January 2017

CALDER INVESTMENT ADVISORS

Quarterly Update

Calder's Comments

It's time to make predictions about what will happen in 2017. Whether it's the economy, politics, or even the Super Bowl, you will hear many predictions from experts. Although experts may be right more often than the rest of us, they certainly won't be right all the time.

When it comes to predicting what will happen, investment experts just can't help themselves. In December of 2015, 10 Wall Street equity strategists were asked to predict the closing value of the S&P 500 Index on 12/31/2016. Predictions ranged from 2,100 to 2,500, all 10 were predicting an increase from the 2,044 mark at the end of 2015. The 2016 closing value was 2,239, a 12% increase. Quite accurately, 6 of the 10 were within 50 points of the closing value.

> **Forecasts create the mirage that the future is knowable.**
>
> **– Peter Bernstein**

In June of 2012, Seth Masters, Chief Investment Officer at Bernstein Global Wealth Management, predicted that the Dow Jones Industrial Index would reach 20,000 by 2020. This month, the Dow reached 19,999, barely missing the 20,000 three years earlier than predicted. These were some of the good ones.

Let's remember that there was only a 20% probability of a Republican sweep, including a Trump victory. On the day of the election, the political website FiveThirtyEight.com was predicting a 71.4% chance that Hillary Clinton would win the presidential election with 302 Electoral College votes (70 more than she actually won). Jeremy Siegel, finance professor at the University of Pennsylvania, predicted that he "wouldn't be surprised to see a 1,000 point drop in the Dow" if Donald Trump were to win the election. After the Trump victory was announced, pre-market indicators were sharply negative. Instead, the Dow gained over 1,600 points since the election. Guess he was wrong.

The stock markets got off to a rough start in 2016, but U.S. stocks were up around 6%, U.S. bonds were up almost 5%, and foreign stocks were mostly flat at the time of the election. Since the election through the end of the year, the U.S. stocks were up another 6%, foreign stocks were up 2%, but U.S. bonds dropped 2%. After the news of a Donald Trump victory and a Republican controlled Congress settled in, the markets reacted favorably due to the hope and expectation that we will see increased infrastructure spending, a simplified tax code, lower tax rates, and lower government regulations. Time will tell if these things will come to pass and in what form. The devil is in the details as they say.

So, what are the predictions for 2017? As a firm, we have focused on current market valuation numbers rather than the outcome of an election. Implementing a solid investment allocation, investing in areas of value, and providing an element of asset protection have been the hallmarks of our portfolio management style. To that end, we select mutual funds with managers that embody this style. Steve Romick of FPA Crescent is that type of manager. Here is how Mr. Romick described maintaining a consistent, disciplined investment strategy worked during the internet bubble of 2000-2002.

"As a history lesson, let us view the five-year period beginning January 1, 1998. Small capitalization stocks traded at a 20% discount to

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their larger capitalization brethren, despite what we believed to be better growth prospects. We therefore heavily tilted our portfolio to smaller companies, but the discount to larger companies expanded to 40%, yielding a temporary decline in portfolio value. We also avoided internet stocks, which further depressed our near-term performance. So Crescent lost 3.7% over the next two years. Our results looked bleak compared to the S&P 500 Index, which appreciated 55.5% over that same period. Most investors (including foundations, endowments, pensions, and consultants) in professionally managed investment products (e.g., mutual funds, hedge funds and separately managed accounts) make buy-sell decisions predicated on recent performance – and we had underperformed the market by 59.2%! We had unintentionally tested our clients' patience – and most fled to those portfolio managers who they believed offered better future returns.

As a result, Crescent lost about 90% of its assets, due to mutual fund holders redeeming their investments, from its early 1998 peak to its trough in early 2000. (Maybe more would have left, but we figured some of them might have forgotten they had invested with us.) The S&P 500 then declined in each of the next three years, while Crescent's few remaining stalwart holders (including ourselves) enjoyed consistent gains. Looking back over a five-year period, a Crescent shareholder who invested $100,000 at the beginning of 1998 would have ended 2002 with $140,900. A similar $100,000 investment in the S&P 500 Index would have declined to $97,200. A Crescent shareholder who capitulated at year-end 1999 and invested in the S&P 500 at the beginning of 2000, would have had just $62,500 remaining, a devastating loss and less than half what they would have earned if they had remained in Crescent. Patience as an investment virtue may only be attained through education."

Our hope for all of our clients is that you will allow us to establish the proper consistent, disciplined investment strategy for your portfolio, just like the managers of FPA Crescent have done for their investors. Over time, this has proven to be a winning strategy and it is our "prediction" that it will continue to be a winning strategy.

Contact us to set up a time to review your overall investment strategy.

Thanks again.

Other Services from Calder Investment Advisors

- Comprehensive Financial Planning
- Life Insurance Analysis & Consulting
- Traditional, Roth & Rollover IRAs
- Stocks, Bonds, Mutual Funds & ETFs
- Retirement Income Planning
- Corporate Retirement Plans
- College Savings Accounts
- Social Security Timing

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