WASATCH
CAPITAL MANAGEMENT OF
RAYMOND JAMES®

"YOU REALIZE YOU REALLY WEREN'T SUPPOSED TO TRY TO KEEP UP WITH THE KARDASHIANS?"

OCTOBER 2018

- - - - - -

INSIDE THIS NEWSLETTER

"Don't do something- stand there!" - Jack Bogle (Article by Mark Lazar)

***Regarding the efficient market hypothesis, this message (attempting to beat the market is futile) can never be sold on Wall Street because it is in effect telling stock analysts to drop dead.* Paul Samuelson**

***I have a name for people who went to the extreme efficient market theory-which is "bonkers".* Charlie Munger**

After the handshake agreement with the EU in July, the U.S. has since reached revised trade accords with South Korea, Mexico, and Canada. While we felt the risk of an all-out trade war was low, it was certainly a possibility and something we were watching with a Spock-like arched eyebrow. Emboldened by recent success, the Administration appears poised to take on the 800-pound gorilla; China. This is all the more obvious due to a special clause in the recent U.S.-Mexico-Canada trade agreement, which gives the U.S. near-veto authority over an attempt by Canada or Mexico to negotiate a trade deal with a "non-market economy." Beijing, the Donald is looking at you.

Not surprisingly, the stock market was hitting record highs before these deals were done. Why? Markets are forward-looking, or what economists refer to as "efficient." The Efficient Market Hypothesis (EMH) simply means that security prices reflect all available information. The EMH by no means infers that markets are right. Oftentimes, they're not. Markets, like individuals, are subject to emotions such as fear and greed, panic, euphoria, herd mentality, and headline anxiety, to name a few. As evidenced by the aforementioned conflicting quotes from two very smart people, there is some disagreement regarding market efficiency. Our view is that in the long-run, markets eventually get it right. But in the short-run, they can get it wrong.

Prior to closing the deal with Canada, the market correctly anticipated resolution and the broad stock indices moved higher. This is a good example of market efficiency. This past week, both stocks and bonds tumbled. Why? After a prolonged period of hovering in the 2.85% range, the 10-year treasury yield moved meaningfully higher (bond prices fell), spooking both the stock and bond market. While bond investors have reason to be wary, we believe steadily rising long-term rates are a sign of a healthy underlying economy. When we penned our August 13 commentary, the 10-year Treasury stood at 2.83%. We said, "While forecasting long-term interest rates is akin to astrology --- we believe the U.S. 10-year Treasury finishes the year in the 3.25 – 3.35% range. However, for the 10-year yield to move higher trade concerns need to subside so markets can focus on fundamentals rather than fear." As of 10/10/18, the 10-year Treasury was 3.24%. While rates could move higher, we think the recent move was a bit of a reach and wouldn't be surprised to see yields retreat and/or pause a bit before eventually grinding higher.

What keeps us up at night? Our focus has shifted from trade squabbles to Europe --- specifically, Italy. We began this piece discussing efficient markets, and Mr. Market is clearly unhappy with Italy's new, populist, anti-establishment, Five Star Movement government. How do we know? Their cost of borrowing has effectively doubled in less than one year; Italy's 10-year bond yield increased from 1.63% to 3.42%. Furthermore, the cost to purchase a credit default swap, basically insurance against default of the issuer, now stands at 714% more than Irish bonds, and 2,550% more than German bonds. Apparently the market doesn't think Italy's recently proposed budget is "brave and responsible" after all. The market is signaling it's concerns regarding Italy's ability to repay its debt over the long run. But unlike Greece, Italy is not only a very big economy (fourth largest in Europe), but also the fourth largest issuer of sovereign debt in the world. Unlike Greece, an Italian default would shake Europe to its very core, and more than rattle global credit markets. The markets aren't sounding alarm bells just yet but they are certainly blowing the whistle on Italy's unsustainable long-run fiscal path.

Assuming markets are efficient, what are the tea leaves telling us today?

