



Market Outlook

February's Wild Ride

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After a year or so of upward price momentum, exceptionally low volatility and record highs, the domestic stock market slipped in and out of correction territory at the beginning of the month and continued to zig and zag until the last minute of trading. At the same time, the 10-year Treasury yield rose to a high of 2.94%, and investors became concerned over the potential pace of wage growth, its impact on inflation and interest rates, and in turn its influence on future monetary policy. The concern was that rising inflationary pressures could cause the Federal Reserve to tighten too quickly, and potentially upset economic conditions. Some of this concern should be alleviated by the strong fourth quarter earnings we've seen, together with the recent tax law change and a stable, growing economy.

The pullback was the first real test of investors' resolve in recent memory. Long-term investors have seen this happen time and again. As mentioned in previous letters, it is common for a stock market pullback to occur in most years, with drawdowns since 1980 averaging in the low double-digits. With market conditions returning to more normal levels, volatility is also likely to return to more normal levels, too. According to Raymond James Chief Investment Strategist, Jeff Saut, "One would expect either some kind of pause, or even better, some kind of pullback to rebuild the stock market's internal energy. Plainly, the fundamentals remain excellent with earnings estimates continuing to ratchet up, revenues trending higher and a stronger economy. And while interest rates have increased, they have done so in a very orderly fashion." With this in mind, the major indices, namely S&P 500, NASDAQ and the Dow Jones Industrial Average, all slipped in the last few days of February and closed with a modest loss for the month.

There was a smooth transition as Jerome Powell took the helm of the Federal Reserve from Janet Yellen. According to his recent testimony, the Fed's decisions will remain data dependent, as they have for the last several quarters. In that light, the labor market and inflation continue to be areas of focus, as the Fed mulls monetary policy decisions.

International equity markets were also volatile in February. In Europe, political discussions remain at the fore with important updates on the status of the proposed German grand coalition and the results of the Italian general election slated for early March. Meanwhile, the Brexit debate continues in the UK.

In Asia, there were lowered geopolitical risks due to Olympics-related diplomacy supplemented by generally positive economic data out of influential countries, such as China and Japan.

Through the recent volatility, technology outperformed; financials and consumer discretionary held up very well; and the interest-rate sensitive sectors (e.g., utilities, telecom, real estate and consumer staples) showed weaker trends. The recent drawdowns in the overall equity markets are likely a combination of the feeling that a correction was overdue and questions about how markets will react, as we return to more normal economic conditions, including a normalization of the interest rate environment.

There are several factors simultaneously pushing and pulling on interest rates, potentially offsetting a significant directional move. The Tax Cuts and Jobs Act looks to free capital for corporations, lower price-to-earnings ratios and potentially increase revenues, all with the potential to promote future economic growth. Global central banks continue to purchase bonds in the open market, yet proclaim an eminent reduction. At the same time the Fed is reducing its balance sheet and positioning to raise domestic rates at least a couple of more times this year. If these events continue to clash, interest rate movement may be dulled. However, if global bond yields follow U.S. yields higher, that could contribute to rising interest rates in the marketplace. These opposing forces make this a situation worth watching.

Inflation and interest rates remain low from a historical standpoint, but are likely to move higher over the course of the year, potentially causing additional bouts of volatility. Given the strong economic and earnings backdrop, pullbacks should be normal in nature and viewed opportunistically.

In the meantime, a well-diversified portfolio geared toward achieving your long-term goals should allow you to participate in upside potential as well as serve as a ballast for any short-term volatility that may arise in the coming months.

Please let me know if you have any questions about current market events or how to position your long-term financial plan for the months ahead. I look forward to speaking with you.

Major Index YTD Performance (As of 2/28/18)

Dow Jones Indust. TR	+1.69
S&P 500 Index TR	+1.83%
NASDAQ Comp.	+ 5.35%
MSCI World Ex US	-0.31%
Russell 2000 TR	-1.36%
Barclay US Aggregate	
Bond Index	-2.09%
Long Commodity Idx.	-0.10%



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*Asset allocation does not ensure a profit nor protect against loss.

What's Happening- A Personal Note

Beki and I made a weekend trip to San Jose. Beki had a speaking engagement that required her presence on Saturday morning at about 10:00 a.m. But, that was the end of her obligation, which meant we had the rest of the weekend to bounce around San Jose.

