Emerald
Multi-Family
Office

Learn More
about us

download
our brochure »

April 11, 2018

Thank you for reading GreenThought$. It is our privilege to provide you with our insight on current financial market events and our outlook on topics relevant to you.

First Quarter 2018: Investment Market Summary

Hard to believe that this past quarter was only three months long, given all of the volatility. The Dow snapped its longest quarterly win streak in 20 years, losing 2%. The S&P dropped .8%, MSCI EAFE international index dropped 1.7% and U.S. bonds, as measured by the Barclays Aggregate index, lost 1.5%. There were few places to invest and make money. The global bond index gained 1.4% and the emerging market stock index was up 1.3%.

The SPDR S&P 500 ETF (SPY) is a popular exchange traded fund that tracks the performance of the S&P 500 index. The chart below shows the weekly performance of SPY from the first day of 2017 through the end of March 2018. The black bars are weeks where SPY finished positively, while red bars show negative performance. Obviously, the character of the market changed dramatically in the first week of February 2018. From then until the end of March, there were four weeks where the market experienced swings of more than 5%, after going through all of 2017 without a single week of that kind of volatility. So has something changed or is this a temporary pause before the market resumes its upward march? Stay tuned. Meanwhile, let's take a look at the chart below to observe some themes we've touched on in the past:

Yes, we do believe something has changed. Central banks around the world, including our own Federal Reserve, responded to the financial crisis of 2008 by dropping interest rates to zero (or negative in some instances) to stabilize and stimulate the economy. The Fed's ZIRP (zero interest rate policy) ended in December of 2015 when they hiked short term interest rates by 25 basis points (a quarter of 1 percent). Rates were hiked by 25 basis points four more times in 2017 and again in March of this year.

At the same time ZIRP was in effect, the Fed engaged in a policy of Quantitative Easing, or QE. This was another tool designed to stimulate the economy by expanding the money supply. The Fed accomplished this by buying government bonds and other securities, and in the process grew their own balance sheet from less than $1 trillion to over $4 trillion. In October 2017, the Fed decided to begin unwinding QE by means of Quantitative Tightening, or QT. They began by reducing their balance sheet by $20 billion each month and will increase that to $50 billion each month by the end of the year. Hiking short term interest rates (increasing borrowing costs) and reducing the money supply via QT will slow economic activity. We are in the midst of a synchronized global expansion, and the hope is that by slowing economic activity the Fed can keep inflation in check without derailing the economic recovery. Mistakes by the Fed historically have led to recessions, and given the unprecedented nature of ZIRP and QE, markets are concerned that the unwinding of these policies may run into problems that slow the economy more than the Fed intends. Additionally, other central banks around the world are exploring how to end their post-crisis policies.

So we think this concern is certainly a contributing factor to the recent market volatility. Another factor is the correction in technology stocks. A large part of the stock market's advance last year was due to the so-called FAANG stocks (Facebook, Apple, Amazon, Netflix and Google). With Facebook receiving a lot of negative publicity recently, there is talk of additional government regulation on a lot of the large technology companies which has caused investors to take profits.

Although the market has become more volatile this quarter, last year was unusual in the LACK of volatility, so this quarter may just be a reversion to the mean. Of course, a volatile market does not mean that the bull market of the last 9 years has ended. However, it's worth noting that the stock market has a negative year roughly 1/3 of the time, but other than 2008 it has been positive for the last 12 years, so we need to prepare for a change in trend at some point.

In our last newsletter we discussed risk tolerance and suggested it was a good time for each of us to re-evaluate how we felt about risk and how we deal with market turbulence. This quarter put that to the test.

One of the reasons given for the strong rise of the stock markets around the world last year was the concept of T.I.N.A., There Is No Alternative. Even though bonds were providing investors with very little yield and stocks were overvalued by many measures, investment dollars had to be put somewhere and so the stock markets

were the recipient of those dollars.

As a firm, Emerald is always looking for alternative investments besides the traditional stock and bond markets. Many clients have investments in gold, long/short funds, and preferred stocks. Real estate is an asset class we like, particularly income producing real estate (IPRE) like multi-family housing, industrial parks, and selected retail. While investors can get exposure to this asset class via publicly traded REITs, we prefer private funds that aren't affected by stock market moves.

Conventional wisdom suggests that rising interest rates may threaten real estate values. Ernst and Young released a study in 2015 that gave some reasons why this may not be true, including:

1) Historically there has been no strong correlation between the 10-year Treasury yield and commercial real estate capitalization rates.
2) The impetus for the Fed raising rates is improving domestic economic performance.
3) Improving economic conditions should engender stronger commercial real estate fundamentals.

Some real estate sectors may be affected by rising rates more than others, so as always investment dollars cannot be thrown blindly at the sector, but good opportunities still exist.

As always, we invite your thoughts and feedback.

Regards from the Emerald Team

Disclosure

Green Thought$

The information herein has been obtained from sources believed to be reliable, but Emerald Asset Advisors, LLC and EMFO, LLC ("Emerald") does not warrant its completeness or accuracy. Prices, opinions and estimates reflect Emerald's judgment on the date hereof and are subject to change at any time without notice. Any statements nonfactual in nature constitute current opinions, which are subject to change. Projections are not guaranteed and may vary significantly.

Currency trading may involve significant risks, including market risk, interest rate risk and country risk. Funds or strategies that use leverage or shorting may experience substantial losses. The investment strategy presented is not appropriate for every investor and individual clients should review with their financial advisors the terms and conditions and risk involved with specific products or services. As with all investments, past performance does not guarantee future results.

Clients are urged to compare the custodian's account statements to the advisor's supplemental statements. Please contact us if you do not receive statements from your custodian.

As of August 2016, Schwab no longer sends month-end statements for those accounts where there has been no activity for the preceding month; these accounts will be receiving quarterly statements.

About Emerald

Emerald Asset Advisors, LLC is a Registered Investment Advisor (RIA) founded in 1998. For more information, please visit our website ».

EMFO, LLC is a Registered Investment Advisor (RIA) founded in 2017. For more information, please visit our website emeraldfamilyoffice.com