STOCKBOY

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Broadsided – Ka'boom!!

Fourth Quarter Falls & Follies

After an almost 10 year bull market, many were wondering when stocks would finally feel the effects of gravity and trend downward. Though history convincingly shows that the stock market rises over time, it also shows there are cycles of ups and downs and we haven't seen a down cycle in quite a while.

This all changed in the 4th quarter of 2018. All major asset categories fell, many dramatically. The DJIA and S&P 500 fell well over 10% and the small cap and international categories even more so. It was the first time since 1970 that no asset class was up over 5%. Cash was one of the best areas to be both for safety and performance!

None of this was on most investors' minds as the 4th quarter started. The markets had been flying higher with a generally smooth and calm trajectory. As often the case with market changes, this switch occurred with little fanfare.

The recent market change seemed to be more of interpretation than change in facts. It appeared investors translated rising interest rates, tariff bluster and general political sparring as finally disconcerting where those same elements had been largely ignored or minimized until then.

So what does one do now? Studies show that after falls as significant as this 4th quarter's, markets usually rise nicely over the next year and beyond. That said, after a decade of strong market returns, this could be that long-awaited down cycle and not just a quarter's readjustment. A recession doesn't seem imminent, but they often don't until they are already at hand.

Thus, it likely makes sense to cut a center path and buy some of the good companies which have seen their stock prices drop precipitously; but buy incrementally rather than 'back up the truck'. If the market continues to fall, be ready to continue to incrementally buy good companies at further reduced prices.

Recessions are Relatively Rare

As mentioned above, after a record long bull market, many are wondering when the music will stop and we'll experience our next recession. This is a very reasonable concern yet one not easily predicted.

The good news is you don't really need to predict it. When the next recession hits, as an investor it is important to remember that it likely won't last long. In the past 100 years, the U.S. has been in a recession only 20% of the time. Thus, 80% of investor's time is spent recession free! (I did the complicated math). When the odds favor you 80 to 20, it's usually wise to 'play', as long as you're respectful of the fact that the bad 20% is not predictable.

The Importance of Looking Forward

The ten worst performing S&P 500 stocks in 2017 were up almost 15% on average in the first eleven months of 2018. Conversely, the top ten performing stocks of 2017 were collectively flat for 2018 through November, even though the market was still up at that time.

This clearly tells you that assuming a stock's winning, or losing, ways will continue from year to year is unwise. As we move into 2019, it may be a good idea to buy those stocks that were beaten up in 2018 and not last year's high flyers. Please take a look at the Phoenix Pfund for what we did there to try to follow this concept.

Sometimes Easier is Better

Justin Thomas is one of the best golfers in the world. His Dad, a golf pro in Louisville, didn't give Justin the usual golf instruction growing up. Instead of just hours of drills and incremental improvements on swings, etc. he made up fun contests (such as seeing if he could hit a ball around a tree or with one hand) for Justin to do that made the game fun.

As a result of this low pressure, enjoyable approach to the game, Justin stuck with golf and became the golfer he is today. This shows that the 'normal' way is not necessarily best and is often not the most enjoyable either. Usually, people do their best at things they enjoy. If you enjoy investing and do things differently than the crowd (and do it consistently), you stand a good chance to also do well over time.

Sometimes Way Different is Also Better

The Tampa Rays are one of the 'have-nots' in baseball. They can't afford high-priced talent and therefore need to compete in different, more creative ways.

Last year they had a much better season than expected. A primary reason for their relative success was they experimented with and changed one of the basic principles of the game – using a 'starting' pitcher for each game. Instead, every 4th or 5th game they used a variety of back-up pitchers to pitch a couple innings each – like Thanksgiving leftovers. It worked surprisingly well and now is being considered by other, more 'traditional' franchises. Re-examining long accepted practices and perhaps blazing a different trail can have a lot of merit.

Again, this approach can work in the investment world too. Don't assume analysts and experts have it right all the time. Look for value and opportunities that are overlooked by the institutions and the crowd. Try to anticipate what they might find interesting next, before the price has already gone up from popularity.

Beware the Annuity, or is that Obvious?

Last October, the Wall Street Journal ran a headline stating: "Annuities Soar After a Rule's Demise." The rule in question is the fiduciary rule, which required all investment 'advisors' to put clients' interests ahead of their own. The rule, though screaming common sense (why would you want to allow investment professionals to put their own interests first?), was recently rescinded in Washington.

Sadly but predictably, soon after the rule was removed, variable annuity sales were the highest in 3 years! There's an obvious correlation here and it isn't pretty. Variable annuities are often not close to being in the client's best interest but are very lucrative for those selling them.

Yes, there are certain annuities that do make sense in certain circumstances; fixed annuities from lower cost providers are generally straight-forward and usually free from heavy and hidden fees. If a consumer is looking for consistent and reliable income for the rest of their lives and are willing to give up a certain amount of money for this benefit, then this can be a good thing.

However, annuities are often sold with very different motivations. They are big moneymakers for the sellers and are often sold to line the pockets of the seller and not to first benefit the client. If they were, there wouldn't be a 7-10 year 'surrender period' before you can get your money back if you decide that an annuity is not for you. How many good deals come from something where you can't get out of it for many years without a penalty?

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