of the investment remains. As part of this ongoing effort we recently attended the annual meetings for two of our widely held private investments, Vida Capital and Ovation Partners.

Ovation partners had a very strong year in 2018. After more modest returns in 2017 Ovation returned to the low volatility 8 – 10% annualized returns we have become accustomed to. The annual meeting was well attended, and we had the opportunity to hear from several of Ovation's partners including representatives from their consumer lending arm and auto finance arm. We were also pleased that the area of Ovation that we identified last year as an excellent opportunity, litigation finance, was the largest contributor to total returns in 2018. The meeting confirmed our outlook for Ovation as a source of low volatility differentiated returns providing cash flow and diversification to client portfolios.

Vida Capital also held their annual meeting in March. Vida's returns were down slightly from previous years. We arrived at the meeting with the intention of confirming there was no change to the underlying investment thesis. After attending the presentation and engaging in Q&A with management we are confident that any issues were cyclical, and we anticipate returns in line with long term levels, in the 7-10% range, going forward. In fact, we were pleased to learn that Vida has gained access to a large database which their internal actuaries believe will give them the ability to better predict life expectancy. This data is proprietary to Vida and should give them a leg up on their competition.

Overall, we were pleased with both meetings and will continue to be proponents of both investments. The power of the diversification advantages of these investments was very clear in Q4. As most assets were red in Q4'18 both Vida and Ovation provided consistent positive returns. For accredited clients who have yet to use these tools or are looking for higher returns on fixed income assets held away from Sterneck Capital, we encourage you to reach out to us to review your allocations.