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OBERMEYER WOOD **NEWS**

FALL 2018

MARKETPOINT

2018 began with considerable volatility in the equity markets, then stabilized and trended upward in the second quarter. This improvement continued in the third quarter, and U.S. equity market indexes are at or near all-time highs. The S&P 500 Index has returned approximately 10% year-to-date, and the New York Stock Exchange Index has returned approximately 4%.

This year marks the inauspicious tenth anniversary of the financial crisis, which included a severe recession and major stock market decline. It began in early 2008 and escalated into a broader financial crisis with the collapse of Lehman Brothers that September. The U.S. economy, along with the financial markets, has recovered dramatically in the past 10 years, with the market appreciating over 300% since its March 2009 low. With this period of protracted strength, many are asking when this nine-year economic expansion and bull market will end. Pundits have published numerous articles “raising the alarm” and calling for an end to this cycle. An unusual combination of positive and negative forces adds to the uncertainty. On the positive side, a strong economy, improving business and consumer sentiment, and low inflation are supporting financial markets. Weighing against these positives are trade disagreements, a tense geopolitical situation, and a domestic political environment characterized by acrimony and disruption.

Thus far, global trade tensions have had minimal impact on U.S. economic growth and overall sentiment. With the recent announcement of additional tariffs, over $250 billion of Chinese goods ranging from furniture to vacuums to technical components will face tariffs, with a potential increase planned for January absent a new trade agreement. These measures have hurt China so far, with the Shanghai Composite down nearly 15% this year. The Chinese yuan has been weak against the dollar, compelling the People’s Bank of China to take restrictive measures to prevent further betting against the currency. While the disagreements with China have escalated, given the negative impact on the Chinese economy and the potential inflationary risk to the U.S. economy, it remains in the interest of both countries to reach a compromise in the near term.

Despite the escalation of this trade dispute, the U.S. economy is strong and expected to grow nearly 3% in 2018. Business sentiment remains solid, with capital goods orders and shipments up 8.5% and 7.5% through July. The NFIB index, which tracks the sentiment of small and medium-size companies in the U.S., is at a 35-year high. Consumption, a large component of GDP, also is strong as consumers benefit from an improved job market. Corporate earnings have risen 20–25% this year, driven by tax reform, revenue growth, and benefits of cost-cutting. It is important to note that while the economic expansion has lasted for some time, it has been tepid. In fact, GDP has grown only 17% cumulatively since its previous ›

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peak in December 2007, significantly below previous expansions.[1] As we move into 2019 and 2020, GDP will likely return to more normal rates of growth of 2–2.5%.

Inflation has also remained benign this year, with U.S. core inflation (not including food and fuel) of 1.98%.[2] Wage pressures in the U.S. and possibly higher energy costs could raise inflation over the next few years. As the U.S. economy has accelerated, the Fed has raised short-term interest rates from the extraordinarily low levels of the financial crisis to 2.25%. One additional increase is anticipated for 2018, with three more possible increases expected in 2019, potentially raising the rate to over 3%, still well below the 4% level considered by economists to be a normalized rate. If inflation increases more rapidly than expected, the Fed would likely accelerate interest-rate increases, which could slow economic growth and cause volatility in the financial markets.

The U.S. political environment remains tense and unpredictable. Midterm elections and the potential resolution of the special counsel's investigations into Russian interference in the 2016 elections will keep the cacophony in the media high. As the Watergate scandal picked up through Nixon's resignation in August 1974, the market fell 15.5%. However, the economic environment at that time was weak, stocks were in a bear market, and oil prices were at highs. Clinton's impeachment in September 1998 resulted in a 2.2% stock market decline. But when it went to trial, stocks began a bull market that lasted until 2000.[3] In short, while political news can be distressing, long-term stock market returns are driven by U.S. corporate competition, innovation, and profits. As shown here, it has been a consistently good strategy to take advantage of short-term market pullbacks to invest for the long term.

Currently, we observe stock valuations that are slightly higher than historic averages. The S&P 500 price to earnings (P/E) ratio on 2019 earnings is 17.3x, higher than the 25-year average of 16.6x and quite a bit higher than the 10-year average of 14.4x. Notably, there is significant divergence across sectors. The most expensive sectors—consumer discretionary, which is trading at approximately 22x, and technology, trading at 19x—are well above the market average. Telecom and financials remain the cheapest sectors, at 10x and 12.6x respectively.

The S&P 500 continues to be influenced by a small group of large, widely held technology companies. A dichotomy has recently arisen between the strong current momentum of these companies and a variety of broad concerns, including antitrust issues, privacy and cybersecurity concerns, and potential pressure on profit margins as these companies increase spending to address some of these issues. We continue to carefully monitor these major companies, evolving technologies, and relevant valuations, in addition to our core holdings. We also work to identify companies with solid cash flow and exposure to high growth areas—including artificial intelligence, cloud computing, electric vehicles, and robotics—that are also trading at attractive prices. We believe it is critical to remain focused on both preservation of capital and long-term returns. Our team works to achieve this by adhering to our fundamental, long-term, value-focused philosophy.

