THE OUTLOOK — STILL HEALTHY

BUT FIRST, A REMINDER ABOUT MARKET TIMING

Although I've already spent a lot of ink explaining how you might reduce your investment-related mail, I would still like to address the current investment climate.

Since equity values have obviously surged, folks instinctively begin to wonder if now might be a good time to reduce or even eliminate their equity exposure. Consequently, I'd like to briefly address that sentiment before I share with you what's good in the investing world.

IT'S AS TEMPTING AS ANY MIRACLE CURE ... AND ABOUT AS EFFECTIVE

Because equity values have surged and because no investor likes to see his or her portfolio depreciate, the temptation to side-step the next market correction before it unfolds is admittedly tempting. Unfortunately, it's tempting the same way miracle cures are tempting. The world offers plenty of alluring propositions and magic potions, but many of them don't work and, on average, market timing is among those that don't.

Timing signals do sometimes correctly predict a given downdraft. Other times, they merely *coincide* with that downdraft. Distinguishing between prediction and coincidence can be tricky, but if that distinction didn't matter, no one would care whether a rooster's crow coincides with the sunrise, or causes it.

For example, the press is fond of crediting Dr. Nouriel Roubini with having predicted the housing collapse of 2008/9. However, the press is less apt to note that Dr. Roubini made that prediction years before (in 2006) or that he did so only *after* housing prices had already begun to tumble. I wonder if the public would take Dr. Roubini's predictions seriously as it does if it were also reminded that his views are generally apt to be gloomy. After all, each one of his gloomy predictions since 2009 has been delivered in the context of what, so far, has been the second-longest bull market in history. If Dr. Roubini weren't more or less a "permabear," the media wouldn't refer to him as Dr. Doom.

As the cable anchors welcome Dr. Roubini to their studios to hear his latest predictions, I wonder how seriously he might be taken if they were to also remind viewers that in

May of 2010, 14 months after the global economy had begun to heal, Dr. Roubini told CNBC's listeners that the world was at risk of falling into a double-dip recession and that investors would be best served by holding cash and commodities.

Eschewing equities because he feared valuations were, once again, set to decline by some 20% over the next year, equity valuations actually *rose* by more than that amount over the subsequent year. Dr. Roubini has been dead wrong plenty of other times, too, but demand for his economic predictions endures, mostly because the press touts his hits while ignoring his misses.

The damnedest thing about market-timers and the prognostication industry, in general, is that since there's so many predictions being made at any given time, someone, somewhere, whether by skill or by luck, is likely to make a correct call about something somewhere along the line. Until the press and/or the investing better differentiates between accurate prediction and prolific guessing, the charade of being able to see around corners is likely to persist. Of course, there are hints, but anyone who claims to know how the markets are going to move is either deluding him/herself and/or trying to con you.

ASSET ALLOCATION STRATEGY — DISCIPLINE REPLACES EMOTION & PRESCIENCE

As an alternative to moving into and out of markets in an effort to avoid downdrafts, I believe that a long-term, asset-allocation strategy, whereby one commits to maintaining a certain percentage of one's portfolio in a variety of asset classes, provides the surer path to investing success for a number of important reasons:

- Prescience, which mostly does not exist, is no longer required.
- Emotion, which is often an enemy of rational decision making, is also removed from the investment process. In this case, it's replaced with disciplined decision making:
  - ⇒ When a given asset class suffers a significant downdraft, the natural instinct is to sell. However, the best time to buy things is when those things are on sale. Since a depreciated asset class is likely to represent a smaller portion of one's overall portfolio, abiding by an asset-allocation strategy will automatically result in assets being purchased when they're less expensive.
  - ⇒ Similarly, when a given asset class rises in value, the natural instinct is to purchase more of it, even though it's definitionally more expensive.

However, abiding by an asset-allocation strategy will automatically result in the sale of at least some of those assets … while their prices are relatively favorable.

