2018: In Like a Lamb, Out Like a Lion

Most of us recognize this as part of a maxim regarding the weather patterns associated with the month of March. However, you could be forgiven for thinking it was related to the investment markets in 2018. At the end of a volatile year in the economic, political and investing arenas, we would like to thank you for your support and share some perspectives. Specifically, we want to address what prevented us from generating our usual returns in 2018, to remind you how we approach managing your capital during difficult periods, and finally to explain why we are cautiously upbeat as we look ahead.

After a strong 2017, the New Year brought further gains early. However, by the end of January 2018, that calmness was replaced by volatility that lasted the rest of the year. This was especially evident in the last quarter and then culminated in the worst December since 1931 for US markets!

The dominant forces of 2018:

- US Federal Reserve promised higher interest rates
- Trade Wars…the United States vs Everyone Else.
- Suggestions of a deceleration in economic growth
- Increasing debt at both Consumer and Corporate levels

= End of Cycle?

In part, these made for a difficult environment. In challenging years like 2018 when conditions swing from hour to hour, day after day, we are reminded of similar periods over the past decades when there has been a reminder that there is a cyclicality to returns. Good times don't last forever…nor do bad. To highlight this, we include a table showing the worst 10 quarters in the last 50 years:

S&P 500 Index (Last 50 Years)

10 Worst Quarters	Performance	Following Quarter	Following Year	Following 3 years (Annualized)	Following 5 years (Annualized)
Q3 1974	-26.1%	7.9%	32.0%	15.0%	11.5%
Q4 1987	-23.2%	4.8%	12.4%	10.2%	12.0%
Q4 2008	-22.6%	-11.7%	23.5%	11.7%	15.4%
Q2 1970	-18.9%	15.8%	37.1%	12.8%	5.5%
Q3 2002	-17.6%	7.9%	22.2%	14.7%	13.4%
Q3 2001	-15.0%	10.3%	-21.7%	2.3%	5.1%
Q3 1990	-14.5%	7.9%	26.7%	14.5%	13.8%
Q3 2011	-14.3%	11.2%	27.3%	20.4%	13.9%
Q4 2018	-14.0%	?	?	?	?
Q2 2002	-13.7%	-17.6%	-1.5%	6.4%	8.7%
Average	**-18.0%**	**4.0%**	**17.6%**	**12.0%**	**11.0%**

Source: Bloomberg

Some interesting data, not the least of which is that this past quarter wasn't anywhere near the worst of all time (however painful). What sticks out to us, however, is the subsequent market gain experienced after most of these drawdowns. We would welcome a similar result.

We want to point out that the above noted rallies (while impressive) aren't quite what they seem, mainly because the gains come off a smaller base than before the decline. Nevertheless, they are notable. More importantly, if the original decline is managed "properly", therein lies the ***real opportunity.***

During difficult times in the markets, we strive to protect capital using the tools that have served us well for over 25 years. When investing in stocks, there are going to be negative periods of time. What we have been able to do over the years is "lose less" than the market during those periods (and sometimes even earn positive returns while the market slides). This simple goal allows us to recoup client capital much faster when what is depicted in the above table occurs.

What you will have noticed in your accounts over the past 6 months is a steadily *increasing* level of cash. This has happened because our discipline led us to sell several positions that no longer met our criteria. With our "X's & O's" tool demanding caution, we did not reinvest the proceeds in new stocks. This resulted in two things: First, that it helped protect from further losses, and second that it left our clients in a better position to capitalize on new opportunities when the market recovers.

As a result, we are confident that we are set up nicely to succeed going forward. Others who rode the market all the way down will be faced with a longer time frame to recover. If the market recovers, we can capture opportunity with our ready cash…if it remains in the doldrums, our cash will act as a large buffer against further losses as we transition to other investments to garner a positive return.

We (almost) always refrain from making predictions because they are based on emotion, and we don't think emotion has a place in successful investing careers. Having said that, we certainly find it hard to avoid reading the myriad of predictions that come out of the mouths of supposed experts (newsflash: statistically they are almost always incorrect). They range from "it's time to crawl in a cave" to "better get that down payment ready for your new yacht". We find neither extreme useful.

We will leave you with this ONE prediction though: that we will continue to abide by our tools when managing one of the most important aspects of your life. Disentangling signals from the blizzard of data/media/political noise, in order to make consistent decisions is always our goal.

We consider it a privilege to work on your behalf and we thank you for your support.

Our very best wishes for a happy and prosperous 2019.

Doug, Phil and Tina