MIDWEST TRUST

PERSPECTIVES

Third Quarter 2018

Stop, Look and Listen

By Bill Koehler, CFA

With a bicycle at her side, a police officer stands tall on a sunny school playground, days before the start of summer vacation. In full uniform, she holds a bicycle helmet and addresses a throng of students seated around her. Her topic is bicycle safety and she articulately relays a number of rules and tips designed to keep the children safe when riding bikes over the summer. One of her primary tips is instructing the children on the proper way to cross a street. "Stop, look and listen", she says putting on the helmet, and pausing to demonstrate the safety rule for the attentive students. The teaching session concludes and the officer feels that her message resonated with the kids.

Don't Rush

While the officer provided a sound lesson for safely crossing streets, she also imparted solid financial counsel as well. Investors' biggest mistakes tend to be made when they are "sped up." Impatience, performance chasing and conclusion rushing are factors, often borne of excess emotion, that can lead to investing missteps. "Stop, look and listen" is excellent advice for mitigating risk when navigating city streets **and** investing in the capital markets. This approach forces one to slow down, which can pay enormous dividends through better judgements.

"Stop, look and listen" is excellent advice for mitigating risk when navigating city streets and investing in the capital markets.

As we stop, look and listen at the start of the second half of 2018, what are our primary capital market observations?

Corporate Cash Abundance

Currently, many corporations are generating a great deal of cash. Factors driving this include the passage of the tax bill, a general pick up in the economy and the repatriation of off-shore earnings to the U.S. Options available for cash deployment include raising dividends, buying back shares, paying down debt, acquiring other companies or reinvesting it back into the business. All of which are occurring at this time. Merger and acquisition activity is at a record level.

Confidence within the business sector is high. A surprising development could be more capital spending than many believe is possible. U.S. manufacturing plants are as old now (14.6 year average age) as they were after WWII. Capital spending is required to upgrade this infrastructure.

Stock Market Vigilantes

In the 1980's, noted economist Ed Yardeni coined the term "bond market vigilantes" to describe how the bond market would sell off (and interest rates would rise) if policy makers in Washington D.C. were deemed overly profligate in their rhetoric or actions regarding monetary or fiscal policies. A political pundit at the time said if he were reincarnated, he would want to come back as the bond market, because then he could intimidate everybody.

Today, the stock market is in a better position to hold policy makers accountable. In the first half of 2018, investors sold stocks aggressively on days when proposed trade policy changes were viewed negatively. U.S. Secretary of Commerce Wilbur Ross recently stated "decisions will be made on trade regardless of the reaction of the stock market." In our opinion, that comment is a solid indication

Copyright by FCI Advisors. This material has been prepared for information purposes only. Factual materials obtained from sources believed to be reliable but cannot be guaranteed.

that the “stock market vigilantes” **do** have his attention. We view this as a positive development.

Trade tensions

In our opinion, the stock market will exert countervailing pressure on trade actions or policies that may be questionable to long term U.S. interests. We believe the Trump administration will pay heed to this stock market action. That said, trade tensions may well persist over the next few years. As the world’s largest consumer of goods, the U.S. does have leverage to negotiate. Trade was a major campaign issue for Mr. Trump, thus markets are not surprised he has targeted global trade issues. We will continue to focus research efforts on this administration’s approach to trade and potential long term consequences.

Interest Rate Trends

The term structure of rates has certainly changed over the last two years. From a low of 1.36% in July 2016, the 10 year treasury yield has touched the 3.00% level in recent months. Money market rates have also shifted from levels near zero 24 months ago, to around 2.0% today.

We are not overly concerned about the rise in rates over the last two years or the narrowing of the yield curve. Historically, it is true that yield curve inversion, where short term rates rise to a level higher than long term rates, can portend recessions up to 24 months later. However, we are still a ways from an inversion of rates. Additionally, interest rates are rising for the right reason, a stronger economy. Correctly, the Fed is trying to normalize interest rates after repressing short term rates beginning in 2008.

A school of thought is developing that the Federal Reserve may error on the side of raising interest rates too quickly. In that case, the aforementioned stock market vigilantes will make their presence felt by marking down stocks. That is certainly a risk to the stock market and something we are watching, but is not a view to which we currently subscribe.

Conclusion: Be Patient

A recent Northwestern Mutual personal finance survey found that money was the No. 1 source of stress for Americans. 44% of respondents said money was their biggest stressor, more than personal relationships (25%) or work (18%). However, the survey concluded that setting goals and creating a plan can go a long way toward gaining a sense of control. A plan lends itself to patience which in turn leads to more success and greater peace of mind. The value of patience in investing should not be underestimated. As Warren Buffett says, “The stock market is a wonderfully efficient mechanism for transferring wealth from the impatient to the patient.” If history is a guide, a “stop, look and listen” approach will foster patience, reduce stress and help investors better navigate their own financial streets.

A plan lends itself to patience which in turn leads to more success and greater peace of mind.

This publication is intended for use by clients of FCI Advisors and investment professionals.

CURRENT DISCLOSURES

Factual materials obtained from sources believed to be reliable but cannot be guaranteed. Past performance is not indicative of future results. Investing in the securities markets involves the potential risk of loss. These investment risks are described in our disclosure brochure (ADV), which can be found on our website: www.fciadvisors.com. Specific securities may be referenced in order to demonstrate a point; these are not investment recommendations. For further information please contact FCI at 800-615-2536 or SourceNotes@fciadvisors.com.