NCM Capital Management, LLC
Newsletter – February 6th, 2018

To all clients and friends:

After such a calm 2017, Volatility has jumped back into the markets with a vengeance; representing their worst period since 2016, both the Dow and the S&P now have negative returns for 2018. Yesterday, the Dow Jones Industrial Average suffered its greatest point decline ever (although not in the more important percentage terms).

Finally, the markets have suffered a long overdue correction of at least 5%. Yes, I say finally because corrections are usually a normal part of the markets. On average there is 1 correction of at least 10% every year. 2017 was a very unusual year--there wasn't even a 3% correction.

So while corrections are always unnerving, they are needed to correct the excesses that build up in the global markets from time to time. Excesses like bitcoin and story stocks with no real earnings, among other things.

It is most important for investors to not react emotionally during market corrections. This falls into the "easy to say, hard to do category." Investors will be bombarded with wild predictions and will be offered THE product that will help them avoid the volatility! To us, corrections are a good time to take a step back and think about why you are investing--what's the goal? What's the time frame? Do I understand the risks I am taking? Does my asset allocation reflect all of this? These are more important questions than the ones being asked now in the media.

Of course, everyone wants to know what caused this correction and why didn't we all see this coming? First of all, nobody knows when these corrections will happen--let's put that argument to rest right now. All I will say is that I think it has been long overdue; again, not because fundamentals are terrible, but because excesses need to be corrected. I play in a 6 am morning basketball game twice a week with guys ranging from their 20's and up. What I have noticed over the last few months is some of them checking their phones for the prices of bitcoin and other related cryptocurrencies at 6 am. That's one of the excesses that needs to be corrected. Another excess may be in all of these relatively new leveraged volatility products that have been created over the last several years. They are getting slaughtered in this market and probably well deserved. Average investors just don't need to be involved in these crazy and complicated products.

We think the correction began in the bond market. Fears over inflation and interest rates rising faster than expected started the turn in the markets. From there it may have turned all technical--meaning that so much of the short-term day to day trading is dictated by computers. All this, of course, was perhaps also exacerbated by the problems with these leveraged volatility products. After this sharp move, I would certainly not be surprised at all to see some funds (ETF's, ETN's and/or mutual funds) completely liquidate. Yes, blow up. Significant damage seems to have been done in that space.

But if we take a step back and think about fundamentals, they are not so bad at all. Corporate earnings are doing just fine and the global economies are humming along. BUT, that said, stock prices have been on the high side and higher interest rates will put some pressure on stock prices. So again, some sort of a correction is well within reason. And let's not be naïve and think this is not potentially more than just a correction. We just don't know; nobody does.

This may come as a surprise to some but it may be just as important to focus now on where investors allocate their "non-stock money." Of course, this is assuming investors have the right percentage of their portfolio in stocks and also assumes it is a well-diversified stock portfolio. If not, then the stock allocation should be fixed asap.

There are lots of questions about the state of the bond market. Was it just propped up by years of QE? How many times will the Federal Reserve raise interest rates this year? What effect will the unwinding of QE have on bond prices? And the biggest one…what effect will rising interest rates have on the stock market? Difficult questions for sure. Investors should understand the risk of their bond portfolios and perhaps reassess the correct percentage to allocate to bonds. There is just not much yield to be had in the bond market so risk may not be adequately reflected in bonds. Our strategy is to have less of a percentage in bonds than we historically have had and keep the average maturities tilted to the shorter side. We do not want to own broad index funds in the bond market because their average maturities are a little too high for where we want to be. And no high yield bonds funds either! We think there are better ways to invest in bonds.

We certainly do not want to get too caught up with year to date index returns where we are today in early February, but it is worth noting that both stock and bond indexes are now negative for the year while our alternative assets are outperforming both, and in most cases, are still positive for the year. We are quite pleased with our allocation to alternatives and continue to believe there is a place for them in diversified portfolios given the risks in both the stock and bond markets. They are doing what we want them to do-- reduce the risk and volatility in a diversified portfolio and potentially add to returns.

In closing, it is also always important to understand what type of investor you are. Are you a long term investor? Are you a trader? Big difference between the two, and where we have seen big mistakes is people changing strategies during corrections. Don't do it. Find the right strategy for you and stick to it. And it should always include some percentage of stocks if you want any reasonable chance of achieving long-term financial goals like retirement.

We will continue to keep our clients updated as things progress. Please send us a quick note if you want to schedule a call anytime to discuss what is happening in the markets and how it impacts your goals and objectives.

The good news is that as markets get re-priced, it should lead to better investment opportunities. We are looking forward to hopefully finding some more attractively priced dividend stocks--it's been a long time since something looked real cheap!

Again, we are in the midst of a long overdue correction. It is well needed and quite normal. Let's get through it and move on. It is better in the long term to have this happen now compared to seeing the markets continue to ascend with little volatility.

Most importantly, nothing that has happened so far should impact our clients' plans. That's what we focus on--- not day to day gyrations of stock prices. Let's keep things in perspective: stocks offer great long-term return potential, but the only way to get those returns is by handling short-term risk. We've spoken about this often; proper investor behavior is crucial to a good long term outcome. It's more important than saving a few basis points here and there.

To this point, Jason Zweig wrote a nice piece in today's Wall Street Journal titled "Stock Market didn't get tested, but you did." It's a good read for anyone thinking about making a significant change to their investment strategy.

All the best,

Nick

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