Investment Update

2nd Qtr. 2017

Market Valuations

Stats!	
YTD Returns	
S&P 500 Large Cap	9.34%
S&P 400 Mid Cap	3.24%
Russell 2000 Small Cap	4.99%
MSCI EAFE Int'l	13.81%
10 Yr. US Treasury	2.298%
Gold	$1240.70
Oil	$46.04
CPI (Inflation)	1.6%
Unemployment	4.4%

Looking back at a newsletter I wrote 3 years ago, I found a similar theme about today's market. Everyone was expecting some sort of correction that never came about. I outlined that a lack of bad news, strong corporate earnings, and a temperate economy kept the market humming. The same theme lies true today. We haven't had really any bad news (no new crisis, yet), and earnings remain strong. Yet, many analysts expect some type of a correction.

Fast forward to 2017. We still have lofty P/E ratios (more to follow). But, now, the S&P 500 has increased 9.61% per annum since June 30, 2014! In that newsletter, I said as long term investors, we remained optimistic, and asset allocation and portfolio risk assessment is so important. I hope that you heeded that advice.

But now, even loftier valuations exist. Based on many market indicators, U.S. valuations do look to be pretty expensive.

The forward P/E (Price divided by anticipated earnings) is about 18 times current valuations, its highest level in 13 years. The Shiller P/E (Shiller is a Professor from Yale and a Nobel Prize winner) also indicates that the next 10 year returns are expected to be significantly less than the past 7 years. I could go on and on with other indicators showing similar results. But it is important to note that these indicators do not mean we are ready for some type of correction, or crash. There is no magic factor that anyone can look at to predict the market. DON'T GET CAUGHT UP ON THE HYPE BECAUSE A FEW INDICATORS SAYS IT'S TIME TO SELL. Professor Shiller is known for his work in market inefficiencies. But he admits that no one can predict the market in the short term. Although he believes returns in the intermediate term will be suppressed, the only ones that predict the top of the market are lucky, not skilled.

What does that mean to the average investor? Asset allocation (not security selection) is even more important now than it was 8 years ago. Many investors have relied solely on the S&P 500 index funds, and broad fixed income index funds. While others have relied on a mix of index and individual stocks. I need to remind you that during the 2000's the equity market did extremely poorly. We had 2 significant downturns, (2001 and 2008), and the entire decade, we the S&P500 drop over 9%. But, a more balanced strategy during that time returned 91%[1]! So, if you are worried about market valuations, it is our belief that asset allocation is vital to your long term success.

Another interesting note is how different sectors have led the markets. Last year, value stocks finally broke out, and did extremely well. This year, growth stocks have been back in the spot light. As you can see, small cap stocks outpaced large cap stocks, and value stocks outpaced growth stocks. But, for 2017, the opposite has been true. Growth stocks have been the biggest gainers for the S&P 500, with significant impacts from a few stocks like Alphabet (GOOGL), which is up 23.16% YTD, Amazon (AMZN), which is up 34.70%, and Apple (AAPL), up 30.17%, and Facebook (FB), up 38.84% as of 7/17/2017. These 4 growth stocks make up almost 9% of the S&P500. Other (value) stocks, such as GE, ATT, and Exxon Mobil, all former largest stocks in the world, all have seen negative returns this year. So, even though the market is strong, there are still some selective returns.

2016 Morningstar Barometer

2017 YTD (as of 6/30/17) Morningstar Barometer

Again, our anticipation of the U.S. large cap market is that returns will be tepid over the course of the next few years. However, momentum is still strong, and the economy is not overheated. I could see the market continue to rise at its record setting pace, as no one can predict short term markets. The economy is still sluggish, but growing, interest rates remain low, and we have really entered into a different economic set than we were 20 years ago. Nevertheless, don't be surprised to see more tepid returns in the U.S. markets over the course of the next decade. A broad market move could be limited, as only a few sectors or stocks make a significant impact on the market. And global markets are probably better poised for improved returns than here in the U.S.

Let me know if there is anything I can do for you. I'm here for *The Long Run*.

Sincerely,

Greg

Gregory W. Smith, CFA, CFP®
Long Run Investment Management llc

[1] This return used various large cap, small cap, REITs, Non-US Stocks, and short term fixed income, with the allocation of 60% equity, 40% fixed income. The return was comprised of index funds and various DFA mutual funds. Investing in equivalent index funds has fees, hence lowering the return. You cannot invest directly in any index.