Investment Manager Meetings Recap

What Are Investment Manager Meetings?

At Strategic Income Group, we believe in reviewing detailed investment research. Every 90 days we set aside a week during which around 7 to 10 investment managers give us recommendations on our current portfolios as well as share their firms' current views on the market and economy. This recap is our commentary on the most recent meetings.

It has been 90 days since our last report and the markets have moved a lot and gone nowhere at the same time. If all you did was read this report you would realize that the Dow, S&P 500, and Nasdaq are all up about a fraction of 1% in these last 90 days – that's not much.

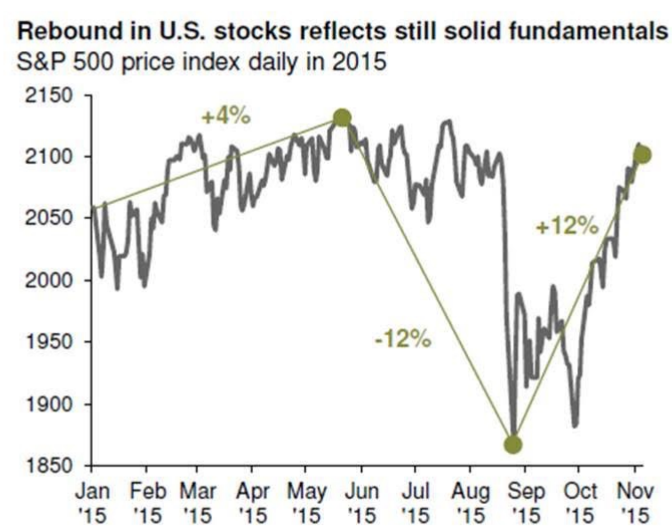
What you would have missed, however, was a wild ride in August and September – a 12% drop followed by a 12% recovery. We even had a day during this quarter that the Dow at one point was down over 1,000 points in one trading day. Can you believe it?

So what has changed, you ask? In our view and in the view of the investment managers that we met with . . . nothing!

Our view this quarter has not necessarily changed. We were encouraged in meeting with MFS, Goldman Sachs, BlackRock, Pimco, American Century, Alliance Bernstein, and Wells Fargo Investments in that many of the themes that we like have started to play out even more than they have before.

One of the major expectations the managers had developed during our 3rd quarter meetings was that a 5%-10% would be coming very soon. The markets happened to give us a 12% correction.

CHART OF THE WEEK



Last quarter when we made our trades, we knew the areas that we wanted to sell out of and the areas that we wanted to begin positions in. Our investment committee decided to make the sales and sit in cash until we saw until we saw a better entry point in the market – we believed one would come.

We did not have to wait long. As mentioned above, on Monday, August 24th, the Dow Jones dropped at one point of the trading day 1,089 points. On Tuesday, August 25th, the Dow was trading up about 300 points for most of the day. It had an incredible reversal and dropped over 500 points in the last hour of the trading day and ended the day down over 200 points. This kind of volatility is not often seen.

This was our opportunity. For most of our clients in our Strategic Portfolios, we had over 20% in cash from the recent sales. As a firm we did over 4,700 trades in the last hour of the trading day and put all of that cash back to work in investments.

In all honesty, we did not know that on Wednesday, August 26th the markets would be up over 600 points or on Thursday, August 27th that the rally would continue and be up over 300 points. We just knew that given the value on August 25th – and our time horizon on those trades over the next 18 months – that it was a great entry point.

We had already decided where we wanted to place the money and what we wanted to invest in. We were just waiting for the right moment and were able to act on it on our clients' behalf. This benefited our clients' Strategic Portfolios.

Volatility and Bear Markets

When markets become more volatile, many investors start to wonder if a bear market or recession is on the horizon. This was a point in many of the conversations we had with our investment managers recently. MFS clarified it pretty well with these five threats to a bull market:

1. Recession
2. Excessive valuation
3. Aggressive monetary policy
4. Geopolitical risks (typically short-term financial impact events like 9/11)
5. High inflation

