Comprehensive Investment Management, LLC

Fee Only Personal Financial Planning

Fall 2018

A Review of the Financial Markets at September 30, 2018

For the quarter Vanguard's Total US Stock Market Index Fund returned 7.1%, and its International Stock Index Fund returned 1.5%. One measure of stock volatility is weekly fund performance. During the quarter the US stock fund averaged just a .3% percent performance swing with three weeks exceeding a +1% and two weeks exceeding –1%. By another longer term measure, volatility was higher. After a good start to the year (at January 26 it was up 7.2%), by mid April the US fund was back down to zero. From there it performed at a steadier pace to finish 2018 year to date +10.5%. The international fund had a somewhat similar experience, but at the end of each quarter it was negative and at the end of September was at –3.1%.

The following article and accompanying charts describe the performance of a select group of mutual funds. Recent market activity can be newsworthy, but for investment purposes performance over longer periods, while not predictive, is significantly more meaningful.

US Diversified Stock Funds

US Stocks	Qtr	1 yr	3 yr	5 yr	10 yr	15 yr
Large Cap	9.7	22.2	21.4	15.9	13.6	12.5
Mid Cap	8.9	26.6	23.5	17.2	16.7	13.0
Small Cap	9.6	30.8	22.7	15.2	15.6	13.0

The Brown Capital Management Small Cap Fund has been on fire with a 2018 return so far of 31.3%. That's even though it took the late January and early February hit like the rest of the market, losing 9.4% in just two weeks. Our performance runners-up for 2018 are large cap Primecap Odyssey Growth Stock (17.5%) and mid cap Primecap Odyssey Aggressive Growth (17.4%.). The accompanying chart shows significant double digit returns for one year through fifteen years, so while some funds do better than others, clearly there are no laggards among all our recommended funds.

Healthcare Stock Funds

The healthcare industry, which represents 14% of the US economy, has been a great investment over the years. It and technology is a big part of what has driven the great returns of the Brown and Primecap funds. For the first time since June of 2016, Vanguard's Healthcare fund had a better quarter

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Mutual Fund Categories	Quarter Return	Average Annual Percentage Returns Through September 30, 2018				
		1 Year	3 Years	5 Years	10 Years	15 Years
Short Term Bonds	0.4	-0.2	1.0	1.3	2.6	2.7
Intermediate Term Bonds	-0.3	-1.3	1.7	2.1	4.4	4.2
US Diversified Stocks	9.4	24.4	21.5	15.6	14.4	12.3
Healthcare Stocks	13.2	19.3	13.2	16.1	16.3	14.2
Foreign Stocks	-0.8	3.6	15.3	7.1	9.1	10.4

The Financial Markets (from page 1)

than T. Rowe Price's Health Science. In fact, Vanguard's Healthcare Fund had the best quarter return (13.8%) among all our stock funds. Big pharma companies like Merck and Pfizer are making a comeback from what has been an extended dry spell for new block buster drugs. Again, no complaints, with both funds showing double digit annual returns over all time periods.

Foreign Stock Funds

Emerging Markets Select went from having the worst quarter at June (-9.7%) to the best at September (1.8%). It is still negative for the twelve months, but at just –.9%. All the funds are up double digits for the last three years averaging 15.3% and in positive territory at all time periods including double digits (10.4%) for fifteen years.

Bonds vs. Stocks

Return	1 yr	3 yrs	5 yrs	10 yrs	15 yrs
Wellesley Fund 65% bonds/ 35% stocks	3.4	7.3	6.2	7.8	6.9
Wellington 35% bonds/65% stocks	8.5	11.6	8.9	9.1	8.7

Comparing the performance of the Vanguard Wellesley and Wellington balanced funds shows the impact of different bond and stock allocations over time. Just a year ago there was practically no difference in the returns at ten years (6.9% vs 6.8%). More recently you see the impact of a run-up in stocks and negative return in bonds. The ten year favorability of stocks will more than likely widen as the devastating stock returns in the 2008 financial crisis drop out of the ten year calculation. Our bond allocation serves as a security cushion against volatility, and provides income regardless of changes in value. Even when running negative (-1.3% over the last twelve months) the lower risk of bonds can be counted on to keep dips in market value relatively low.

Looking Ahead

The market is on pace for a better than 14% return for 2018. That is supported by a U.S. economy growing better than 3 percent. Buoyed by a major tax cut, this year's corporate profits are on a pace to come in 20% higher than 2017. The major industry sectors continue to offer an encouraging picture of the underlying economy.

So everything is looking up. And that's the problem. When stocks are hitting new highs, they have no where to go but down. Trees don't grow to the sky, and neither do stock prices. Overall the stock market generally lags what is really going on in the economy. Enthusiastic stock buying is a lagging indicator and that is frequently a sign of a pending downturn. It's said that bond investors are smarter than stock investors, and bond investors are starting to show concern. We see that as interest rates go higher, which is a result of there being more buyers of bonds than sellers.

Concerns are growing in a few familiar areas. After a long stretch of growth the question of whether we have peaked is understandable. Will trade disputes with other countries, especially China (the second largest economy in the world and one of our major suppliers), continue to intensify and ultimately upend global growth and further stress international markets. Market relationships based on mutual trust take years to build, but can be lost in a matter of days.

