Registered Investment Advisor
Wealth Management Advisors, Inc.
4000 West 114th Street, Suite 160, Leawood, KS 66211
913.661.1650 fax 913.661.1654

First Quarter Investment Commentary
April 2019

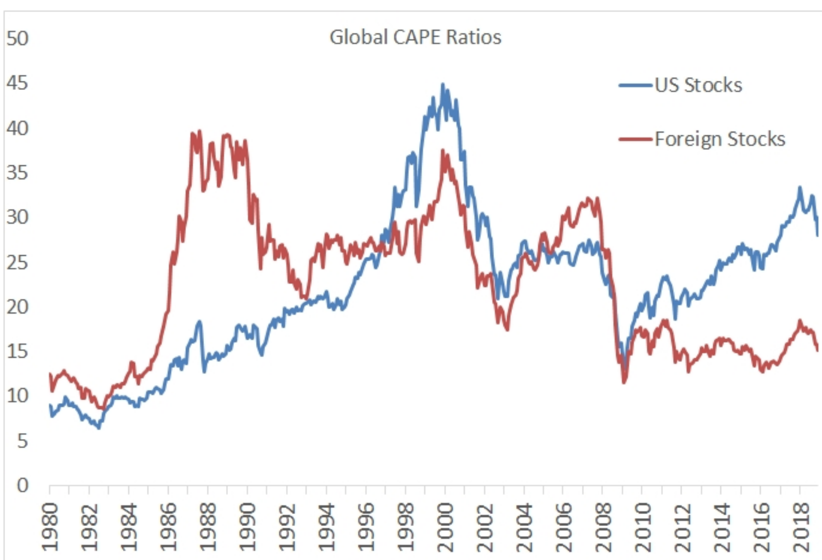
"If your ambition is to maximize short-term gain without regard to the long-term cost, you are better off not knowing the cost." – Michael Lewis, *The Fifth Risk*

"Confidence in a forecast rises with the amount of information that goes into it. But the accuracy of the forecast stays the same." - Dean Williams

The Quarter

Over the past 70 years the US stock market has been a standout, outperforming foreign stocks by 1% per year. $10K invested in US stocks in 1950 turned into $14M vs. only $8M in foreign stocks. Want to know how much of that outperformance has come since 2009? All of it.

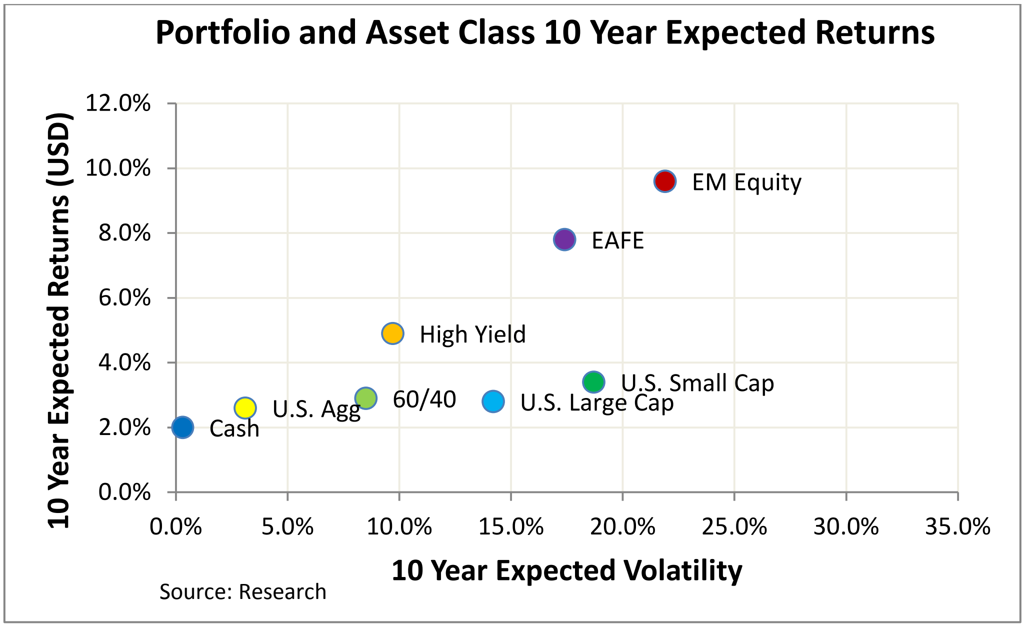
Below is a chart showing the U.S.'s CAPE (cyclically adjusted price/earnings ratio) versus the world ex-U.S. (i.e. foreign stocks). The CAPE is often used as a longer term stock market valuation metric. Going back to 1980, both have an average CAPE ratio of about 22. The historical valuation premium has been ZERO.



