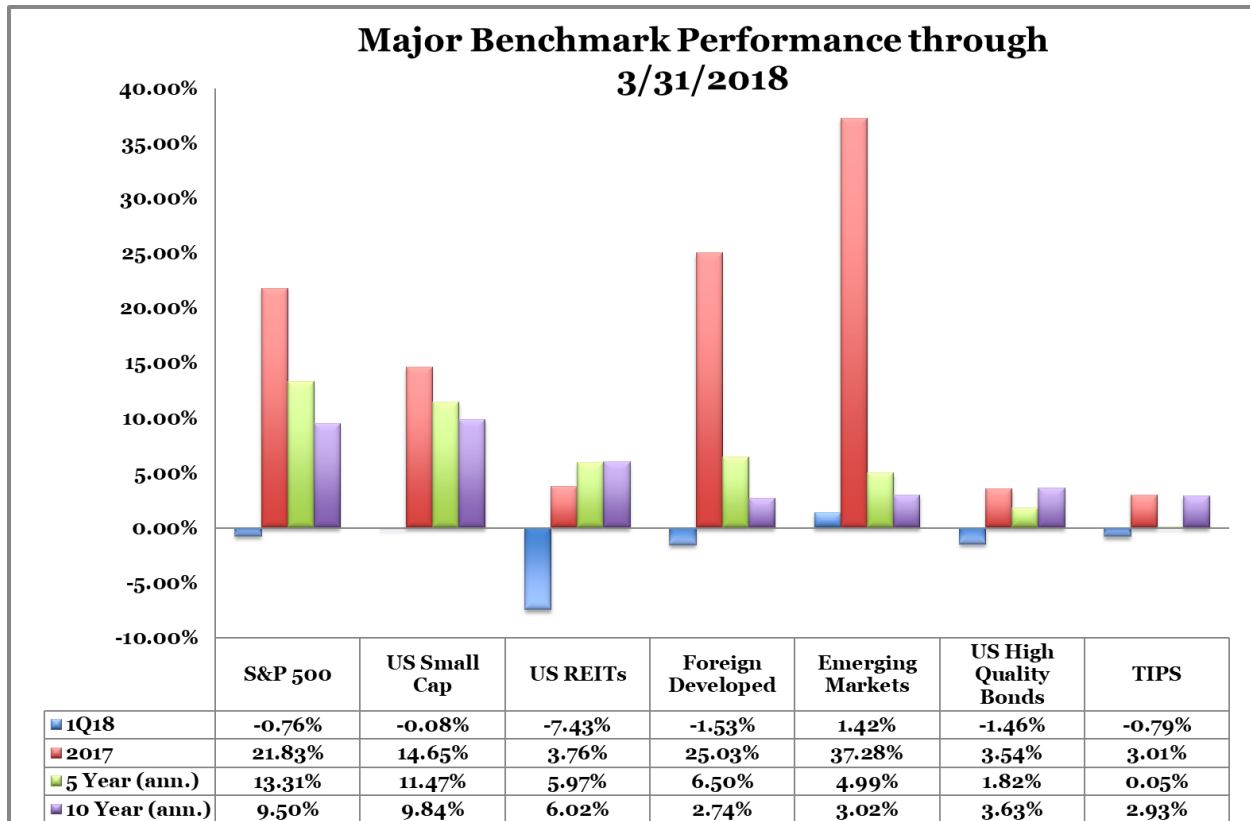


## 2018 First Quarter Market Outlook

After a spectacular 2017 and a “melt-up”\* for the month of January, the markets pulled back in February and March. While economic fundamentals continue to look strong, volatility returned with a vengeance this quarter and we expect to see more of it for the remainder of 2018. After many quarters of positive returns, most diversified portfolios (containing stocks and bonds) were slightly negative in the first quarter. In the chart below, we included 2017 as a reminder of how unusually strong market returns were last year.



Source: DFA

During all of 2017 and January 2018, the market let negative news just roll off its back. However, as of February, the market has become much more sensitive to ongoing political turmoil, White House personnel shakeups, tariff announcements, data breaches and other indicators of instability at the top of the U.S. government. As we noted in our previous newsletter, last year’s strong performance and low volatility were exceptions to the rule; this year is closer to the norm.

JP Morgan’s Chief Economist likened this quarter to a close boxing match - on the one side there are: Very positive economic numbers as well as recent tax reform that will benefit the economy in the short run including very good expected earnings.

On the other side:

Stock valuations were high at the end of 2017, we are in our 10<sup>th</sup> year of a bull market (long by historical standards), and the Federal Reserve will continue to raise rates.

The major benchmarks are quite close to where we started the quarter.

Even though there are plenty of great reasons as well as data to support staying invested, the volatility we have experienced for the past two months is tough on morale, especially since we haven't experienced any downturns recently. Although this may not "feel" like a good time to be in the market, the recent drop was probably more a sign of health than market chaos. Further, the dips present good buying opportunities for investors with a long-term outlook. US stock valuations are closer to their 25-year average and despite a significant run-up in international equities in 2017, their valuations remain even more attractive than US stock valuations.

### **Managing Your Expectations**

Has the coverage left you wondering about your portfolio? After a long stretch of good returns with minimal volatility, the current volatility may have you questioning whether you should "do something," in case the ride gets rougher. Remember, if there was never any real market risk, you couldn't expect extra returns for your risk tolerance.

Even so, you may have forgotten how awful the last round of extreme volatility felt during the Great Recession. Insights from behavioral finance tell us that our brain's ingrained biases cause us to gloss over those painful times, and panic all over again when they recur, long before our rational resolve has time to kick in.

As *Wall Street Journal* columnist Jason Zweig said during the February dip: "A happy few investors ... may have long-term thinking built into them by nature. The rest of us have to cultivate it by nurture." We definitely agree with this quote, and we consider it our duty and privilege to advise you accordingly, through every market environment.

We encourage you to call or email if you want to discuss current events or the economy further. Even though we believe in long term outlooks for investing and do not believe in frequent trading (especially emotional trades that are a reaction to current headlines), we are following the markets and news very closely.

\*A dramatic and unexpected improvement in the investment performance of an asset class driven partly by a stampede of investors who don't want to miss out on its rise rather than by fundamental improvements in the economy.

Sources: Dimensional Fund Advisors (DFA), PIMCO, JP Morgan, Morningstar, New York Times, Schwab, Vanguard, Wall Street Journal.