DECEMBER 12, 2018

In Touch

a review for our valued clients and friends

A publication of Trent Capital Management, Inc.

Perspective and Outlook

On the surface, many equate risk with market volatility, because of its harmful effect on investor psychology and behavior. Corrections and market swings tend to cause investors to sell (or invest less) rather than buying more at lower prices. Conversely, rising prices breed optimism, and these good feelings cause investors to want to buy more as prices go up. For most people, however, risk is really the loss of purchasing power over time, leading to a lower quality of life.

It may seem counterintuitive, but markets perceived to be "riskier" are ideal for longer-term investors. If an individual stock falls 20% or 30% in value, many perceive it to be very risky. However, this obviously creates an excellent buying opportunity (assuming the company is simply out of favor and its fundamentals are still solid).

"negative headlines create buying opportunities"

Additionally, a long-term investor should welcome a long-overdue correction, knowing that it's a normal part of stock market cycles and catalyst for discounted stock prices. While most investors don't realize it at the time, the most money to be made in equity investing is during a bear market.

There are ample opportunities outside the U.S. stock market. Europe's recovery is following the same script that the U.S. used a decade ago but is still far behind. Issues such as demographics, heavy regulation, and coordination among nations have led to a slower recovery for the region. A major advantage Europe has is that their largest corporations are globally-oriented.

Significant opportunities lie in the premier, multinational companies that have strong global growth potential. These companies are usually colored by general negativity surrounding the European economy yet have attractive outlooks.

In emerging markets there are many opportunities, due to strong earnings growth, a fast-growing middle class, and attractive valuations. However, investors must remain cognizant of currency, political, and regulatory risks in these regions. These risks are not

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OUTSIDE THE BOX

Volatility

Recent market swings and declines have led some investors to head for the exits, but important to remember is that corrections are a normal part of market fluctuation and are temporary in nature.

The current market environment is normal, but doesn't feel that way because of the extended period of low volatility that investors have recently experienced. Headlines telling the tale of stock prices "tumbling", "plunging", and "plummeting" are exaggerated; recent declines aren't even in the top 300 days of largest percentage movements going back to 1928.

The recent stretch of low volatility has generated a sense of complacency in some, causing them to forget that such environments are the exception and not the norm. In fact, statistics show that investors can expect a 5% correction every 6-8 weeks and a 20% correction about every 2.5 years.

The important lesson is not to attempt predictions on when market corrections will occur, but to understand they will occur and are normal.

Trent Capital Management
A Disciplined Approach to Investing

Perspective and Outlook

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uniform among all emerging markets and vary by country, which means that country selectivity is just as important as company selectivity for active managers.

Some emerging economies are exhibiting rapidly growing consumer service sectors. This is where investors need to look, as this characteristic coincides with a growing middle class. Conversely, state-owned or controlled companies are best avoided. In addition, industry leaders, specifically in China, Brazil, and India are attractive investments as well.

Recent trade disputes between China and the US are a classic example of news headlines distorting reality. Admittedly there are negatives involved; tariffs are bad for free market enterprise because money is taken from both businesses and consumers and given to governments. However, nobody truly knows how current disputes will play out over the long-term.

Performing a country-by-country historical analysis will reveal how easily perspectives can be distorted. A decade ago, net exports from China were almost 10% of its GDP. Today that number is only 2%. Investor perception tends to favor the past, when China was a major exporter, but the reality is that China is quickly transitioning to a more consumer-led economy similar to the U.S.

Negative headlines are sometimes unnerving, but they always create buying opportunities. The biggest opportunities arise in emerging markets, where companies that possess strong growth models exist that are largely insulated from perceived problems. These companies are unfairly punished, driving down their multiples.

"We give others the courage to do great things by our own example of doing great things."
- Steve Ackerman

TCM Digest

Ben Bronson, *Kiplinger Report*, December 2, 2018 … "Financial conditions have tightened, some economic data have begun to roll over, and interest rates are on the rise. This has translated into a "rolling bear market," with different regions, sectors, and styles taking their turn at falling out of favor and succumbing to market corrections."

Scott Grannis, *Barrons*, Dec 8, 2018 … "Last year also was unusual for the dearth of volatility that is now again commonplace. We had an incredible amount of investor optimism coming out of the election in 2016. Last year was the anomaly, not this year. A year (of volatility) like 2018 is much more normal for the market than we had in 2017."

David Trent… "Early this year, the S&P 500 was trading at a price-to-earnings ratio of 18.7 times the expected average earnings of the S&P component companies for the next 12 months, according to FactSet. Now, with the market having tumbled, that forward P/E multiple has dropped to 15.4, which is about average. They're in line with historical norms. "

Market Commentary

INDEXES 1/1/2018 - 12/10/2018	
S&P 500 - Large Cap US Stocks	0.46%
Barclay's Aggregate Bond Index	-0.98%
MSCI EAFE - Foreign Stocks	-13.0%

There are several outcomes that could spark a rebound for markets in the coming quarter. First the U.S. and China could reach a trade agreement that would settle investors. Second, the Fed could decide to slow down its rate hike schedule. And finally, both corporations and the overall economy could keep showing healthy growth.

Slower earnings growth does not in itself indicate a recession is on the horizon. High single-digit earnings are still very attractive for corporations. The signs of an imminent recession are still not present.

While slowing down, the economy is continuing to grow. Corporate earnings will likely moderate in 2019, but the expectations are that they will remain strong. Things are not as good as they recently have been, but are still relatively good.

Insight Spotlight

Congress and the Budget

Unlike most businesses, Congress is unable to balance a budget (and as of recently even produce one). It seems counterintuitive that politicians who are incapable of fiscal responsibility are given the task of financial reform to a system that historically has produced immense wealth and a very high standard of living for many. Before the nation considers allowing government to take over corporations by political decree, one could argue that Congress should solve its own problems first.

Recently, Senator Elizabeth Warren proposed the "Accountable Capitalism Act", which would allow employees of large corporations to sue their employer if they believe management is not sharing profits equally with stakeholders.

While the intentions may be noble, the implementation of such a law is unnecessary at best and costly to all involved at worst. Companies provide products and services to consumers, and profits are a byproduct of these transactions. As long as capital, employees, investors, and customers are free to choose freely, the system holds no one hostage and keeps itself accountable.

Questions or comments about our newsletter?
We want to hear from you! Call us at 501-868-7772

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IN TOUCH

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IN THIS ISSUE:

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