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Asset Management • Retirement, Tax and Estate Planning • Fee Only • No Commissions • Independent Advisor

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Here is our newsletter for the 4th Quarter of 2018

The Markets Update

There was not a lot of movement in the markets last quarter with the exception of the U.S. stock market where gains were 7.7% for large cap stocks. Looking at the year-to-date figures the U.S. and foreign stock markets have diverged with U.S. markets up over 10% while foreign developed and emerging stocks down 1.4% and 8.8% respectively. We will discuss this in detail later in this newsletter.

Fixed income was either flat or down for the quarter but down 1.6% year-to-date for US Intermediate-Term bonds. Since the end of the quarter interest rates have risen to 8 year highs with the 10 year Treasury bond hitting 3.2%. Cash yields have increased to over 2.0% annually now and offer decent returns for savings and money market accounts.

Asset Class Returns- Ending 9/30/18

Asset Class	3rd Qtr 2018	YTD
US Large Cap Stock	7.7	10.5
US Small Cap Stock	3.6	11.5
Foreign -Developed Mkts Stock	1.3	-1.4
Emerging Mkts Stock	-1.7	-8.8
US Intermediate-Term Bond	0.0	-1.6
Emerging Markets Local Bond	-2.1	-9.3
High Yield Bond	2.5	1.8
Inflation-Protected Bond (TIPS)	-0.8	-0.9
Cash	0.5	1.4
US Real Estate	0.6	0.6
Natural Resource Stocks	-2.6	1.1
Commodities	1.5	7.9

Fourth Quarter To-do List

Here are a few items to consider before year end.

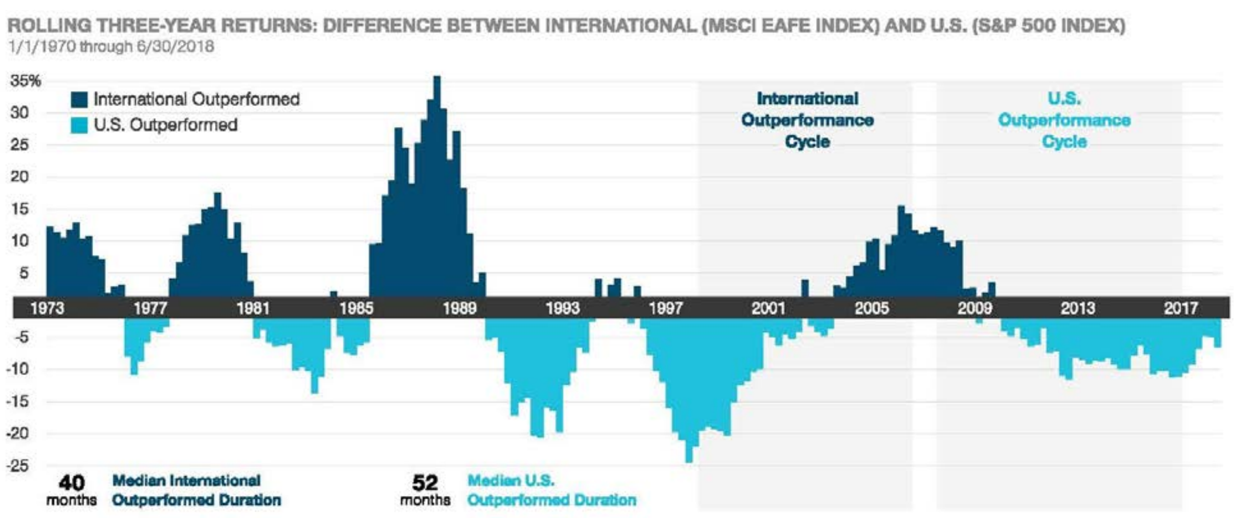
1. Annual enrollments are opening for your health care insurance. With all the changes in the markets it would be a good idea to make sure you are in the best plan for you. This includes company provided and Medicare.
2. Make sure you are getting competitive interest rate on your savings. (Our short-term bond fund BSV is now yielding almost 3.0%)
3. If you have a child or grandchild who is in college or a senior in high school make sure they file the FASFA form to reduce the cost of college. Even if you think there is no way you will qualify for needs based aid, many colleges will give you a discount just for filing the form. Yes, these are a real pain but I can offer some help.
4. Make sure you do some tax planning as the new tax law will have some big impacts. Give me a call to set up.

Déjà Vu All Over Again
Eleven year ago in my newsletter of Q3 2007 I wrote a piece on where the herd is running to and from. Here is an excerpt of what I wrote in 2007. When you read it just substitute "U.S." for "foreign" and that will get us to where we are today.