- A portfolio that's diversified across a variety of asset classes is likely to lag the performance of the overall stock market when stock prices are surging. However, some of that lag may be partially or even wholly overcome as a result of gravitating toward equities *after* they go on sale during soft market periods.
- An asset-allocation strategy allows one to remain fully invested at *all* times. Since the capital markets are (I believe) structured to allow for positive returns more often than not, remaining invested eliminates the primary risk of market timing — the risk of missing market advances by being un-invested during those times.

MARKET PULLBACKS ARE OPPORTUNITIES TO POSITION FOR FUTURE GROWTH

In terms of stock market volatility, 2017 was aberrant. As much as investors may enjoy high returns coupled with low volatility, that combination is not often on the investment menu, as shown below.

Year	Intra-Year Drawdown	Total Return for the Year
2009	-28%	+23%
2010	-16%	+13%
2011	-19%	0%
2012	-10%	+13%
2013	-6%	+30%
2014	-7%	+11%
2015	-12%	-1%
2016	-11%	+10%
2017	-3%	+19%

Source: J.P. Morgan

When volatility does return to the equities markets, as it assuredly will, I encourage you to embrace it as an opportunity to set your portfolio up for future gains. During late 2008 and early 2009, when the meltdown was in full swing, we purchased a variety of securities that routinely fell in value immediately after purchase. Years later, however, folks were happy we set emotion aside and acquired assets on the cheap.

WHAT'S GOOD IN THE WORLD OF INVESTING — A SERIES OF GRAPHS

I'm going to present a few graphs and some economic data points that, I hope, will provide some context for the surge in equity values. Good economic data does not in any way assure outsized equity returns, but having a strong economic backdrop is clearly preferable to the alternative.

ADVANCED & EMERGING ECONOMIES — SUSTAINED SYNCHRONIZED GROWTH

World Bank data suggests the world economy is experiencing a broad-based upturn. As of January, it projects this growth to continue for at least the next few years.

			Estimate	Forecast		
Annual GDP Growth (%)	2015	2016	2017	2018	2019	2020
World	2.8	2.4	**3.0**	**3.1**	**3.0**	**2.9**
Advanced Economies	2.2	1.6	**2.3**	**2.2**	**1.9**	**1.7**
Emerging Market & Developing Economies	3.6	3.7	**4.3**	**4.5**	**4.7**	**4.7**
Including						
China, Indonesia, Thailand	6.5	6.3	6.4	6.2	6.1	6.0
Russia, Turkey, Poland	1.0	1.7	3.8	2.9	3.0	3.0
Brazil, Mexico, Argentina	-0.6	-1.5	0.9	2.0	2.6	2.7
Saudi Arabia, Iran, Egypt	2.8	5.0	1.8	3.0	3.2	3.2
India, Pakistan, Bangladesh	7.1	7.5	6.5	6.9	7.2	7.2
South Africa, Nigeria, Angola	3.1	1.3	2.4	3.2	3.5	3.6