- Inflation will be 2.16% over the next ten years
- S&P earnings growth for 2019: 10.20%
- We'll see three more Federal Funds rate increases (.75%) over the coming year
- Implied forward price to earnings ratio: 16.17
- Current U.S. unemployment rate: 3.7%. 2019 forecast unemployment rate: 3.50%
- Probability of a U.S. recession in one year: 14.51%

When you combine the economic ingredients; tax cuts, tame inflation, double digit earnings growth, a strong labor market, sensible/transparent monetary policy, stocks trading at a reasonable multiple of earnings, and the expectation of a future trade deal with China, the outlook for the U.S. economy and stocks are good. And if the Administration secures favorable trade terms with China, U.S. stocks should move higher. However, foreign stocks would likely be the biggest beneficiary, with emerging market and developed international equities enjoying a meaningful boost. Bonds, we believe, will continue to see downward pricing pressure as rates move higher, and struggle to generate positive returns.

MEDICARE OPEN ENROLLMENT: OCTOBER 15 TO DECEMBER 17

Make the most of Medicare's open enrollment period

Medicare's open enrollment season is upon us. That means from now until December 7, you are able to make changes to your Medicare Advantage and prescription drug coverage. If you're happy with your coverage, you don't have to do anything. Even if you're satisfied, open enrollment presents a great opportunity to make sure you're getting the most out of Medicare.

Here are some tips to help you get started.

- Ask yourself some important questions: Have your needs changed? Is your current coverage adequate? Will the cost of your current plan be going up? Are there comparable, lower-cost plans available?
- Review the annual notice of change from your current plan provider. You should have received this in September.
- Compare plans using medicare.gov's Medicare Plan Finder.
- Get one-on-one assistance from the State Health Insurance Assistance Program.
- Call the Medicare Rights Center at 800.333.4114 for free counseling.

Medicare decisions can be complicated, but with the right tools and information, it doesn't have to be. Raymond James is partnered with HealthPlanOne to provide you with personalized service, unbiased advice, and additional support from a dedicated licensed agent. There is no cost to use HealthPlanOne's services and those services don't end after enrollment. Your licensed agent will continue to provide support throughout the lifetime of your enrollment for coverage questions, appeals and plan renewals.

To utilize HealthPlanOne, call our team to schedule a 20 minute conference call: **385-275-3600**
**This is a complimentary service we recommend everyone utilize, you can only benefit from it! **

If you have any questions about open enrollment, or if you'd like to discuss how healthcare costs factor into your overall financial plan, please contact me so we can walk through the process together.

Wasatch Capital Management Thanks the Grand Canyon Trust for their educational hike through Gold Bar Arch in Moab.

If you're unfamiliar with the Grand Canyon Trust, check out their website to learn more about their important conservation efforts across the Colorado Plateau: www.grandcanyontrust.org

Wasatch Team Updates

Mark

Mark and Savina battling the heat and hills during a scenic hike in Moab, UT. If you ever get a chance, take the hike up Gold Bar Canyon, through Gold Bar Arch, and down Dragon Fly Canyon. The spectacular vistas are not to be missed!

Morgan

The month Morgan travelled to St. Petersburg, FL to Raymond James Headquarters to meet with a prospective client. While there she attended a reception with Tom James, Chairman of Raymond James for over 30 years!

John

When John isn't mountain biking he can be found outside hiking or tailgating (Go UTES!)! Pictured here on our team hike in Moab, Utah on his way to Gold Bar Arch.

Elisha

A warm welcome to our newest team member, Elisha Rhoades! Elisha relocated from California, back to her home state of Utah to join us on Wasatch Capital Management. We couldn't be more thrilled to have her on the team. Here she is with her husband Patrick, and her new daughter, Josie. Congratulations to Elisha and Patrick!

WASATCH
CAPITAL MANAGEMENT OF
RAYMOND JAMES®

About Us

2750 E COTTONWOOD PARKWAY
SUITE 520
COTTONWOOD HEIGHTS, UT 84121

Mark.Lazar@raymondjames.com | Senior Vice President, Investment | 385-275-3609
Morgan.Irvin@raymondjames.com | Financial Advisor | 385-275-3606
John.Bergerson@raymondjames.com | Investment Portfolio Associate | 385-275-3608
Elisha.Rhoades@raymondjames.com | Client Service Associate | 385-275-3591

www.wasatchcapitalmanagement.com

Like us on Twitter & Facebook! @WasatchCapital | www.facebook.com/wasatchcapitalmanagement

"Successful investing is about managing risk, not avoiding it" Benjamin Graham