ACCESS | WEALTH MANAGEMENT

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Liz Ann Sonders, Chief Investment Strategist, and Jeffrey Kleintop, Chief Global Investment Strategist; of the Charles Schwab Corporation have presented data some for us to talk through. Let's get right to it.

"An investment in knowledge pays the best interest."

— Benjamin Franklin

Key Points

- Volatility has receded a bit recently, but stocks have made little headway due to the lack of enthusiasm surrounding a trade truce between the United States and China.
- Economic "surprises" have been mixed across the board and key indicators have not confirmed a resumption of strength; while the monetary policy outlook remains elusive.
- The timeline for a Brexit deal has been fluid, yet support is building along with a somewhat brighter forecast for the U.K.'s economy.

Sound and fury

While volatility has subsided a bit of late, U.S. stocks remain in a wide trading range. Mixed earnings and economic data; persistent skepticism surrounding a U.S. - China trade truce and Brexit; and monetary policy's perceived impotence have kept equities around the world from breaking out to the upside. U.S. stocks are at relatively strong levels and continue to crawl to new highs, but the numbers reveal that little progress has been made in the past 21 months. Since January 26, 2018, nearly every major global index has experienced a bear market at some point; and some have failed to come back to their prior highs.

Many think the market has been booming over this period, but you may be surprised to see in the table below that since January 26, 2018 U.S. large-cap and technology stocks have just eked out positive gains, while U.S. small-cap, the Value Line Arithmetic Index (includes 1,700 stocks and represents a much broader swath of the U.S. stock market), and international stocks, are all negative.

Performance Since January 2018 Has Been Quite Mixed

Index	Price return 1/26/18-10/24/19	Maximum drawdown			
		High date	Low date	% change	% change from high date
S&P 500	4.8%	9/20/18	12/24/18	-19.8%	2.7%
Dow Jones Industrial Average	0.7%	10/3/18	12/24/18	-18.8%	-0.1%
NASDAQ	9.1%	8/29/18	12/24/18	-23.6%	0.9%
Value Line Arithmetic	-2.7%	8/29/18	12/25/18	-23.3%	-5.9%
Russell 2000	-3.6%	8/31/18	12/24/18	-27.2%	-10.8%
MSCI Emerging Markets	-19.0%	1/26/18	10/29/18	-26.6%	-19.0%
MSCI EAFE	-11.5%	1/26/18	12/25/18	-22.9%	-11.5%

Source: Charles Schwab, Bloomberg, as of 10/24/2019. MSCI data as of 10/23/2019.

With the exception of small caps' weakness, U.S. stocks overall have managed to stay above their January 2018 highs; yet the current bull market has had some weak underpinnings—not the least being extreme bouts of volatility (notably, the near-bear market in the fourth quarter of 2018) and defensive sectors' leading the way. As you can see from the following table, sectors that are considered "safe havens" have led equities higher. This tells me that underlying market behavior is reflecting ongoing uncertainty.

Defensive Sectors Continue to Lead Cyclicals

Sector	Price return 1/26/18-10/24/19
Utilities	27.0%
Real Estate	24.4%
Information Technology	19.5%
Consumer Discretionary	9.8%
Consumer Staples	4.2%
Communication Services	1.6%
Health Care	0.3%
Industrials	-3.0%
Financials	-5.6%
Materials	-10.0%
Energy	-24.0%

Source: Charles Schwab, Bloomberg, as of 10/24/2019.

An update (or lack thereof) on trade

Trade tensions have cooled since the Chinese delegation's visit to Washington in early October. Optimism initially soared on the heels of an announcement of a "phase one" trade deal; but investors dialed back their exuberance after realizing that the agreement had yet to be put into writing. Not to mention, the major issues surrounding Huawei, technology transfers, and intellectual property theft have not been meaningfully addressed. The increase in tariffs from 25% to 30% on $250 billion in Chinese goods was delayed, but the already-imposed tranches remain in place; and the December 15 round—which directly hits consumer goods—is still set to take effect.

Absent a comprehensive trade deal—one that encompasses the major structural issues at stake and addresses both sides' list of desires—we continue to foresee bouts of market volatility that could continue to spread throughout the confidence channels. Business confidence has taken a hit, and an increasing number of companies continue to cite tariffs/trade on earnings calls. Capital spending intentions also remain under pressure, as supply chain disruption and persistent uncertainty have forced C-suites to adopt defensive postures. Additionally, should the December tariffs kick in, we may soon start to see the business malaise wade into the consumer side of the economy, given that the goods targeted for those tariffs are heavily consumer-oriented.

So What?

As our friends at St. James Investment Company pointed out what people do is far more important than what they say. Sounds like something our parents told us somewhere along the line doesn't it? If one looks at what Warren Buffett is doing with his money right now, his actions speak volumes. Famous for being one of the world's most discerning investors, Warren Buffett has never been afraid to invest when others were fearful. Buffett is also known for his distaste for holding large amounts of cash, and he famously wrote that "Cash does not make us happy" in his letter to shareholders in 1998. It is certainly noteworthy then when his company, Berkshire Hathaway, currently has $122,000,000,000 sitting in cash. Yes, that's $122 billion – doing nothing at all. To put this figure in perspective, it is more than 8 times larger than the $15 billion he was holding in 1998 when he penned his famous words, represents nearly 60% of Berkshires public equity portfolio, and is the largest proportion since the years leading up to the 2008 Financial Crisis.

Yet, Buffett remains vocally quiet on whether stocks are too expensive. However, it would be a safe bet that if he believed that there were great opportunities in the market today, he would not hesitate to invest his cash. According to Bloomberg, Buffett's company has sold more investments through 2019 than it has bought. He is patiently waiting for compelling opportunities to invest. Sometimes actions speak louder than words. We are in good company.

It's hard to believe that the Iowa Caucuses begin in approximately 3 months, and we expect volatility to persist, if not increase, heading into what's widely expected to be a very emotional election. The good news is I think we are positioned well to not only withstand volatility but to take advantage of it. Volatility can provide opportunities, especially for those who are strategically holding some cash in their portfolios like we are. It doesn't make sense to us to have 100% of your money at risk, 100% of the time like those who are fully invested in an index such as the S&P 500. That's limiting to say the least and it simply doesn't compound money as well over time. We continue to invest in high quality businesses, pay a great deal of attention to price paid and look for value. It has been a very nice year for our client portfolios and we are excited for the future. As always, we sincerely appreciate the opportunity to work with you.

Respectfully,

Anthony L. Christensen, CPWA®
President, Managing Partner

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