

THE LONG RUN

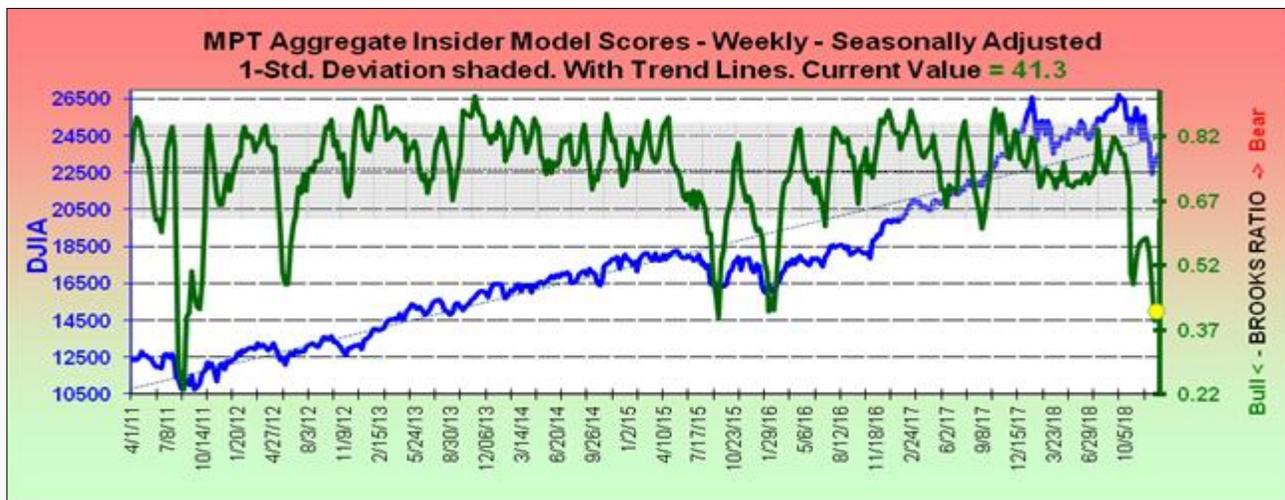
Reynders, McVeigh Capital Management, January 2019

*Before enlightenment, chop wood and carry water.
After enlightenment, chop wood and carry water.
--Zen proverb*

Stock markets hit a wall during the fourth quarter, declining significantly and erasing gains made earlier in the year. Investors came to the conclusion that policymakers, including central bankers and governments, had underestimated the corrosive effects of rising interest rates and trade wars on the economy and corporate earnings. For only the fourth time since 1950, stock prices declined by 20% within four months. The S&P 500 and the MSCI World indices declined by 13.52% and 13.42%, respectively, during the fourth quarter alone. For the full year, these indices fell by 4.38% and 8.71%.

Where do we go from here? With one year ending and another beginning, there are expectations of enlightenment. As the calendar turns, we believe we can briefly pause, reflect, and offer wisdom that was not present previously. In reality, successful investing is about daily habits and long-term thinking. It is about selling in times of excess and buying during periods of fear. It is about chopping wood and carrying water. It is not about being swept along with the herd as emotions swing violently in the moment.