We were fortunate to find a special flight deal out of Burbank that did not leave out of the main terminal. Instead, it left out of a large hangar away from the main terminal. The airline is called Jet Suite X and flights go to limited destinations which include Oakland, Las Vegas, Mammoth and of course, San Jose. Flights usually cost about 40% more than the traditional flight. But, as I said, we happened upon a special deal, well in advance of our flight, which made the cost very reasonable. I have to say, the experience was absolutely stress free. We were told to arrive about 30 minutes before our flight. There were no long lines through security because they pre-screen all passengers and have X-ray right in the hangar. They host a no-frills lounge with complimentary chips and soda and the walk from the hangar to the plane is about 100 feet. Planes hold about 40 passengers and our flight had 6 people on it. Drinks and snacks were included during our flight and when we got to San Jose, we exited the plane at a small off-site terminal where my rental car was waiting right outside the terminal doors. If I were to do this again, I would just keep an eye out on the internet for specials like we received. Probably the best commercial flying experience I have ever had.

After Beki made her presentation, we decided to go to the Winchester Mystery House. The house and the story behind it are quite interesting. Mrs. Winchester was married to an heir to the Winchester Firearms company. After her husband died, she began to believe that she was being haunted by the spirits of the people who had been killed by Winchester guns. A spiritual guide told her that in order to keep the spirits at bay, she needed to start building at her home and to keep the building ongoing, at all times. The idea being that the sound of the hammers and other tools would confuse the spirits and keep them away from her. This resulted in a couple of interesting outcomes. The first, of course, is that the house is enormous. Even after the three top stories of the home were removed after they were damaged in the 1906 San Francisco earthquake, there are still over 160 rooms in the house. Secondly, sometimes, in order to keep the building going until more rooms could be designed, building just happened, which resulted in things like doors that open to brick walls or second story doors that open to the outside where no balcony exists, or stairways that end on the underside of the story above. But she was also quite a good architect of sorts and many components were residential advances, such as elevators and advanced heating systems. She also designed many of the exquisite stained glass windows in the house, which were then made by the Tiffany glass company. All in all, we spent about five hours at the house and on the grounds, which included two tours. The history and design of the house are fascinating and a trip to San Jose should include a visit to the Winchester Mystery House.

The following day we decided to visit a facility owned and run by an organization called the Rosicrucians. I have heard of the Rosicrucians before, but I was not familiar with them. Even after a visit to their beautiful facility in San Jose, I can't say that I know much more than I did before I visited. But from what I was able to learn, they are an organization dedicated to knowledge, peace and service. Our engagement with them came in the form of a visit to their facility in San Jose. The grounds are beautiful with several gardens and areas for reflection. The architecture of the buildings is a mix of Egyptian and Art Deco which makes sense, since it was built in the 1930s. Our visit was spurred by a surprising revelation that this facility houses one of the largest collections of Egyptian artifacts in the U.S. I have to admit, I was not expecting much, despite the claim of the size of the exhibit. But the collection was impressive and if you are interested in ancient Egyptian history and artifacts, as I am, you will not be disappointed.

There is also a small planetarium on the grounds, built in 1936, again in the Art Deco style. According to the guide, it was the 5th Planetarium built in U.S. It was small and similar to many other planetariums I have visited. It is composed of a small domed theatre designed for presentations and a modest waiting area that is filled primarily with Rosicrucian paraphernalia and literature. We watched an interesting movie about space exploration and that ended our visit.

Much of this weekend's adventures were not planned out. We simply went out and stumbled upon interesting and exciting new places on our travels. There is a Disney movie called "*Up!*" that has a wonderful quote I truly appreciate, "Adventure is out there!". I have to agree.

Disclosures

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 - The **NASDAQ Composite** is an unmanaged index of securities traded on the NASDAQ system.
 - The **MSCI World ex USA** index captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries excluding the United States. With 1020 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
 - The **Russell 2000** index is an unmanaged index of small cap securities which generally involve greater risks.
 - **Morningstar Long-Only Commodity Index.** The Long-Only Commodity Index is a fully collateralized commodity futures index that is long all eligible commodities.
 - **Barclays US Aggregate Bond Index** is a broad based index often used to represent investment grade bonds being traded in the United States
 - The **Dow Jones Industrial Average**, commonly known as "The Dow" is an index representing 30 stocks of companies, maintained and reviewed by the editors of the Wall Street Journal.
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