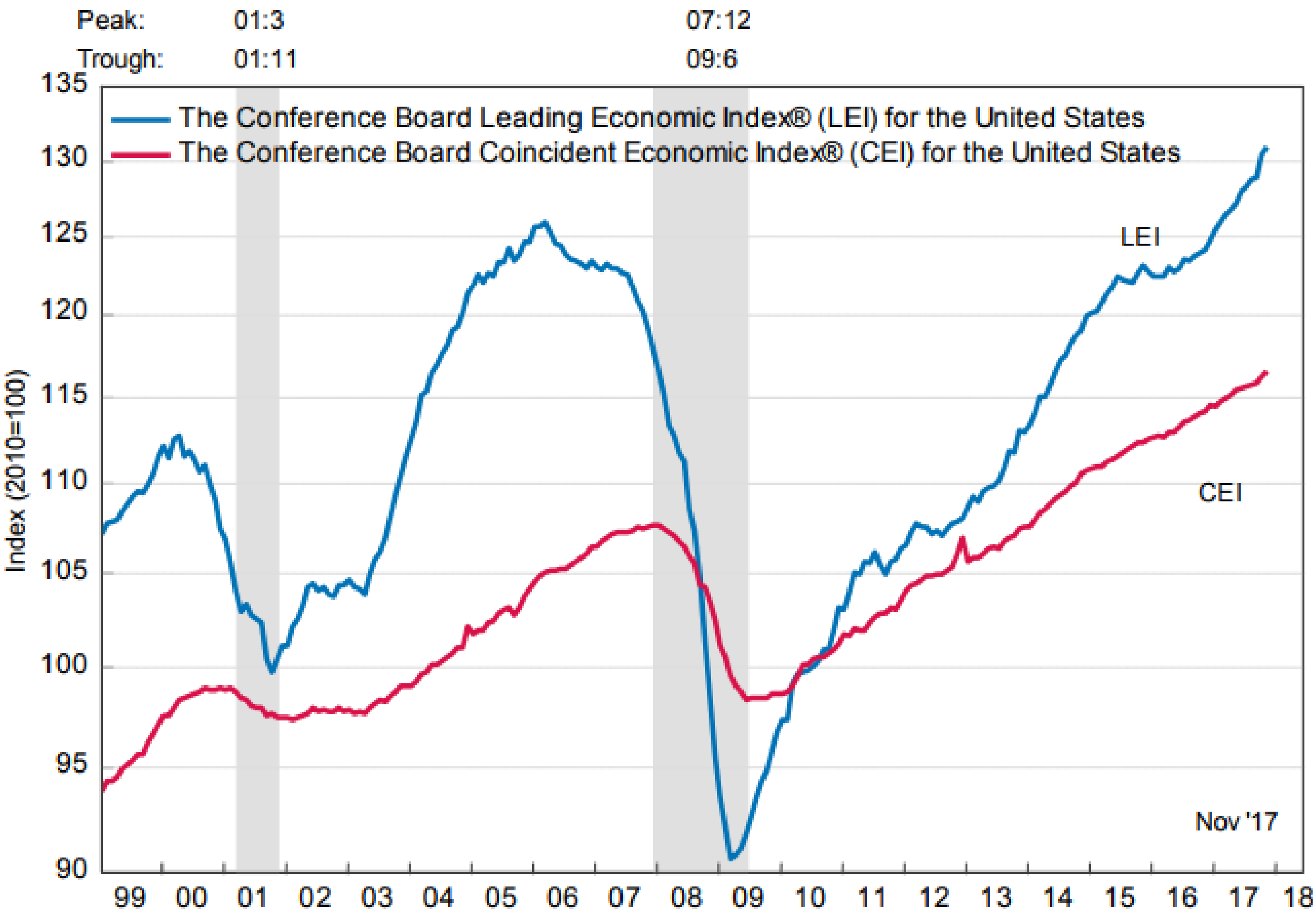
Source: World Bank Global Economnic Prospects, January 2018

INDEX OF LEADING ECONOMIC INDICATORS® SURGES FURTHER

I've outlined the economic components that comprise the Conference Board's Index of Leading Economic Indicators in past notes so I'll skip those details this time, but I would, once again, like you to note how this indicator inflected downward *prior* to the onset of two previous recessions in the U.S. As smoke detectors go, the Index of Leading Economic Indicators has been a pretty reliable one.

Since the Leading Economic Index is forward looking, you might think of it as pulling the "current" index toward it. Both of these indicators are reassuring.

The Conference Board Leading Economic Index® (LEI) for the U.S. Increased in November



Latest LEI Trough March 2009, Latest CEI Trough June 2009
Shaded areas represent recessions as determined by the NBER Business Cycle Dating Committee.
Source: The Conference Board

EARNINGS ESTIMATES ALSO CONTINUE TO RISE

Securities analysts have a long-standing history of being overly optimistic with respect to estimating corporate earnings and subsequently having to tame their estimates as the future unfolds. In that context, it might be comforting to know that since the end of November, analysts' consensus estimates pertaining to earnings growth for publicly-held companies have not only risen, they have risen at an accelerating pace. This is true not only for the first quarter of 2018, but for 2018 as a whole.