Source: Global Financial Data, mebfaber.com

Looking above, you can see that foreign stocks were more expensive during most of the 1980s (mostly due to the massive Japan bubble), whereas the U.S. has been more expensive during the Internet bubble and the recent post Great Financial Crisis.

Today marks one of the widest valuation spreads in history, with foreign markets trading at much cheaper levels than that of the U.S. This suggests higher expected returns for foreign stocks.



Economic and Market Review and Update

Since the September 2018 peak, it has been a tale of two markets. From September 20th through Christmas Eve, the market declined 19.8% over 65 market days. From the Christmas Eve trough, the market then rallied 20.5% over the next 56 market days.

There are many different opinions on the direction of the economy and the equity market for the remainder of the year. Let's look at what has changed in the past quarter, and what it might mean for the next several months.

Probably the most significant shift has been in the expected path of interest rates. The Federal Reserve Open Market Committee (FOMC) met in December, concluding with a fed funds rate increase to 2.375% and stating that "economic activity has been rising at a strong rate" and judged "that some further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity." The majority of Fed members expected two to three additional 0.25% increases in the fed funds rate in 2019.

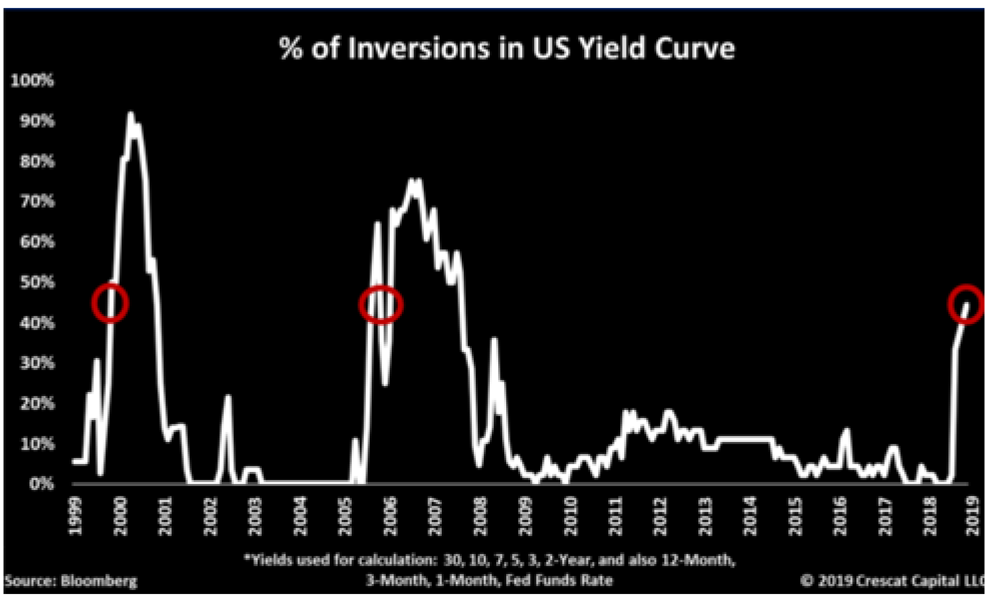
Fed opinion shifted dramatically by the March 2019 FOMC meeting. The Fed downgraded its assessment of the economy and held rates steady. Unexpectedly, the majority of Fed members now expect no change in the federal funds rate this year. 11 of 17 participants now have rates remaining unchanged this year, up from two participants in December. This dovish shift is attributed to the sudden slowing in the economy, deceleration in inflation, and the risks from abroad.

Global economic growth has slowed but remains positive in the U.S. Some forecasters believe growth will rebound later in the year as some factors are temporary: the partial government shutdown, delayed tax refunds and unseasonably cold weather. Trade tensions, Brexit and slowing in China remain risks to the outlook.

The Treasury bond market was particularly surprised by the shift in tone and actions by the FOMC. Following the Fed meeting, the probability of a rate cut by the end of the year increased and the 10-year Treasury yield fell to 2.52%. The 10-year yield fell further to 2.37% at the end of March for its lowest reading since December 2017.

