Kevin Prendergast

From:	Kevin Prendergast
Sent:	Tuesday, August 21, 2018 11:28 AM
To:	Kevin Prendergast
Subject:	It was the best of times, it was the worst of times...

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Kevin J. Prendergast, CFA
August 21, 2018

More than 150 years ago, *A Tale of Two Cities* provided us with its famous opening line. It's a line we use again and again, and it's a line that perfectly describes the global financial system in 2018 as noted economists and market commentators present compelling arguments for each the bull and bear cases with equal conviction.

Representing the bull case, in his August 13 blogpost *The Kevlar Economy,* First Trust Chief Economist Brian Wesbury cites "five threats to prosperity": (1) Excessively tight Fed policy (2) Excessive government spending (3) Excessive regulation (4) Tax hikes, and (5) Trade protectionism. With interest rates remaining at very low levels, regulatory rollback, and tax cuts for many businesses and households, Brian contends threats 1, 3, and 4 are non-issues and supportive of a strong economy, particularly in the US. Brian concedes government spending is clearly a problem and an impediment to economic growth, but argues that other countries have more to lose than the US in global trade, and will ultimately bow to our demands, moving threat 5 from the negative column to the positive.

"There's bears in them thar woods!" On the very same day, David Rosenberg, formerly Chief North American Economist at Merrill Lynch, now Chief Economist with Canadian investment firm Gluskin Sheff, wrote for Financial Post: *A reality check on the US strategy of cutting taxes*. David argues that bestowing tax cuts upon US corporations already flush with cash and able to borrow money at very low interest rates contributes to unsustainably high stock market valuations, as well as government debt levels likely to impede future economic growth.

So, where the in the world do we put our money? The conservative choice for many is cash, specifically cash denominated in US dollars. At present, we're seeing some online banks offer high-yield savings accounts that pay 1.85% provided no more than 6 withdrawals per month. Conservative investors, or investors concerned about the stock market but willing to take some risk and forego access to part of their savings for a number of years, might consider US Treasuries or municipal bonds that produce interest exempt from federal and/or state income tax. But as Warren Buffet wrote in The New York Times in October 2008: "Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value."

From the date Warren Buffett's op-ed, *Buy American. I Am.*, was published in The New York Times, through March 9, 2009, the S&P 500 (Large US Stocks) declined approximately 30% before reversing course and returning about 380% through June 29, 2018. To borrow another quote from the Oracle of Omaha: "Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month – or a year – from now." So while it may seem like a good idea to sell stocks and hoard cash, let Warren Buffett's net worth give you 80 billion reasons to resist the urge.

Last quote, I promise, from Sir Winston Churchill: “For myself I am an *optimist* – it does not seem to be much use being anything else.”

With the wisdom of Messrs. Buffett and Churchill in our front pocket, color us optimists. For nearly all of our investors, we remain committed to holding a measured allocation to global stock market indexes for the long-term inflation protection and growth potential inherent in the ownership of productive businesses. Moreover, with history as our guide, while there will always be ups and downs, with the downs perhaps feeling worse than the ups feel good, we view 4-6% average annual returns as reasonable to expect over the next 10 years. In a world with a sub-3% 10-year Treasury and 2% inflation, that’ll be just fine.

-KP

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Please let us know if we can be of additional service.

Best,

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