I suspect these upward revisions are being driven by the reduced tax burden that will now be a reality under our revised tax code.

Source: Zacks Investment Research Inc.

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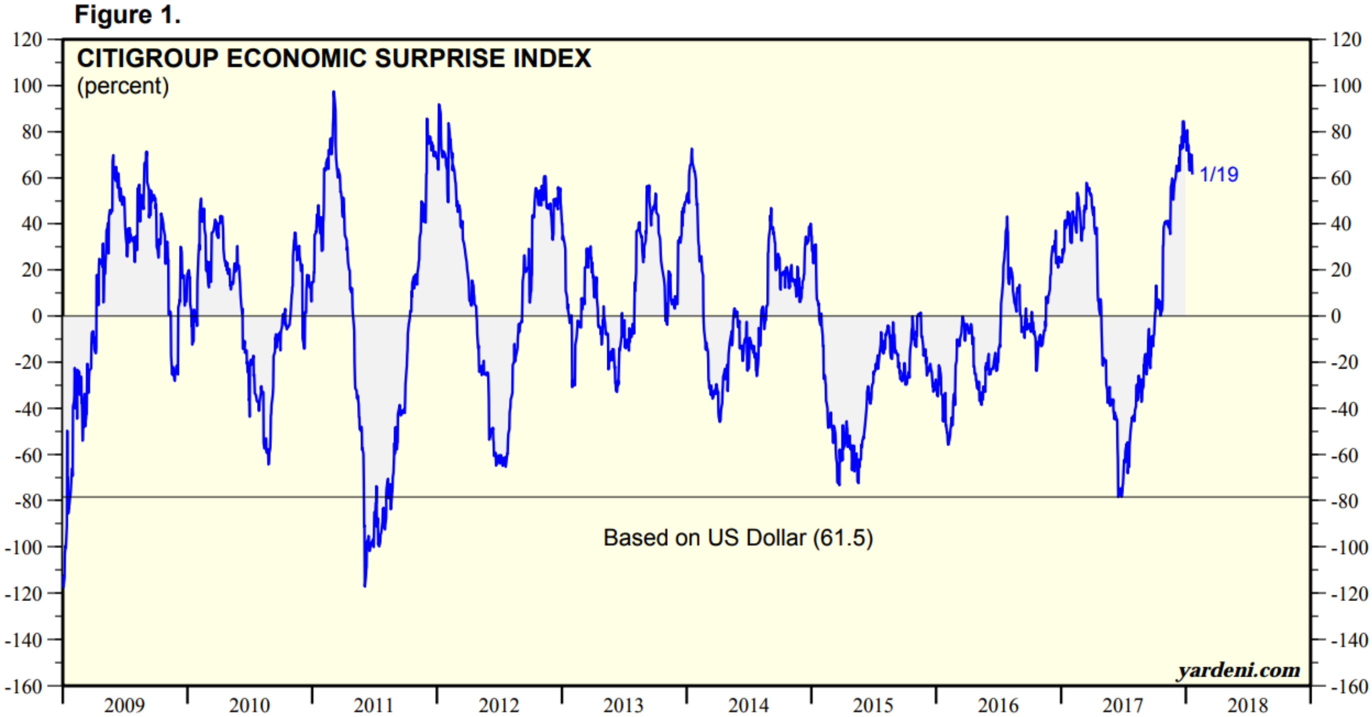
CITIGROUP ECONOMIC SURPRISE INDEX

This index is intended to objectively quantify various measures of economic performance by comparing the actual data points to the expected values as tracked through Bloomberg surveys.

In general, economic data that is better (worse) than expected results in a positive (negative) index value. Investors prefer positive surprises to negative ones as much as any other cohort group and, as you can see, recent surprises have been overwhelmingly positive.

Citigroup Economic Surprise Index

Figure 1.