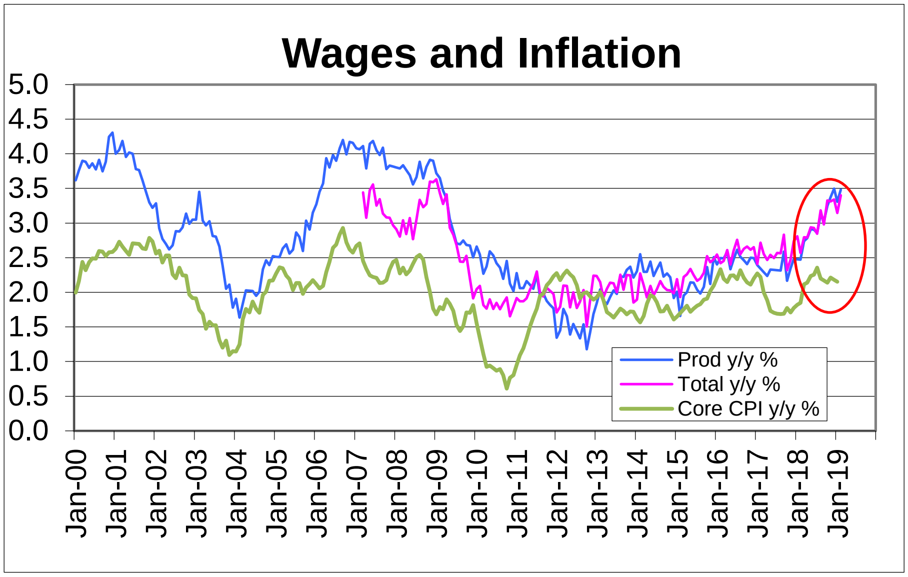
The yield curve (difference in yield between different terms of bonds) went negative from 3 month Treasury bills to the 10 year bond. An inverted yield curve is a well-known recession indicator. The yield curve has inverted before each of the last seven recessions. However, the lag between the inversion and recessions has varied from two months to two years. Some analysts are downplaying this relationship looking at the massive quantitative easing (central banks buying bonds and increasing their balance sheet) over the last decade, or pointing out the yield inversion is not at all points on the curve.

However, the chart below from Crescat Capital looks at yield spreads across the entire yield curve, and although not all segments of the yield curve have inverted, nearly 45% of the yield curve has inverted which historically has led a recession.



We feel it is time to be cautious. While the economy is still growing and not all indicators are flashing a recession signal, we realize the difficulty in forecasting recessions. Valuations are high, labor markets are tight and the Fed has tightened policy. Whether or not the Fed can reduce rates and avoid a recession is unclear. Real short term interest rates (taking into account inflation) are low and wages continue to increase. As the chart below shows, consumer inflation has decelerated despite increasing wages. Historically, either prices increase to help offset higher labor costs and/or profit margins are squeezed.

Will lower inflation be enough to lead the FOMC to cut short term interest rates? It might, but with tight labor markets and rising wages, it is unlikely that the Fed will rush to reduce rates. If the current lull in economic activity is temporary, the next move is more likely to be an increase in rates. A rate cut is likely if the economy is much weaker than many analysts expect.



Closing Comments

"Almost none of us is really asking 'are we going to beat the market.' All of us are really asking 'am I going to be okay?" – Brian Portnoy, author of *The Investor's Paradox* and *The Geometry of Wealth.*

There are some legendary investors alive today with great track records; Warren Buffett, Stanley Druckenmiller, Michael Steinhardt, and George Soros, beat the S&P 500 over time. Their secret? Start investing in the early 1980's when the Federal Funds rate was 20%, the P/E ratio of the S&P 500 was below eight and index funds were in their infancy. None of those factors exists today.

My (Kevin) point is that beating the market, at least on a consistent basis, is virtually impossible. The few that can do that are already managing billions and will not take your money, even if you ask nicely. If they had a great market-beating process, would they let you in on it? Of course not. Beating the market should not be a goal; trying to beat the market involves taking risks that may result in big losses, losses that can be crippling. Trying to manage risk, particularly in retirement, when portfolio withdrawals support one's livelihood, is more important than beating the market.

It is finally spring here in the Midwest. However, with the warmer weather, the above-average snowfall has caused flooding in Missouri, Iowa and Nebraska. When we sit in our warm, dry houses, let us not forget those who have been affected by the floodwaters.

Kevin   Paul   Matt   Diane

Kevin S. McGrew   Paul L. Watkins   Matthew D. Ison   Diane C. Dercher