

# Comprehensive Investment Management, LLC

## Fee Only Personal Financial Planning

### Spring 2018

## A Review of the Financial Markets at March 31, 2018

**F**or the quarter Vanguard's 500 Index fund was down .8%. It had a great January (7.2%), but that got wiped out in the first two weeks of February amidst great volatility. By February's end the fund was still ahead, but just by 1%. Volatility carried over into March, a month that included the worst week of 2018, during which the 500 fund dropped 5.7%.

Most of the damage came from two months of uncertainty over probable rising interest rates and potential global trade warfare. As the quarter neared its end, the tech sector stumbled, and doubts rose about whether any of the big technology companies will be in a position to lead major indexes higher.

A long established adage is that financial markets don't like uncertainty. If that's the case, one wonders why we don't find ourselves in a bear market of -20% or even lower?

*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

As you can see from the accompanying chart, our stock funds had a better quarter than the S&P. That's something they have done on a consistent basis. How consistent? In every time period in the accompanying chart the average return is higher than the S&P.

US Stocks	Qtr	1 yr	3 yr	5 yr	10 yr	15 yr
Large Cap	1.7	20.0	12.7	15.2	11.7	11.9
Mid Cap	6.6	29.6	15.4	19.4	14.9	14.1
Small Cap	4.4	22.4	12.7	15.4	14.1	13.6

There was an unusually high variation in the quarterly performance of our funds. For example, PRIMECAP Odyssey Aggressive Growth's return was +11.5%, while its mid cap brethren Vanguard Capital Opportunity returned just +1.7%. Among the small caps, Brown Capital was +6.9%, while T Rowe Price Small Cap was up just +2.0%.

*(Continued on page 3)*

Mutual Fund Categories	Quarter Return	Average Annual Percentage Returns Through March 31, 2018				
		1 Year	3 Years	5 Years	10 Years	15 Years
Short Term Bonds	-.5	.1	.7	.8	2.0	2.6
Intermediate Term Bonds	-1.6	.5	1.4	1.3	3.9	4.4
US Diversified Stocks	2.6	21.2	12.8	15.7	12.7	12.9
Energy, Health & Real Estate Stocks	-3.0	5.2	2.5	7.6	7.2	11.4
Foreign Stocks	2.9	26.4	12.5	9.6	4.8	12.8

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### **What are the Chances of a Global Trade War?**

Vanguard expects minimal direct economic impact from the new tariffs. Instead, it sees their real importance lies in the broader and longer-term implications for U.S. trade policy.

The United States and the European Union are the world's least protectionist countries. Donald Trump has been complaining about these policies for years, first as a private citizen, then candidate and now President. He feels strongly about it, using graphic terms and words like "stupidest ever" "idiotic," "worst ever" and "disaster." Even so, Vanguard thinks it unlikely that the US will dramatically shift its trade policy at the risk of disrupting domestic growth. The benefits of economic integration are just too great. History provides a lesson on that.

There is a consensus among economists that the Smoot Hawley Tariff Act of 1930 exacerbated the Great Depression. In 1927 the League of Nations, which the US played a major role in establishing, but never joined, issued a report that said the way to cure the ills of a struggling global economy was to put an end to tariffs. The US Congress saw it differently, and was convinced by Senator Smoot and Congressman Hawley that over-production within the US could best be cured by excluding other nations from the equation. During his 1928 campaign, President Hoover promised to help beleaguered farmers by increasing tariffs. When they were implemented, not surprisingly, other nations retaliated.

All politics are local. Smoot Hawley passed into law because votes were traded based on the impact on a given state's industries. We see that again today. President Trump now says he wants to take another look at his decision not to join the Trans-Pacific Partnership. His turnaround followed a meeting with congressional members representing primarily agricultural states including Texas, Nebraska, Kansas, Wyoming and Iowa. The agricultural industry has already experienced major disruptions in its markets just from talk of possible tariffs.

Vanguard puts the likelihood of a trade war at less than 10%, which is good because it estimates it would have a significant 1.7 point negative impact on the country's Gross Domestic Product. In any case, Vanguard expects the rhetoric around global trade to continue to add to market volatility.

### **Market Corrections vs Fund Performance**

A correction is a 10% drop from a 52 week high in the average price of stocks in a major index, i.e. the DOW, the S&P or the NASDAQ. Corrections come often and quickly, and are usually gone just as quickly. In February both the DOW and S&P corrected, and in the last two weeks of March the S&P again came real close. If the question is how much importance should a long term investor in mutual funds assign to a correction? The answer is not much.

On March 23rd the S&P closed down 9.9% from its high in January, and for the week was down 5.9%. A week later on the 29th it closed down 8% from its high, but for the week was only down .1%. So does the change in market price of an index on a given day provide any meaning for a longer period, even one as short as just five days?

Corrections are said to provide buying opportunities. Generally CIM is not looking for buying opportunities. During this bull market, we have been selling not buying in order to keep our portfolios close to a 50% stock allocation. You can see why that's the case, just by looking at the double digit annual returns listed on page one of this newsletter. When we rebalance, we are selling high.