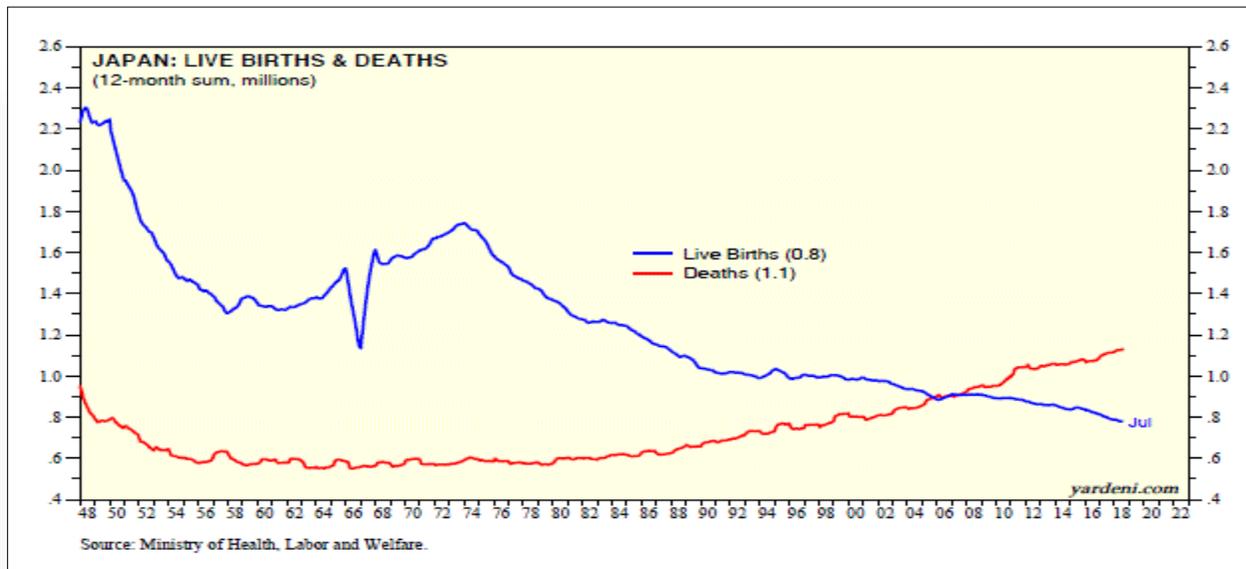
A year ago, nearly 60% of investors surveyed by the American Association of Individual Investors said they were bullish, a level reached only twice in the past 14 years. Our advice last January was that much of this good news was likely already discounted in stock prices. As stock prices declined in the fourth quarter, these emotions predictably shifted and investors reported their highest levels of sustained pessimism since 2012. It is moments like this that we begin to see more opportunity.



The above chart, while a bit complicated to explain, reflects a focus away from emotions and on calmer reflections. It measures the actions of corporate insiders buying and selling their own stock. Those who work for companies tend to have a solid understanding for their own respective outlooks. As stocks were rising early last year, nearly 82% of all of their transactions were sales of stock. As the market plummeted in the fourth quarter, sales comprised a near record low 41% of transactions. Insiders are aggressively buying.

While global growth conditions have definitely slowed somewhat in the face of political obstacles, most data still point to growth continuing over the next year. Inflation remains subdued. Interest rates now appear to be on hold. Employment growth has been surprisingly good. Meanwhile, small business confidence remains high and companies still report record job openings and increased plans to boost inventory levels. The CEO of Citigroup, for example, just noted that, “...we clearly see a disconnect between what we see in our business on an anecdotal basis and what the markets are saying. Right now, we see the biggest risk in the global economy is one of talking ourselves into the next recession, as opposed to the underlying fundamentals taking us there.”

The primary barrier to market recovery appears to be political. Trade negotiations with China have had a negative effect on their markets and economy. Stocks fell by 25% in China during 2018 and their most recent economic growth was at its slowest annual rate since 1990. While we believe progress is being made in resolving this conflict, if a resolution is not reached soon, this has the potential to disrupt the global economy during 2019.



Though walls of worry are likely to be a continuing presence in the year ahead, our focus on fundamentals—chopping wood and carrying water—still can find opportunities in which to invest. The global economy is undergoing the largest technological transformation in history. Gene editing, genome sequencing, blockchain technology, and energy storage are but a few examples. In addition, demographic shifts are also reshaping the world.

The above chart illustrates that Japan is leading the world down a path of shrinking, not growing populations. Birthrates in the United States hit a record low in 2017 and, according to a just released study from the National Center for Health Statistics, the fertility rate in the U.S. has generally been below the replacement rate since 1971. On an investment level, this points to greater demand for robotics, technology and other labor-saving devices, and higher valuations paid for companies that can truly grow their sales. From a political perspective, it screams for an inclusive immigration policy not built on barricades.

While we don't believe the current market volatility is over, stock valuations are now at more reasonable levels than they have been in some time. We will balance that with the political uncertainty we face. Chop wood. Carry water.

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