Wasatch Capital Management Commentary, Garlic Milkshake
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The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been far safer to invest in a diversified collection of American businesses than to invest in securities — Treasuries, for example — whose values have been tied to American currency.

Stock prices will always be far more volatile than cash-equivalent holdings. Over the long term, however, currency-denominated instruments are riskier investments — far riskier investments — than widely-diversified stock portfolios that are bought over time and are owned in a manner invoking only token fees and commissions. That lesson has not customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is far from synonymous with risk. **Warren Buffett**

Mark Twain famously said "There are three kinds of lies: lies, damned lies, and statistics." For better or worse the investment industry is awash in statistics; statistics which are oftentimes contradictory. Economics is a “soft science,” not taught in business school but, rather, in the school of behavioral science. The data economists review is an amalgamation of leading, current, and lagging charts, reports, and numbers. As a result, trends are much easier to identify by looking into the rear view mirror than reading the tea leaves, so to speak.

In an attempt to provide information in the proper context, below is a summary of facts and figures that we believe are both truthful and relevant:

Item	Data point
Year-to-date S&P 500 Return[1]	1.91%
Year-to-date Bond Index Return[2]	-2.80%
Current unemployment rate[3]	3.9%
Current wage growth[4]	2.60%
Current S&P 500 earnings growth[5]	25.70%
Expected inflation[6]	2.15%
2018 GDP (projected)[7]	2.87%

While January started off with the bang, February gave up all of the gains and then some. However, this was, we believed, “technical” in nature as opposed to fundamental. While there were certainly no shortage of geopolitical headlines to rattle the market, such as tough trade talk, rising oil prices and a weakening dollar, the underlying fundamentals were very strong, and markets were long overdue for volatility, which all but disappeared in 2017 only to come back with a vengeance in February.

While the stock market and the economy are oftentimes fairly correlated (the stock market is typically forward-looking or a leading indicator), there are times when volatility is just volatility. Or to quote John Maynard Keynes; why did the market move lower/higher? *Animal spirits.*

If you turn off the television, online news, put your cell phone away and, instead, take a drive down Main Street, how do things look? I travel out of state at least two to three times per month and make a point of talking to locals and observing economic activity in each city I’m in. While anecdotal, I always observe the same thing: shopping centers are bustling, restaurants are full, construction, both residential and commercial, is booming, help wanted signs abound, and people in-general feel good about their jobs and the economy at large. This is why both consumer and business confidence is at nearly a two-decade high. In fact, about the only complaint I hear is that business owners are having a tough time finding good employees. What a difference a decade makes!

It’s hard to not look at the underlying economic data and not be encouraged. What matters to the average person isn’t what’s happening in Washington, but rather do they have a job? Are their wages increasing? Are there better employment opportunities out there? Are their investments (wealth) increasing in value? Are they paying less in taxes? The answer to

these questions is a resounding "yes," which explains the boost in consumer confidence. When we believe there's a chicken in the pot and a check in the mail we're a lot more likely spend our hard-earned money on that home remodel, trip, new car, or gadget.

But it's not just the US economy that's doing well. The rest of the world is as well. Canada, Mexico, Japan, Australia and broader Europe are all showing surprising economic strength, or at the very least, beating expectations. You actually have to look fairly hard to find countries that aren't doing well. The short list would include, notably, Venezuela, Argentina, South Africa, and Russia.

If trade talks continue to progress and the cloud of uncertainty is lifted, we believe stocks will continue to grind higher. Stocks are, in our opinion, actually fairly valued and maybe a little cheap relative to future/expected earnings. Why? The stock market is trading around 16 ½ x forward earnings, which is about the long-term average of the stock market. However, earnings are growing much faster than the long term average of about 4% per year … almost 6 times faster. Also, interest rates are still low relative to historic averages, and low interest rates means future earnings are worth more today. So, barring an unexpected event, we believe stocks will likely continue to produce good returns for the near term. Bonds, however, should continue to struggle. Rising interest rates are a headwind for bonds, and we expect both the Federal Reserve will continue to tighten/raise interest rates and, more importantly, the 10-year Treasury bond will move in similar fashion. Thus, we continue to favor stocks to bonds, with approximately a 1/3rd allocation of stocks to international + emerging market equities.

For most of the country, spring is here, plants are blooming and birds are chirping, and the US economy is as strong as a garlic milkshake. It's hard not to feel good about the rest of 2018.

Mark Lazar, MBA
Senior Vice President, Investments
Certified Financial Planner™

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www.wasatchcapitalmanagement.com

Mark Lazar, Senior Vice President, Investments, CFP®, MBA | 385-275-3609 | mark.lazar@raymondjames.com
John Bergerson, Investment Portfolio Associate, CFA, MBA | 385-275-3608 | John.bergerson@raymondjames.com
Morgan Irvin, Senior Client Service Associate, Operations Manager |385-275-3606 | Morgan.irvin@raymondjames.com
Ali Phillips, Client Service Associate | 385-275-3691 | ali.philips@raymondjames.com

Source: [1]Bloomberg, 5/16/18, [2]Bloomberg, 5/16/18 (Barclay's Aggregate Bond Index), [3]Bloomberg, 5/16/18, [4]Bloomberg, 5/16/18, [5]Thompson Reuters, 5/16/18, [6]Bloomberg, 5/16/18, [6]Federal Reserve FRED, 5/16/18, [7]Wall Street Journal, 5/16/18*

Barclays Capital U.S. Aggregate Bond Index – The index measures the performance of the U.S. investment grade bond market. The index invests in a wide spectrum of public, investment-grade, taxable, fixed income securities in the United States – including government, corporate, and international dollar-denominated bonds, as well as mortgage-backed and asset-backed securities, all with maturities of more than 1 year.

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