> "Where is the Herd Running to Now? According to the Investment Company Institute, Americans added a net $160 billion into stock mutual funds last year, of which 93% went to funds investing in foreign companies. For over six years now the foreign stock markets have been outperforming the U.S. market by around 10% per year on average."

As it turned out 2007 marked the end of an 8 year period when foreign stocks outperformed U.S. stocks. Chasing outperformance, even if it has been going on for many years, is rarely profitable. You can see this in the chart below, which shows multi-year cycles where U.S. outperforms, followed by foreign outperformance, again and again. It really does not make much sense, as the world markets are more highly interconnected and correlated over time. Notice how the cycle times appear to be lengthening. Robert Shiller describes market behavior not so much as an analytical, rational decision by informed markets but rather more to "animal spirits". Once a segment of the market does well for a couple of years the herd follows.

From the chart below you can see U.S. equities have outperformed foreign equities for about 9 years now. If you look at any measure of value, foreign equities are much more reasonably priced currently. Emerging market equities as a whole are discounted 50% (half price) compared to U.S. equities, measured by the Cyclically Adjusted Price Earnings Ratio (CAPE).

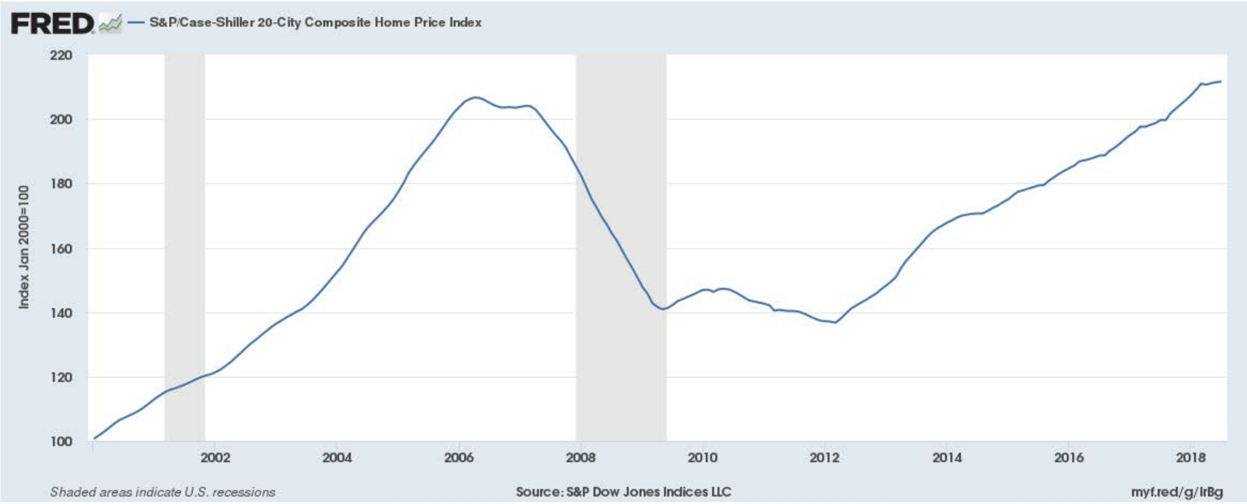


11 years ago our portfolios equity allocation was about 70% U.S. and 30% foreign. We have indicated several times over the years we expect that allocation to shift toward more foreign over time. Currently our equity allocation is close to 45% U.S. and 55% foreign, with about one half of that in the emerging markets. Most portfolios I see elsewhere have more like 70-85% U.S.

Back to my newsletter of 11 years ago. We also pointed out that the housing market was running into trouble and the herd was starting to run away from housing.

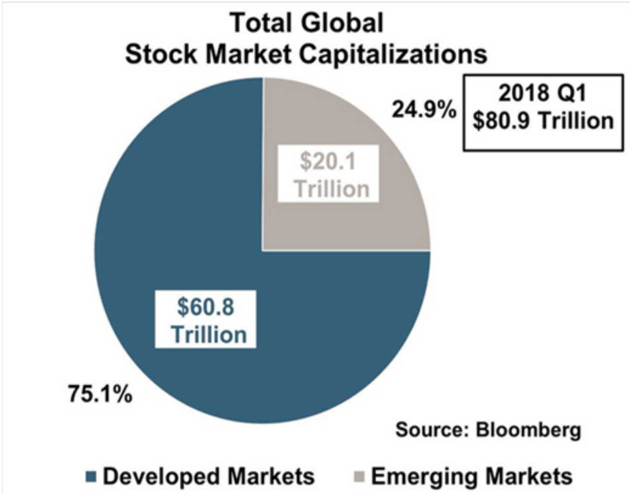
> "Up until recently the herd has been running to housing with investors buying multiple houses in hopes of flipping for big profits and homeowners using their home equity like a bank account. No more. The Case-Shiller 20-city price index fell 3.9% year-on-year thru July (2007). The price declines have been accelerating and will likely get worse before hitting bottom."