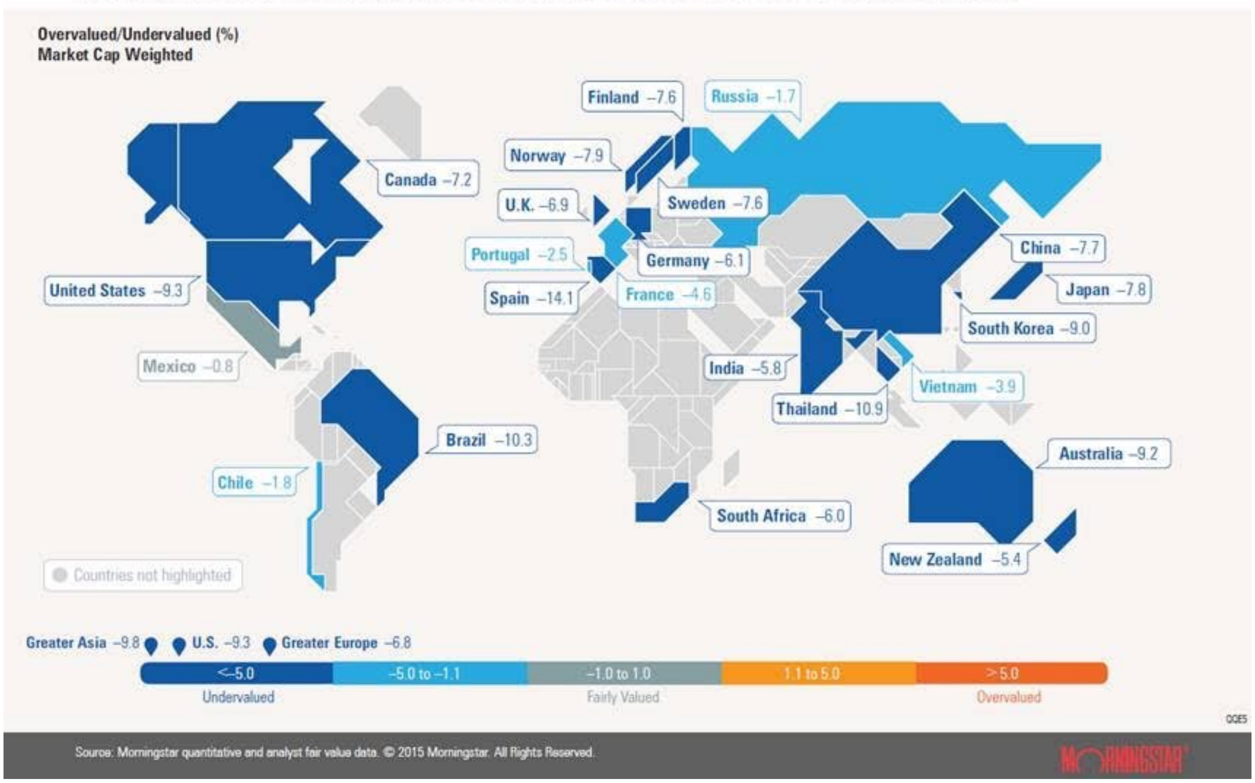
As we read through these common threats that typically will end a bull market, none of them seem to hold true. Of course, we can never predict geopolitical risks, but historically they have the least impact and are very short-term in nature.

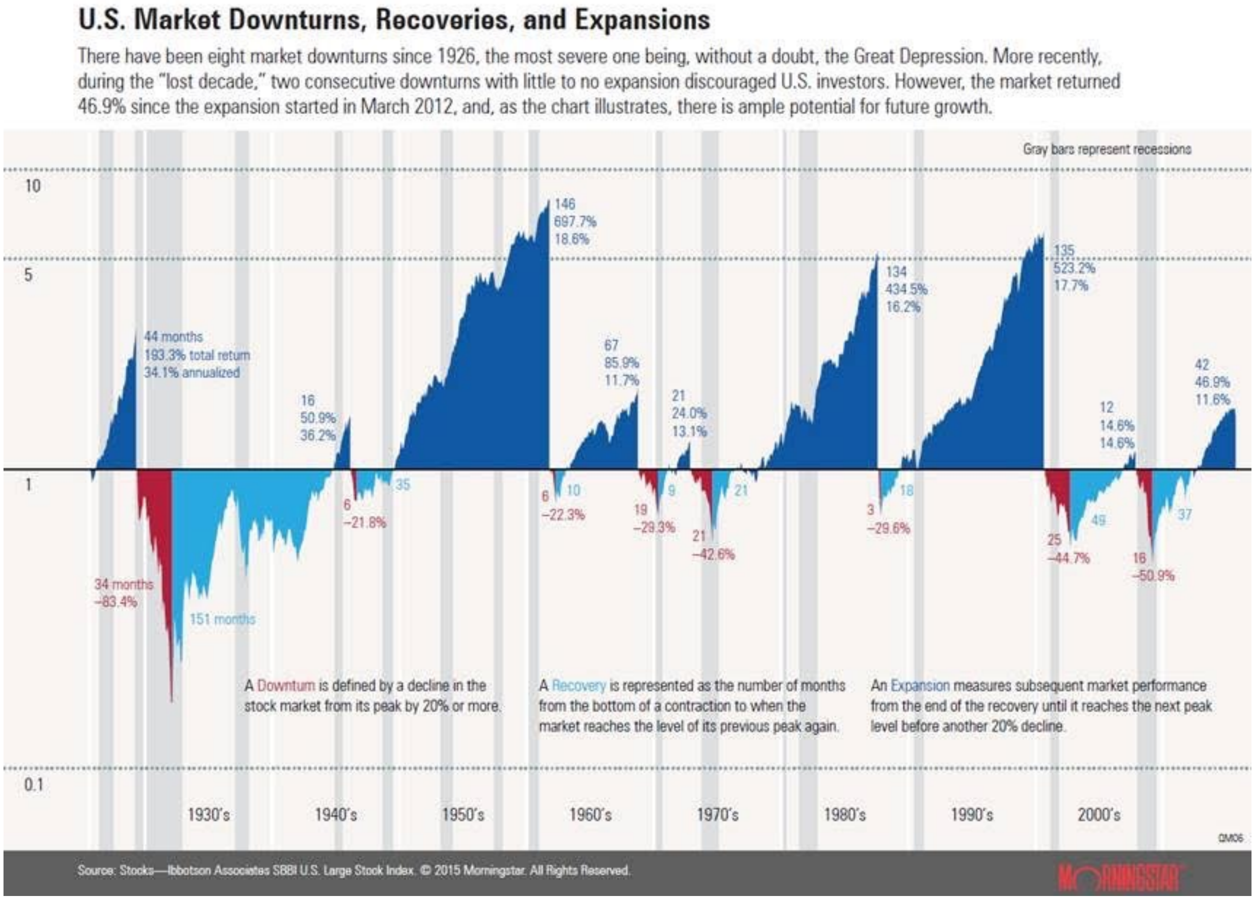
This discussion prompted us to make another list of the five reasons we will not see a recession anytime soon:

1. There are favorable (pro-growth) central banks all around the world.
2. Oil is low due to supply not demand – this will continue longer.
3. Years of low rates have allowed companies and consumers plenty of opportunities to create strong balance sheets.
4. Low inflation (current is 1.7% with the Fed targeting 2.0%). In the last 40 years it has been averaging 4%.
5. Current valuation of equities historically puts recession out 3-4 years.

Morningstar Price to Fair Value by Country

In a dramatic reversal from last quarter, all of the world now appears undervalued after the global stock market selloff. Even though valuation is an important metric to consider, risk levels are also a crucial factor when investing internationally. For example, the United States and Brazil are similarly undervalued, but persistent problems in Brazil make it an unattractive investment when compared with the U.S.





Real Return

Another important action item we undertook as a firm over the last quarter was reviewing countless clients' financial plans. For the most part, the changes and fluctuations in account values did very little to impact longer-term financial plans.

The biggest reason for this is that your financial plan is calculated using "real returns." Let us explain . . . .

In the 1990s, the average Growth portfolio return was around 9% on average for the decade. The average inflation rate during the 1990s was around 4%. If we look at an investor's *real* return it was 9% gain minus 4% inflation which equals a 5% real return after inflation.

Now, let's look at this last decade. In the last decade a Growth portfolio only returned a frustrating 5.3%; however, inflation was only at about 1%. When we calculate the *real* return then it is 5.3% minus 1% for a total real return of 4.3%. This is not that much different than the returns after inflation that were realized in the 1990s.

We are expecting continued slow growth with mid-single digit returns for the next 18 to 24 months. We are also expecting low inflation numbers as well. This is one of the biggest factors of why longer-term financial plans have not taken any real haircuts due to lower than normal rates of return.

As of 11/11/15 (intraday):

- Dow: (0.36%)
- Nasdaq: 7.33%
- S&P 500: 2.96%
- Nikkei: 12.84%
- EAFE: (2.57%)

Questions?

If you have any questions whatsoever regarding our investment manager meetings or any of the notes, give us a phone call or stop by our office:

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Majority Investment Manager Consensus Points

- Favored Sectors: Technology, consumer discretionary, and healthcare.
- MLPs are showing a great value and one manager even called them "stupid cheap."
- Active management over passive management should create additional value over this next market cycle.
- While the U.S. economy is stronger, many managers see the developed international economies outperforming.
- Manager favored growth companies over value: with growth slowing, firms that can grow are posed to lead.

Final Thoughts

This last quarter is a testament to the Strategic Income Group process. We gathered the information, made decisions on how we wanted to implement changes, and whether we were lucky or skilled, we implemented them on the lowest day of the quarter. We cannot guarantee in any way timing like that in the future but it does show that our process is sound.

We feel confident in the areas that we have overweighted in our Strategic Portfolios such as equities, growth, technology, healthcare, and consumer discretionary. We are positive on the growth of the markets over the next 18-24 months; however, completely understand the challenges that are present across the globe. We will continue to work and do research on your behalf. As always, we encourage all of our clients to meet with us on a regular basis.

Interesting Facts

- Our political campaigns have never been more ugly, right? Check out these ads from the 1800 presidential campaign:
    - Ad from John Adams: "If you elect Thomas Jefferson, murder, robbery, rape, incest, and adultery will be practiced throughout the land. Are you prepared to see your dwellings in flames . . . female chastity violated, or children writing on the pike?"
    - Ad from Thomas Jefferson: "John Adams is . . . importing mistresses from Europe or trying to marry one of his sons to a daughter of King George . . . . a hideous, hermaphroditical character with neither the force of firmness of a man, nor the gentleness and sensibility of a woman.
- With 253 million vehicles in the U.S. driving an average of 13,500 miles per year with a vehicle that averages 20 miles per gallon at $2.38 per gallon is an annual savings of $203,000,000,000.00 ($203 billion). (Source: AAA as of 2/28/15)

Please remember while we spend a great deal of time managing the investments, they are still one part of a comprehensive financial plan. Let us make sure that your insurance plan, estate plan, and tax plan is complimenting your investment plan. You can learn more about all of our services by visiting StrategicIncomeGroup.com and clicking on "Our Services" in the navigation bar at the top of the website. We hope to hear from you real soon!