S&P Composite Index
Log scale, annual

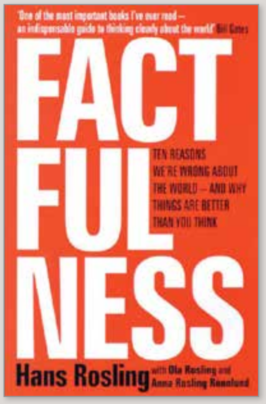
Source: FactSet, NBER, Robert Shiller, J.P. Morgan Asset Management.
Date shown in log scale to best illustrate long-term index patterns.
Past performance is not indicative of future returns. Chart is for illustrative purposes only.
Guide to the Markets – U.S. Data are as of June 30, 2018.

1 Minneapolis Fed – Real GDP – BEA (Chained 2009 Dollars, Seasonally Adjusted), Historical Recessions and Recoveries Data, July 27, 2018.

2 "US economy: statistics at a glance," Ft.com, accessed September 13, 2018.

3 Investment News, "History of Presidential Shocks to the Stock Market," October 30, 2017.

RECOMMENDED READING: *Factfulness: Ten Reasons We're Wrong About the World – and Why Things Are Better Than You Think*



Renowned doctor and educator Hans Rosling has spent years asking his audiences questions about global trends: *What percentage of the world's population lives in poverty? Is the number of endangered species increasing or decreasing? How many girls finish school?* Audiences around the world consistently get the answers wrong and usually paint a far more pessimistic picture than reality.

In *Factfulness*, Rosling, his son Ola, and daughter-in-law Anna summarize their findings from the polls they have conducted, and explain why we are so often wrong as part of their quest to correct "mega misconceptions." The problem, they say, is that people often don't know what they don't know, and their guesses are usually informed by unconscious biases. The authors explore ten instincts that distort our perspective—from our tendency to divide the world into two camps due to the "gap instinct" (often some version of *us* and *them*)—to how we downplay progress due to our "negativity instinct" (our tendency to notice the bad more than the good). Rosling's emphasis on continued global progress doesn't mean that the world is perfect or that real concerns don't exist. But when we worry about everything and make decisions based on the wrong facts, we can lose our ability to encourage effective change. He challenges readers to adopt one simple rule: Only carry opinions for which you have strong supporting facts. "When we have a fact-based worldview, we can see the world is not as bad as it seems—and we can see what we have to do to keep making it better."

Rosling recently passed away, but his messages live on. Bill Gates embraced this book this summer, calling it "an indispensable guide to thinking clearly about the world." He went so far as to offer it as a gift to every 2018 college graduate in the United States. *Factfulness* is a fairly quick read, largely due to the witty anecdotes infused throughout. For people who would like an uplifting take on today's society, we are happy to deliver you a copy. You can also watch Rosling's TED talks, which provide a pithy summary of the key points.

YEAR-END REMINDERS: GIFTS AND RMDS

REQUIRED MINIMUM DISTRIBUTION (RMD)

As we enter the 4th quarter, some clients will need to take distributions from their IRAs and other retirement accounts before December 31. If you have questions or need guidance on how to handle these distributions, we are here to help. You can also contact the custodian directly.

CHARITABLE GIFTS

In the next few months, you may also be considering gifts of cash or stock out of your brokerage accounts. We encourage you to plan your giving strategy as early as possible to avoid running into custodian-specific deadlines (which are generally around the middle of December).

In certain situations, you may consider making part or all of your RMD a charitable gift. Please confirm this strategy with your CPA and allow more time for processing. Most custodians will not send checks directly to charitable organizations.

If you need help with any of these items, please be in touch with our team. Our goal is to work together to make sure these year-end tasks are processed in a timely fashion.

Our Team

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FIRM UPDATE

NEW TEAM MEMBER: BRET HIRSH

We are excited to welcome Bret Hirsh to Obermeyer Wood in the role of *Vice President, Investments and Client Advisory*. Working in Aspen, Bret will be responsible for performing security analysis, collaborating closely with the other members of our Portfolio and Investment Committees. He will also manage select client relationships in the Roaring Fork Valley. Bret joins us with thirteen years of experience in the financial industry, most recently as a founding senior research analyst at One Tusk Investment Management in New York.

OBERMEYER WOOD RECOGNIZED BY *FORBES* AND *BARRON'S*

Our team was humbled to be included in a few prestigious rankings in recent months.

Representing our firm, Wally Obermeyer was named one of *Barron's* Top 100 Independent Financial Advisors in the magazine's September 17th issue. Published annually, this ranking evaluates advisors on a variety of factors, including managed assets, the size and experience of the teams, and firms' regulatory records. 2018 marks Obermeyer's 11th appearance on the *Barron's* "Indies" list, and we are honored to be the only Colorado-based advisor listed this year.

Forbes (in partnership with Shook Research) published the Top Wealth Advisor Ranking on September 30th, listing Obermeyer as No. 106 and the second-ranked advisor in Colorado. Furthermore, earlier this summer, Dana Nightingale was listed in *Forbes'* second ranking of the nation's top 500 next-generation wealth advisors, ranking second in Colorado. Both of the rankings consider a broad universe of both brokers and registered investment advisors.

We are incredibly proud of our team and believe these accomplishments reflect the collective efforts of everyone at Obermeyer Wood as we work closely on each client relationship and investment idea. We also know that none of this would be possible without our clients' loyalty and support; thank you to all of our clients for making honors like this possible.

More details on these recognitions are available under the News section of our website.

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