Scotty C. George
Chief Investment Strategist

April 24, 2017

Market Outlook:

Almost war

It's pretty much conceded by "the Street" that amongst those exogenous variables that might have the most significant impact upon market trends the most determinative is war. Although the world seemingly now stands on the precipice of rhetorical confrontation, we have averted regional annihilation for at least one more week.

As a result, we seem to have entered a new phase of market activity, one in which post-election euphoria has somewhat subsided, new "resistance points" have been established, and a return to the mean is likely. All this, of course, assuming no other man-made calamities ensue.

What separates this current trend from that which preceded it is a sense of trepidation about *"what comes next?"* Despite the fact that even during the rally global fundamentals were largely unchanged, the macroeconomic backdrop is today decidedly much different.

During this current phase, my proprietary integers register a conflicting residue of both troubling possibilities and extraordinary opportunity. For example, the excessive valuation expansion in stocks was one part investor enthusiasm and one part justifiable fundamental momentum. Those manic expansions usually precede a period of negative (inverse) probabilities. **Disproportionate linear valuation spikes increase the probability of gradual...or in some cases immediate...price declines or, if nothing else, limit the room for upside trend continuity**.

Lower probabilities does not mean *zero probability*, however. Investors felt that the election results gave them comfort about traditional fundamental economic data already in the pipeline. To be sure, the US economy has been improving, as has a general tone about global trade. Further, with very low levels of interest rates around the globe investing in equities represents the "best" option for building one's net worth. A key unknown, however, is how to unwind, without unintended consequences, a heavily indebted global balance sheet if indeed interest rates do begin to rise during a period of stimulus withdrawal. The Fed and other global central banks must tread very lightly if they wish to avoid a repeat of a bungled attempt at interest rate manipulation in 2013.

However, given the potential of other exogenous events occurring, there still remains a cautionary note about risk and equity exposure. Volatility is part of the investment process, and one should always be prepared to encounter the inevitable ups and downs. This is accomplished by using prudent asset allocation and fluidity of sector rotation. Not all market periods are equivalent, which is why our clients are comfortable with changes in geography, sectors, asset classes, and allocation within their portfolio constructs. Each of these is predicated upon where the cycles calibrate and how best to mitigate overall portfolio drawdown.

A little advice

If investors expect a traditional buy-and-hold approach to work successfully they must also steel themselves against the possibility of passive investment volatility. While diversification might also provide some measure of protection against putting all one's eggs in one basket, it is better still to use cycle phase analysis to boost the probability of entering and exiting an asset at the optimal inflection point. At its best, portfolio management is always about increasing client's standard of living, of not letting one good year be eroded by one bad one consecutively. That is why I typically abhor one year balance sheet analysis in favor of a longer term approach. Reliance upon short term prognostication is usually a weakness to many client's investment programs.

If you remain concerned about geopolitical events impacting upon your portfolio success, you obviously need to adopt a different mindset about the investment experience altogether and adopt a methodology that shelters the portfolio from taking on too much instability.