Inverted Yield Curves and the US Federal Bank Chairman Comments

Topics:

- Trade Wars
- Inverted Yield Curves
- Chairman of the Federal Bank Comments
- Revisiting the Life Boat Drill
- Key Investor Affirmations

One of the best summers I can remember is soon coming to an end, and here we are yet again experiencing a period of volatility. As you know, this is not unexpected, and while the level of volatility may have very little impact on our fundamental investment strategy, it often has tremendous impact on our sense of confidence in financial market performance. Because of this, our emotional reaction to market volatility is something that we must work on all the time, even as this great summer concludes…

The continuation of the trade wars between the United States and China, Europe, and at times it feels like the entire world, along with indications of a slowing of certain economies around the world, has led to a heightened level of anxiety with respect to market performance. Technical indicators of recessionary trends are appearing, and the media is reporting on them without having the balance of understanding how these technical indicators foretell things that **may** occur, but do not predict **when** or **how certain** they are to occur.

For example, the last time the yield curve inverted was December 2005. The next year was positive. In mid-2007, the yield curve returned to normal. Investors that viewed that as a safe entry point entered months before the worst crash in decades. On average, the S&P 500 has returned 2.5% after a yield-curve inversion in the three months after the episode, while it has gained 4.87% in the following six months, 13.48% a year after, 14.73% in the following two years, and 16.41% three years out, according to Dow Jones Market Data. This outcome is far different from what recent media coverage may lead you to imagine.

Date of first 2/10-year inversion	3 months later	6 months later	1 year	2 years	3 years
8/17/1978	-10.14%	-6.10%	3.06%	19.64%	24.88%
8/20/1980	13.44%	2.27%	5.59%	-8.69%	32.49%
12/9/1988	6.10%	17.93%	25.87%	18.31%	36.54%
5/26/1998	-0.90%	8.49%	19.26%	25.96%	16.81%
12/30/2005	4.16%	1.76%	13.62%	18.44%	-28.65%
Average	2.53%	4.87%	13.48%	14.73%	16.41%

Also, the Chairman of the Federal Bank in the US spoke Friday, August 23rd and reiterated that the US economy remains strong with low inflation, low unemployment and good growth. His point was that the Fed has decided it isn't prudent to dramatically reduce rates when the economy is strong, choosing to keep their powder dry for when it may be needed. That also doesn't mean that a recession will not occur, it just indicates that for the US anyway a recession does not appear to be imminent. As I have stated in the past, we can be certain that a global recession will occur at some point, we just don't know when.

Finally, global trade tensions escalated yet again on Friday after China increased and implemented new tariffs, and the US President called for US companies to move manufacturing out of China and back to the US. He further complicated the market experience with confusing remarks on his stance on trade wars, first seeming to indicate regret for getting into it and then doubling down and suggesting he should have been much harsher. Very confusing. Fortunately, cooler heads seem to have shored up the relationship and talks continue with hopes of getting this mess under control. This is a perfect reminder that volatility is part of investing, and that the geopolitical environment is just one more factor, albeit a pretty confusing one these days.

As you know, these factors and many others all combine to inform our portfolio strategy. Fundamental to that strategy is our inability to **"TIME THE MARKET"**. To counter that inability, we apply clear strategies for managing volatility, things such as geographic and market diversification, asset allocation, diversification of investment strategy within portfolios, and "time till use of capital" strategies that help to isolate income payments from market volatility. As I have mentioned many times, we focus on the long-term objective and try to ignore the short-term volatility unless it has direct impact on our financial plan. If you have any concerns about your personal situation, please do not hesitate to reach out to me. My work is not just managing your portfolios, it is also helping you to manage the emotional aspect of investing as well.

Over the past few years, my commentaries have often dealt with volatility, incorporating suggestions to help manage emotions and expectations when investing in financial markets during periods of volatility. To help you to deal with our current environment, I want to **revisit two of the concepts** that I shared with you over the past two years.

First let's revisit the **Lifeboat Drill**. You may recall in that previous message from January 2018, I suggested that a lifeboat drill is best implemented when the "seas are calm" and everyone is relaxed and happy. At that time, I forecasted that volatility would return, and we needed to prepare ourselves for the emotional roller coaster that volatile markets may lead to.

The lifeboat drill was just an opportunity to remind you at a time when markets were great that there would come a point when they were not so good. We may have reached that point, and the answer is still the same:

"You have heard me point out the flaws of the ill-advised strategy of "Timing the Market". Rather, we follow a proven strategy of preparing portfolios for volatility through the implementation of diversified investment strategies, and by having appropriate risk profiles that properly complement your investment objectives and timeframe. We also focus on the long-term. Short term volatility is just that, and it is often when we find the greatest opportunity for future growth. This Lifeboat Drill reminds you that markets will not always be this smooth. When the bad times come, and they will, be assured that we are prepared for them. We have structured the portfolio appropriately, identified the managers who are able to manage volatility, and to take advantage of it."

The second concept are the "Key Investor Affirmations to Ensure Financial Success" that I have shared with you in the past. It's a great time to remember these points, they can be very helpful:

Key Investor Affirmations to Ensure Financial Success

Because successful investing often requires going against your basic human instinct, investors can be their own worst enemy, behaving in ways to prevent them from reaching their financial goals. Next time the investment market goes down, remind yourself what you will and will not do as a better-than-average investor.

1. I WILL stick to the investment plan I set when things were calm, especially when I'm feeling anything but calm. When my emotions are running high is the wrong time to make rational decisions, including rethinking my investment objectives.

2. I WILL NOT try to predict the future or listen to those who claim they can. Whatever happens next is anyone's guess. I can take comfort in knowing the value of the investments I own.

3. I WILL listen to my Financial Advisor when I am panicked. Once I've done my homework and have partnered with a skilled and principled advisor whom I trust, I may need them to be both my Financial Advisor and informal psychologist.

4. I WILL NOT crave uncertainty. Although it's in my nature to seek assurances, I accept that the stock market is driven by events that can't be consistently forecast.

5. I WILL avoid noise. Reading negative headlines leads to negative thoughts, which can lead to negative actions that negatively affect my long-term outcome as an investor.

6. I WILL NOT make investing harder than it needs to be. Just because making money in the market isn't easy, doesn't mean some complex investment strategy that I don't fully grasp is the answer.

7. I WILL treat the latest investment fad as exactly that - a fad. The tried and true, as boring as it may seem, is the greatest potential to help me compare to an unproven investment approach, no matter how trendy.

8. I WILL NOT expect the stock market to only rise in value. While losses aren't enjoyable, they are inevitable and I should keep my long-term investment goals in mind.

9. I WILL resist the urge to act but no action is required. Time in the market is key, not timing the market.

10. I WILL only look at my investment account statements as often as is absolutely necessary. The more I check in, the more short-term focused I become to the detriment of my long-term investment performance.

As always, I am here to help. Please let me know if you need anything at all, or just want a chat. I look forward to our next conversation.