Still there are times when the current market activity guides buy/sell decisions. For example, if we are reducing a position in energy, we want to do it when energy is on an upswing, as it is now. But even then we take longer periods into consideration. The Energy fund now has a positive three year return. In 2016, the fund's one year return was 34%, but its three year return back then was -3%.

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### The Financial Markets (from page 1)

#### Sector Stock Funds

Like the S&P the Energy fund started the year off well but fell behind in February. The energy industry is looking up, as OPEC has managed to gain some control on supply. Global economies are expanding, and that means more demand for energy. Having seen this movie before, CIM continues to reduce allocations to energy. Real Estate suffers when interest rates rise, so it did not have a good January, and an even worse February. The same as energy, CIM is reducing allocations to real estate. The average portfolio allocation to energy two years ago was 3.0%, but is now 1.8%. For real estate 4.4% is now 2.8%. We haven't lost money in the two sectors, but, especially with energy, we haven't made much either. In regards to healthcare, the ongoing debates about the future of the industry have not dimmed the investment returns. Still we have been cutting the allocation to it as well. Two years ago healthcare was 6.1% of a typical portfolio, and now 4.6%. That still leaves healthcare over-weighted, with its percentage of stocks about double the percentage of what healthcare is as a portion of the total US stock market.

Sectors	Qtr	1 yr	3 yr	5 yr	10 yr	15 yr
Energy	-2.4	4.8	2.4	.2	.3	9.9
Health	.8	11.8	4.2	16.3	14.9	14.2
R/Estate	-7.2	-1.1	.8	6.4	6.4	10.3

#### Foreign Stock Funds

The foreign funds had a positive quarter and their one year return of 26.4% beat US funds at 21.2%. The foreign markets are coming back but have struggled since the financial crisis. That can be seen in the 2.8% 10 year return of Vanguard's Total International Index funds. Our managed foreign funds did much better with 7.2%.

#### Bonds vs. Stocks vs. Mattress

Here's a comparison of two well regarded five star Vanguard funds with opposing bond/stock allocations. Wellesley is 65/35 bonds vs. stocks, Wellington the opposite at 35/65. If fifteen years ago you invested \$20,000 in Wellesley you would now have \$58,704. In Wellington you would have \$77,912 and about twice the amount of gray hair because stocks have twice the volatility of bonds. Adjusted for inflation the two figures are \$43,381 and \$57,576. If fifteen years ago you put that \$20,000 under your mattress it would now be worth \$14,780 having loss 26% to inflation.

Return	1 yr	3 yrs	5 yrs	10 yrs	15 yrs
Wellesley	5.0	5.2	6.0	7.1	7.2
Wellington	8.7	7.5	8.9	7.8	9.1

#### Looking Ahead

Growth is what drives an economy, and profits are what drives stock prices. This bull market is almost nine years old. If it can last to September, it will be the longest on record, the prior longest ending with the 2000 tech crash. It seems most likely this bull will end amidst uncertainty.

In the meantime, the soon to be announced profits for the first quarter should be gang-busters, especially with corporations reporting lower income taxes thanks to December's tax reform. Rising interest rates will be a headwind, as the Federal Reserve increases rates a quarter of a percent at least three times in 2018, maybe even four or five times. Unemployment can't go any lower, labor is very tight, and wages are going up. Add in a robust economy, and the Reserve is going to want to tighten monetary policy before inflation gets a foothold.

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Investment Management &  
Personal Financial Planning Services

*It's morning in the personal financial services industry*

The CIM investment strategy:  
Control risk yet outperform the market  
by using well managed, no  
commission, low cost mutual funds.  
Maintain appropriate asset allocation and  
diversification. Minimize taxes.

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### Q & A with Ernie

Q: I recently saw an exhibit on how the median price of a home has changed over the years. It didn't seem to increase that much back in the old days. Is inflation something new?

A: Certainly not new. In 1368 inflationary concerns caused the Ming Dynasty to end the use of paper money. Since 1914 US annual inflation has averaged 3.3%, which is 50% higher than what today's Federal Reserve considers tolerable. But the rate can vary quite a bit from year to year. The highest ten year average was 8.5% from 1974 to 1983. The lowest was -2.6% from 1924 to 1933.

The highest single year for inflation was 1917 (17.8%). The lowest was 1921 (-26.8%). The largest change from one to the next was 1921 (-26.8%) followed by 1922 (+4.8%). Some would call that "whipsawed". How about this scary three year string (1979-1981) of 11.2%, 13.6% and 10.4%?

Using inflation as a guide, the value of a \$5,000 home in 1914 grew to \$8,550 by 1924, then in the next ten years it dropped to \$6,700. By 1954 it's at \$13,450, and after another twenty years \$24,000 in 1974. That's when inflation took off. In just ten years it doubled to \$50,000. Today's price for a 1914 home of \$5,000 is \$126,000, a 2,400% increase over 104 years.

There is more to home prices than just inflation. The US census bureau lists the 1963 median sale price of a home at \$17,200. It crossed the \$100,000 mark in 1987, and crossed \$200,000 in 2003. Today it's \$327,000, a 1800% increase in 55 years. CNN reports the average square footage of a house is 2600 feet up from 1725 feet in 1983.