Interim Market Updates

December 22, 2018

Dear Clients and Investors,

Stocks suffered their worst weekly selloff since 2008 and are on track for their worst month since the financial crisis.

I have to admit that I did not see this coming. It's not that a "correction" or possible "Bear market" would be a big surprise after having just experienced the longest-ever Bull market in history. The bigger surprise is that I did not see the catalyst for this current drop.

In fact, as I wrote about in my Q3 letter, this particular period after the midterm election of a 1st term president is historically very positive. But of course not everything always goes by the script! So despite being in what I call a double positive historically good period for stocks, adding in the usual Santa Clause rally, we have had a serious and painful "correction". I am still calling it a correction but NASDAQ has now had a decline of more than 20%, which qualifies as a Bear Market.

From the September highs, Nasdaq is down 22%, the DOW (DJIA) 16% and the S&P500 18%. Correction, Bear call it what you may it's a nasty, swift decline. The core of this decline has occurred, in great part, thanks to the FANG stocks. They are, Facebook, Apple, Netflix and Google. As you know we have been long-term holders of Apple and sometime holders of Google. I still like these companies for the long-term and will add to these positions.

Additionally I will look to initiate positions in some of the worlds best companies now that they have corrected to more reasonable prices. FedEx, CVS, Black Rock and JP Morgan Chase for example.

Why do I consider this "correction" an opportunity and not the beginning of a longer downward phase, or Bear market", for stocks? For one, I watched carefully the interview with Federal Reserve Bank of New York President John Williams on CNBC Friday morning. Williams

is essentially the #2 official at the Fed under Jerome Powell and quite frankly he is a better communicator! What Powell said was that the Fed, and he, see an economy on solid footing but that the central bank is closely watching to see whether the economy will slow down next year and that officials aren't "sitting there saying we know for sure what's going to happen." The Fed is listening to bank and company CEO's and looking at all the data and are ready to reassess and re-evaluate their views as necessary."

These words were the most investor friendly response that any investor could have hoped for. These are not idle words and confirm what we know which is that the FED is not entrenched into a data driven, dot-plot path towards a recession.

Are there things to worry about? Of course, when is that not the case? Let's go over the top 3:

A recession? That is addressed above and I believe the Fed will slow or halt their rate increases as required to keep the economy on a growth track.

Trade war? Yes, it's real, and has been in place for 6 months but we are closer to a resolution than a beginning.

Government shutdown? Typical Washington politics and will be resolved shortly.

In the mean time, equity prices are not expensive, inflation and interest rates are low, S&P 500 earnings are at a record and on track for gains of 8% in 2019. The outlook for stocks is much better than what the current market outlook and trading activity suggests. A lack of buyers, the expiration of 4 types of derivatives ("quadruple witching") and program trading seem to be at the core of this selloff.

One caveat: Do I see any comparisons with the selloffs in 1999 and 2008? From an economic standpoint no.. From a trading perspective so far yes, some, since the declines have been so severe. The old saying, "What came first the chicken or the egg" can come into play since the markets are not always rationale. My hope is that indiscriminate illogical trading will not lead the economy into a downward cycle. I will be on the lookout for this as we move into 2019.

Please see the below statistics which relates the above discussion and shows that there is light at the end of the tunnel and opportunity abounds.

S&P 500 10%+ Down Quarters Post WWII

Quarter	% Chg	Next Qtr %	Next 2 Qtrs %	Next Year %
9/30/1946	-18.83	2.27	1.40	1.00
9/30/1957	-10.45	-5.73	-0.75	18.01
6/29/1962	-21.28	2.78	15.25	26.70
6/30/1970	-18.87	15.80	26.72	37.10
12/31/1973	-10.03	-3.66	-11.84	-29.72
9/30/1974	-26.12	7.90	31.19	32.00
9/30/1975	-11.89	7.54	22.53	25.48
9/30/1981	-11.45	5.48	-3.63	3.65
12/31/1987	-23.23	4.78	10.69	12.40
9/28/1990	-14.52	7.90	22.60	26.73
9/30/1998	-10.30	20.87	26.49	26.13
3/30/2001	-12.11	5.52	-10.29	-1.12
9/28/2001	-14.99	10.29	10.23	-21.68
6/28/2002	-13.73	-17.63	-11.11	-1.55
9/30/2002	-17.63	7.92	4.04	22.16
12/31/2008	-22.56	-11.67	1.78	23.45
3/31/2009	-11.67	15.22	32.49	46.57
6/30/2010	-11.86	10.72	22.02	28.13
9/30/2011	-14.33	11.15	24.49	27.33
12/31/2018	-17.07	?	?	?
	Average	5.13	11.28	15.94
	Median	7.54	10.69	23.45
	% Positive	78.9%	73.7%	73.7%

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