Market Commentary

2018 Year End Review

SUNFLOWER BANK
First National 1870

The Market in 2018 and What's Coming Next

The market has moved down from late September 2018. The tech heavy NASDAQ has declined 20% from its recent peak. Underneath the broader market we have most stocks down 20% or more.

This severe decline comes while unemployment is historically low with current and forecasted GDP as robust as it has been for the last 10 years. This is not the typical backdrop from which one would expect a decline to come. At the same time, there has been a series of events that various people would ascribe as the likely cause. Key events being:

1. Slow growth and social unrest in Europe
2. Trade tensions between the US and China
3. A slowdown in housing sales
4. A Federal Reserve that appears to be on a path of continued rate hikes
5. The stock market being in a period of unprecedented gains and possibly being overvalued
6. BREXIT – British discontinuing their membership in the European Union

Granted these events are all serious but there is nothing that points to why the market is in such a dismal state at this moment. Most of these issues were around when the market was soaring to new heights. The lack of clarity of a proximate cause, leads some to go down a more technical route believing that the market is being controlled by algorithmic trading that is driving the market down as indiscriminately as it drove the market up. In addition, there is very little technical support for the market as it went up without the normal pauses and consolidations that typically occur.

Then we have the President's own situation and its impact on the market. There is plenty to choose from here. Additional causes could be:

1. The trade tensions with China may not resolve due to the volatile nature of the President
2. The President is openly attacking the Fed Chairman and challenging the concept that the Fed can remain totally independent from the Executive branch of the government
3. Republicans lost the house in November; increasing the probability of impeachment
4. The government shutdown

As pundits try to explain the why; will we ever really know until ex-post when one of these problems emerges as the true cause of a change in future earnings?

This country and the world have some serious problems to grapple with that have been around for decades. They must determine how to deal with serious trade and budget deficits and the need to fund medical, pension, and social security deficits. Any or all these items could be the proximate cause of the current environment, but they have been around for a long time.

On the flip side we appear to be on the precipice of some of the largest innovations ever. The launch of 5G, Autonomous Vehicles, and the Internet of Things are all catch words that have deep social and economic changes imbedded in them. These developments have the ability to fundamentally reduce costs and enhance productivity worldwide.

We take investing as a long-term journey that takes an asset base and uses it to fund cash flow needs over an extended period. We believe that market returns cannot be forecasted for any short-term period and in the long run the market will fairly represent the aggregate growth and size of the economies it participates in. With this backdrop we accept volatility as part of the price we pay to earn more than is available in less volatile alternatives. Fundamentally, our largest concern is whether long term earnings growth is going to change. Since the market is always discounting future earnings it does give us an aggregate view of the future. Since the discount rate is subject to all the risks identified we can expect that current prices will reflect the changes in the probability of the expected outcome.

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The larger concern should not be the volatility–that is to be expected. What it should be is whether the economy will continue to grow as expected. This means will population and productivity growth continue? Do we expect that corporations will share proportionately in that growth? We believe so, but we also believe that in the intermediate term our current Nationalistic behavior is unsettling and could lead to a change in our politics that might reverse the pro-growth tax and regulatory policies that vaulted our returns in the past few years. Yet even this transitory risk will pass. In the long run we have proven that we will do the right things–it is just we might do a few things wrong until we figure out what is right.