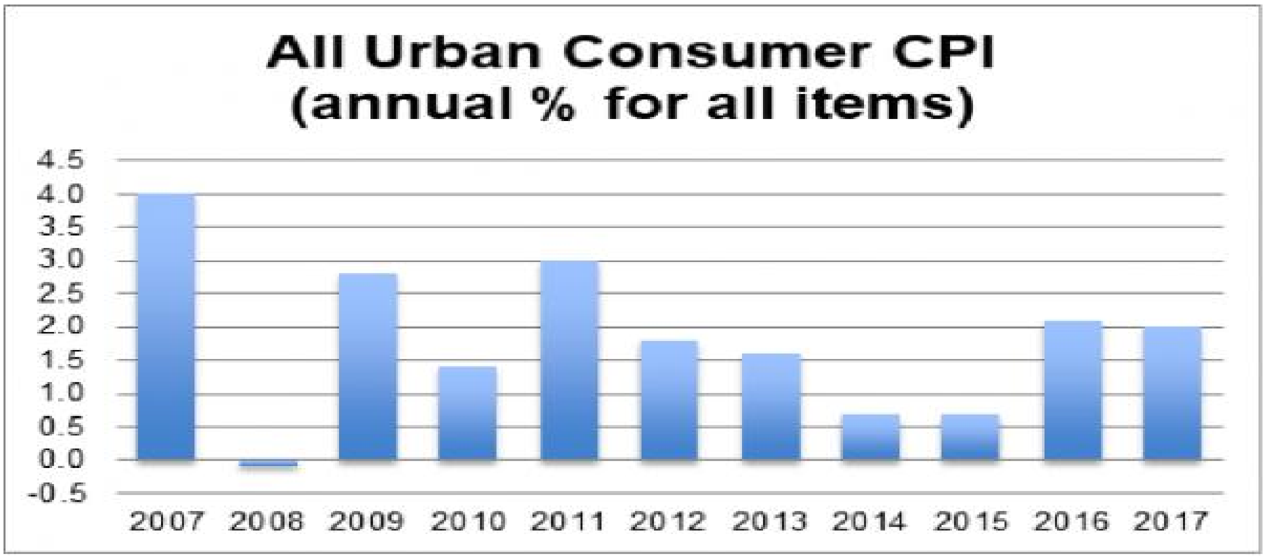
Source: Citigroup.

Citigroup publishes surprise indices for other areas, too. I haven't bothered to include graphs for any other regions in this note, but the index for the world's "developed markets" as a whole (all the first-world countries) is also quite positive and the index for the Eurozone, in particular, is substantially more positive than it is for the U.S.

Remember, though, positive economic data and positive investment returns don't necessarily go hand in hand. Nonetheless, it's better to have it than to not have it.

FOR BALANCE, SOME WORRY

In the wake of the recession of 2008/9 the Federal Reserve did it's part to spur economic growth by keeping a lid on interest rates. The usual downside of a low-rate environment is price inflation, but other than 2011, the rate of inflation within the U.S. has been persistently below the Fed's 2% target. Over the past couple of years, however, the Fed's preferred measure of inflation has hovered near its 2% target as shown, here.



If Consumer CPI were to trend above that 2% target, the Fed might be inclined to raise rates more aggressively and those higher rates would then bear negatively on most every corner of the U.S. economy. Were the U.S. to withdraw from the North American Free Trade Agreement as has been threatened, businesses and consumers within the U.S. would face higher costs and inflation would likely exceed the Fed's 2% target.

Even without the U.S withdrawing from NAFTA, the Fed could be on the cusp of acting more aggressively during 2018, but if the U.S. were to actually withdraw from that agreement, I would expect the Fed to act preemptively to ward off the inflation that would be expected to follow. Disappointment could also be triggered by softer-than-expected corporate earnings, a successful Robert Mueller, backlash during the mid-term elections, trouble with North Korea or any of its tacit supporters, a bursting of the cryptocurrency bubble, etc.

Nonetheless, I encourage you to remain committed to your asset allocation targets and to view any volatility that might occur as a potential opportunity to acquire assets at relatively attractive prices. — Glenn Wessel