

Market Outlook:

Forest or trees?

Everyone knows the exhaustive influence that reckless impulsive rhetoric and knee-jerk political policies can wreak upon stock markets and investors' psyches. Witness the carnage markets took last week when the topic of global tariffs was bounced between the United States and China. Market volatility skyrocketed as was to be expected. But, believe it or not, global trade wars are likely *not* to be the most severe obstacle investors will face in the months ahead.

Before the year is out, the US Federal Reserve...as well as other global central banks...will embark upon a vigorous redirection of monetary "easing" begun over a decade ago, and will pivot sharply towards addressing overcapacity, inflation, and hyper-profitability in the markets. In the process their benign economic assessments of the past will start to look slightly more dour, which will affirm their bias proactively to continue raising interest rates. Even as budget deals and trade pacts are hammered out later this year, monetary policy is the "elephant in the room" that could significantly shift portfolio dynamics for days to come.

It is remarkable that in spite of knowing these data the markets have been relatively slow to factor allocation and sector changes into its performance. Whether the change in interest rates is one quarter of one percentage point...or other...the pace and direction of monetary policy is irrevocably changed for the future. **In turn, we are forecasting that the impact of these monetary policy shifts is likely to have a negative impact upon future equity performance expectations/projections.**

Market definition tells us that *as interest rates rise there may be an inverse effect upon upwards cyclical in equity prices*. Whether large or small, rising rates at least offer alternative strategies to be considered as defensive options while the headwinds are building.

Additionally, trade war threats exacerbate negative outcomes for existing portfolio structure.

Sometimes, capricious intentions have unintended effects.

Brushfires

In the wake of all things developing, our focus will be on recalibrating our portfolio allocation by sector and asset class to try to minimize any negative impact of global brushfires upon our expectations. For example, as long as the bond market (rising rates) begins to offer significantly improved return on investment (ROI) our focus will be on capitalizing upon that opportunity to reduce portfolio volatility and risks associated with equities. We will not abandon the significant capital gains potential of stocks, but we also believe that during times of cyclical inflection and uncertainty it is prudent to explore as many options as possible to protect capital gains already won.

Pundits might tell you that the stock market is *always* risky, and should be avoided if you want to keep your money safe. But this "all or none" approach to equity avoidance also comes with a risk...the risk of lower portfolio returns and not keeping pace with cost and inflation factors. Our thesis is that asset classes must be blended to account for risk tolerance, time horizon, and individual preference.

Indeed, if rates push beyond the 4 percent level, we think it would take a profound amount of economic activity and output to sustain the kind of equity capital gains expectations that investors have become accustomed to, particularly in an economy that has been predicated upon growth using low-cost credit and borrowing.

In other words, higher rates *will* take a bite out of equity price performance...we just don't know by how much or when.

Based upon its own forecasts the Fed is suggesting that annualized inflation, with the exception of employee wages, will accelerate at its highest rate since before the credit bubble in 2008. That, combined with the unintended consequences of tariff "tax hikes", might impede the purchasing power of consumers, leading to a slow-down in demand and inventory expansion and, thus, profitability.

Portfolio management is an art, not a science. Jockeying for position to gain an information or operational advantage is the essence of being a nimble investor. I would much rather "be early" to the party than to be caught off guard or unprepared by information about which we already know the details.

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