From the chart below you can see the home price index fell another 25% over the next couple of years and just at the beginning of this year got back to the 2006 peak. The chart below shows the home price index going back almost 20 years now. Note: During that time the home price index has more than doubled. So, thru the boom and bust and recovery home prices have averaged 4.4% increase annually. That is really close to the longer-term average. Going forward, one should expect price increases for housing to moderate. The recovery since 2010 has been fueled by low interest rates but rates are rising now. Also, home affordability has dropped to 2008 levels as a result of price and interest rate increases.

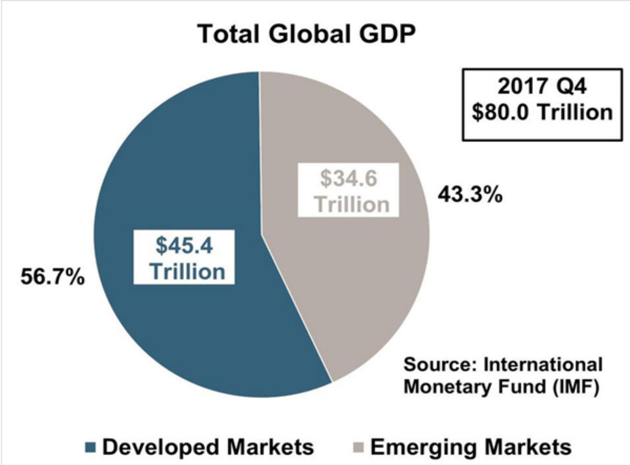


Sizing Up the Global Markets

Some of you may be wondering why we have more of our equity allocation in the foreign markets. The bottom line: the opportunities for growth are all over the world and increasingly overseas. Here is a snapshot of the total size of the Developed and Emerging markets. The U.S. markets make up about 40% of the total, with Western Europe and Japan making up the rest of the Developed Markets. So one could say having a 45% allocation to U.S. equities is an overweight based on market capitalization alone. The U.S. share was only 32% 10 years ago and has increased during the U.S. bull market.

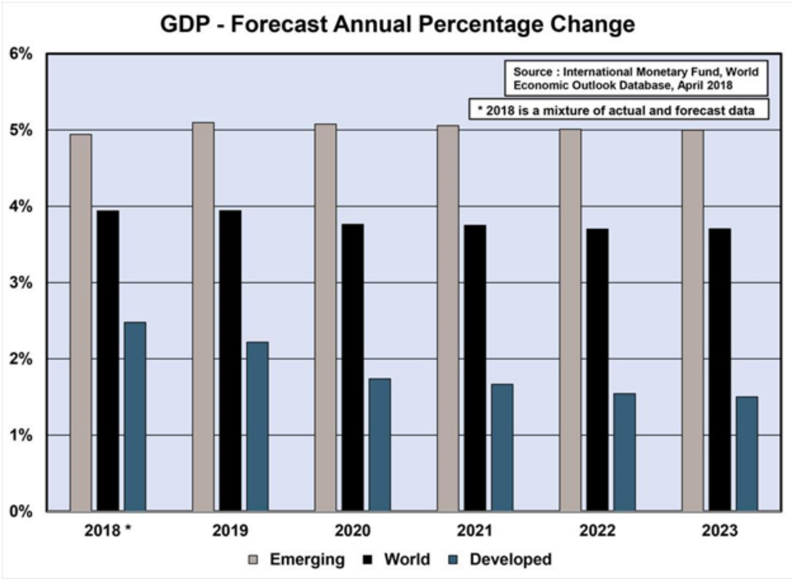


At the same time the number of companies in the U.S. stock market has been dropping. In 1997 there were about 7,600 companies listed in the U.S. Today there are only 3,600. There has been much discussion about the big drop with mergers and companies going private for regulatory reasons being the prime candidates. For sure a handful of large firms are dominating the U.S. markets.



At the same time the number of foreign companies listed on the stock exchanges have increased, especially in the developing markets. The total number of foreign companies now stands at about 27,000. So there are over 7 times more companies in the foreign markets than the U.S.

How big are the foreign economies? The chart above shows the emerging market economies represent about 43% of the world Gross Domestic Product (GDP). With higher growth rates the emerging economies will represent over 50% of the world total in a few years.



Here is a chart showing the current and forecasted growth rates from the IMF. Currently the developed world growth rate is 2.5% and the emerging world is 5%. The forecasts show the growth rate differentials will increase over time as the developed world growth rates are expected to decline, primarily due to population growth and other demographic data.

Let us know if we can help in any way.

Sincerely,

Stan Johnson
Comprehensive Financial Planning, LLC
Registered Investment Advisor
NAPFA Registered Financial Advisor