viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

Fall 2016 newsletter

Emotional Quarter

Last quarter, our newsletter concluded with the following recommendation:

"It is important during this slow growth period to avoid letting emotions change our investment process or risk profile in an attempt to achieve higher investment returns. In these times, as we always do, the key is to identify good companies with growing earnings at a fair price. Then hold these companies until they become over valued or quit growing their earnings. This is a cornerstone of our investment selection process and will continue regardless of who is elected next month."

Clearly, the investing public did not heed our advice as emotion-driven transactions overwhelmed the investment landscape. Even as the election results were being tabulated, pre-open market trading was down over 5%. However, once the election was finalized, the markets opened to a frenzy of buying while market pundits switched from discussing the Federal Reserve to predicting the date the Dow Jones Industrial Average would top 20,000.

As President-elect Trump tweeted his comments about everything from the economy to taxes, we saw the stock prices for many individual companies run up or down as investors sifted through his words for clues to which business might benefit or suffer from a Trump administration.

Boeing (not one of our holdings) was a classic example: When Trump won the election, industrial stock prices began to rise with the idea they would benefit greatly from a Trump administration. When he tweeted that the new planes being ordered for the president were too expensive, Boeings stock dropped 8% intraday due to fears of order cancellations. The stock recovered as emotions calmed and the stock resumed its upward march along with other industrials and is now up over 10% since the election.

As emotion drove the market higher in the final quarter of 2016, fundamentals were thrown by the wayside. Investment decisions were based on what "might" happen if the new administration could follow through with its campaign promises of lower taxes, higher interest rates, a growing US economy, and relaxed regulatory environment. With money flowing toward the industries that have not done well the last few years, industrial, financial, and basic materials stocks were all up over 15% for the quarter. Conversely, consumer discretionary, consumer staples, healthcare, information technology, real estate, and utilities were flat to down for the quarter.

If you held a well-diversified portfolio, you likely were not up as much as you'd think given all the news; this was primarily the result of very narrow market with participation by only a handful of sectors. Yes, it can be a little frustrating, but when investing gets emotional, it is hard for a disciplined approach to keep up in the short term.

Once the emotions subside, companies will again be valued on fundamentals. This will cause one of two things to happen. The stocks that ran up on emotion will soon retreat or the companies that have become cheap will catch up. We are already starting to see this happen with those companies possessing good fundamentals beginning to advance slowly. We feel this trend will continue. On a positive note, the patient well-diversified investor does not get whipsawed like the emotional investor making it easier to stay invested for the long term.

Interest rates have started to go up and bonds have been coming down in value. For our clients who hold bonds this is a positive. We have been keeping our maturities short so we can take advantage of the rising rates. We will continue to do this until we see rates much higher than they are today.

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