June 8, 2017

The Two Sides of Every Coin

"No price is too high for a bull or too low for a bear."

-Unknown, Circa 1884

Amidst a near constant stream of seismic news, markets have been remarkably stable and consistent so far in 2017. As of the end of May, the total return of the S&P 500, in 2017, checks in at 8.66%[1].

The fear we hear a lot of is: Are we at the top? After all, markets are hitting new highs and valuations are above historically average levels. The phrase "The markets hit all-time highs" has become a scary omen since we all remember, with trepidation, the "all-time highs" of 2000 and 2007. Here's a fun fact: Markets have hit "all-time highs" in 29% of months since 1926. In just over 80% of cases, the S&P 500 has been higher 365 days following when the market hits a high[2]… thereby hitting more "all-time highs".

Another interesting tidbit - According to Bloomberg, three stocks (Apple, Amazon, and Facebook) have made up over one-third of the gain in the S&P 500 this year[3]. Now, this could mean that the markets actually aren't doing that well. Take away some of these giant, top performers and we have a mediocre-to-lagging U.S. index. Things might not be so rosy. Or, I could look at this information and think: Well, this means the other 497 companies have room to run.

If you're predisposed to thumbing through financial news (despite our implorations to the contrary), a fun game to play is the daily search to find two completely contrasting headlines and conclusions to the exact same information. Here's a good example from this past Tuesday:

MarketWatch
@MarketWatch

U.S. home-price gains gather momentum in April: CoreLogic

Home prices pick up steam as spring selling season heats up, CoreLogic says
marketwatch.com

REAL ESTATE

Fast-rising home prices finally hit a wall

- Home values rose a healthy 6.9 percent in April compared with April 2016, according to CoreLogic, but that is a drop from the 7.1 percent annual gain in March and the 7 percent gain in February.
- CoreLogic is also lowering its predictions for annual gains, to 5.1 percent in April 2018.

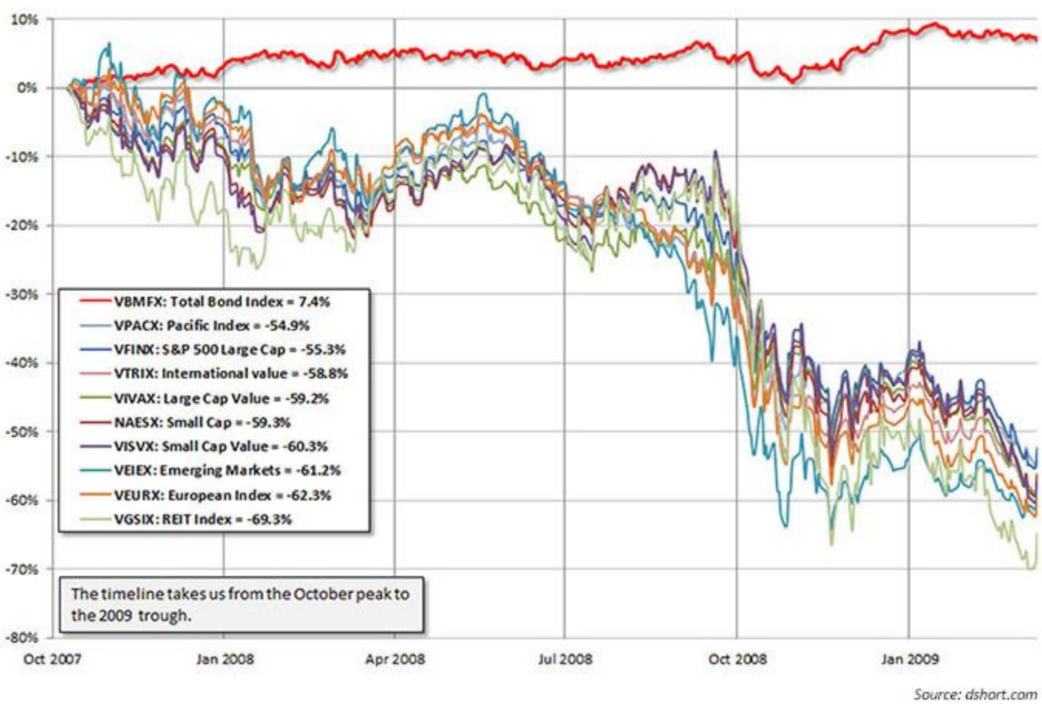
Diana Olick | @DianaOlick
1 Hour Ago
CNBC

My point here isn't to assure you that markets will rise or won't fall. I'm simply trying to illustrate that there is a glass half-full and glass half-empty way to look at everything in finance. When you hear what sounds like bad news, or good news, it's just data being shaped to fit a narrative. Flip the channel to CNBC at your own risk…

Federal Reserve Meetings

The Federal Reserve meets next week where many expect a small bump to interest rates to be announced. Putting aside, for a moment, the unreliable track record of "professionals" correctly forecasting rate hikes, we are left to wonder: What does an increase in interest rates mean for my portfolio? Nominally, when interest rates rise, the price of existing bonds fall. While counter-intuitive at first glance, the rationale is surprisingly straight-forward - Why buy an old bond yielding 2%, when you can now buy a new bond yielding 3%?

So, given that increases in interest rates are (allegedly) imminent, why invest in bonds at all? This mindset misses the point on 1) where returns come from; and 2) what the purpose of fixed income in a portfolio is. While the nominal price of a fixed income security may fall, the interest it pays is unaffected. If held to maturity, the prevailing interest rate in the market has zero bearing on the earnings of the fixed income security. Furthermore, the role of fixed income in many portfolios is to act as a ballast to the volatility created by the equity portion of the portfolio. Put simply, bonds are there to mitigate and dampen risk. Think back to the recession of '07-'08. Everything went down… Except for good ol' fixed income, which checked in with pleasant returns.



Fixed income is a necessary component of a durable, prudent portfolio in all market cycles. Interest rates will rise and fall in the future and bonds will continue to serve their function irrespective of the news of the day.

Personal News

This Spring, we welcomed the newest member of the Johnson clan into the world. Adalynn Margaret Jean Johnson was born on May 21st, 2017 at 9:28pm. She weighed 7lb, 13oz. This is Derek, and his wife Tiffany's, second child following the birth of their first daughter, Sloane, 18 months ago. Both mommy and baby are happy and healthy.

Try to stay cool in the next few months as we creep in to Summer. Don't get too worked up paying attention to the news. Most of all, take some time to enjoy who and what you have in your life. That's what really counts.

[1] Source: Yahoo Finance, as of 5/31/2017.

[2] Source: Dimensional Fund Advisors, as of 12/31/2016.

[3] Carlson, Ben. "A Few Stocks Don't Tell the Whole Market Story." Bloomberg. Published 5/24/2017. Accessed 6/6/2017.

Derek Johnson is an Investment Advisory Representative of Ferguson-Johnson Wealth Management, a values-based investment management firm located in Maryland. Derek Johnson can be reached at (301)670-0994 or djohnson@mymoneymanager.com