Is nothing sacred?

We've got mid-term elections coming up, adding to uncertainty. How might the Federal Reserve rate hiking campaign restrain growth? This bull market is the longest ever, and is showing its age. Home buyers are looking at the highest mortgage rates in eight years. Home builder stocks find themselves in a bear market, and we know housing is a big driver of the overall economy. Bank stocks are struggling, and there are hints of inflation. Still, no one ever knows for sure how close we are to the end of either a market or economic cycle.

The Past Crisis

In October 2008, stocks were already in a bear market when Lehman Brothers couldn't find a buyer and the company collapsed. Bank stocks were cut in half and a recession was underway.

The crisis scared everybody, and some investors understandably gave in to the fear. By March 9th, 2009, the S&P had dropped 50 percent from its high. It made no sense to sell with the market down like that, but that`s what many did. Outflows from mutual funds accelerated, and didn`t turn positive again for over a year. Mortgage-backed security markets, which had always been considered safe, fell apart. Investors learned the hard way about derivatives and subprime mortgages. Markets around the world seized up. Even Wall Street had poor visibility on what was going on. We know this, because the big banks and investment houses were holding large amounts of the tainted assets themselves. Federal Reserve Chairman Ben Bernanke was convinced, and kept telling us that the mortgage debacle wouldn't spread to other sectors. He was wrong about that.

The Fed stepped in to make sure banks would not fail and that finally stopped the free fall. But even after the market had bottomed in March 2009, the recovery was fitful and anxious. Three years later, the broad stock market still had not fully returned to pre-crisis levels and a European debt scare threatened to cause a relapse. It took extraordinary efforts by US and global governments and their central banks to support markets by giving them critical time needed to recover. Only recently have they taken steps to reduce unusually accommodating policies.

Ten years after the height of the crisis, the stock market is very different from what it was. The number of publicly listed companies is dramatically reduced. Today there are just 3,400 companies in the Wilshire 5,000 Index. In 1998 it had 7,000 companies. They should think about changing the name.

The new Dodd-Frank laws make it harder to go public. Regulations have strengthened the banking system by vastly increasing capital requirements. Volatility has been significantly reduced, in part because of low interest rates and a more enthused transition to indexed investing, which some investors consider safer than trying to pick winners and losers.

The Next Crisis

A few potential causes: How about cyber-attacks on banks and other financial institutions, the collapse of the Euro Zone, high debt levels in emerging markets and in the US energy industry? Maybe too many subprime auto loans or too much unpaid student debt, shortfalls in pension plans or the negative impacts of tariffs and other geopolitical disruptions? How about various combinations and degrees of some or all of the above?

We can be fairly confident that the next crisis won't look like the last one. Afterall 2008 was the worst in eighty years. It erased a decade worth of gains. The market recovered but that only benefitted those who remained invested. History teaches lessons, but we only gain insight after we've worked to understand what really happened and how we reacted to it.

The goal is to be ready for the next one. There has to be a look-out for weak spots and gauge their seriousness. Economies are always changing, expanding and sometimes contracting, so there will always be weak spots. Do you think our government leaders are up to the job on this? Even if the answer is yes, the task is formidable.

A balanced and diversified portfolio remains the best safeguard. And remember a typical market gyration, either a correction or even an extended bear market, does not a crisis make. Short term volatility doesn't negate the long term growth potential of stocks. Long term results are what really matters.

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Q & A with the Editor

Q: Thanks for taking my question. Quick and to the point. Are the markets safer than in 2008 or not?

A: Former Federal Reserve Bank Chair Ben Bernanke and former Treasury Secretaries Timothy Geithner and Henry Paulsen recently wrote in the New York Times that in some ways reforms have helped the markets be better prepared for the next crisis. But they also say Congress took away some critical tools used by regulators in times of crisis, and they are urging lawmakers to bring them back. They specifically mentioned some of the most powerful tools used by the FDIC, the Fed and the Treasury: the FDIC can no longer issue blanket guarantees of bank debt as it did in the crisis, the Fed's emergency lending powers have been constrained, and the Treasury would not be able to repeat its guarantee of the money market funds. Those powers were critical in stopping the 2008 panic.

From a political perspective, the decision by Congress to limit these crisis-fighting tools was predictable. Many of the actions necessary to stem the crisis, including the provision of loans and capital to financial institutions, were controversial and unpopular. The responses often seemed unjust, helping some of the very people and firms who had caused the damage. Those reactions are completely understandable, particularly since the economic pain from the panic was devastating for so many. The article ends with: "For those working to keep our financial system resilient, the enemy is forgetting".

Clearly not a great endorsement from the three men who are considered by the great majority of economists to be the heroes of 2008. Without their bold actions and guidance, the US probably would have had a depression in 2008, instead of the most severe recession since that depression eighty years earlier.

Currently bank capital levels are up, their funding is much more stable than it was, and risk management immeasurably better. Banks now go though an annual stress test to see if they will hold up in a financial panic similar to 2008.The Federal Reserve and other central banks are much more in tune with what`s happening within financial markets.

The answer to your question is yes. Regulations are in place to prevent a recurrence of 2008. In the unlikely event it happens again, Congress will restore the tools. Beyond the guaranteed political posturing, a majority of office holders will respond, as they did in 2008 when they approved the bank bail-out.