# NOTES FROM THE NORTH: MARKET OUTLOOK

***December, 2016***

The penning and production of our monthly newsletter is a team effort, and with this issue we introduce the team's newest member, Fletcher Cole, CFA. Being new to the group but an old hat in the investment business, we thought you might be interested to hear some of his observations about his experience thus far:

**"When I first visited the firm's website, I was pleased to find the following: "*Confidence in your advisor during difficult markets will help weather the storm and prevent the very common and very costly mistake of making drastic changes at precisely the wrong moment.*" The word "confidence" is being used in a broad sense, but I would apply it most specifically to our competence and our integrity. Warren Buffett, put it this way. "In looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if they don't have the first, the other two will kill you." Confidence is not achieved overnight, and is most unwavering when it has been earned over time through both good times and bad. TCEA's client retention rate suggested to me that client confidence was high, and it made me very comfortable joining the team.**

**I've found TCEA a wonderful atmosphere in which to work. Employees share the common values of respect, integrity, trust, hard work, and commitment to excellence. I have been given a very warm welcome by all and I get a strong sense everyone here wants everyone else to learn, grow and succeed. There is no "I" in team. Or as Robert Woodruff (the person credited with being the person most responsible for Coca-Cola becoming perhaps the world's best known American product) once said, "There is no limit to what a man can do or how far he can go if he doesn't mind who gets the credit." There is no distraction from office politics. We focus our energies on a common goal of meeting clients' needs.**

**I feel privileged to work with Martha, Ed, and Carl, three investment professionals who, like me, have been battle-tested in both bull and bear markets. They understand and appreciate the challenges of investing their own money, but more importantly, they understand how to be good stewards of capital entrusted to them by others. They have confidence in their abilities, but each is balanced by a healthy dose of humility. Both attributes are critical in the investment business. Overconfidence is an enemy of the prudent investor. As Mark Twain said, "It's not what you don't know that kills you, it's what you know for sure that ain't true." We cannot control the markets but we can control our response to them through our investment approach. Investment decisions should be made with this reality in mind.**

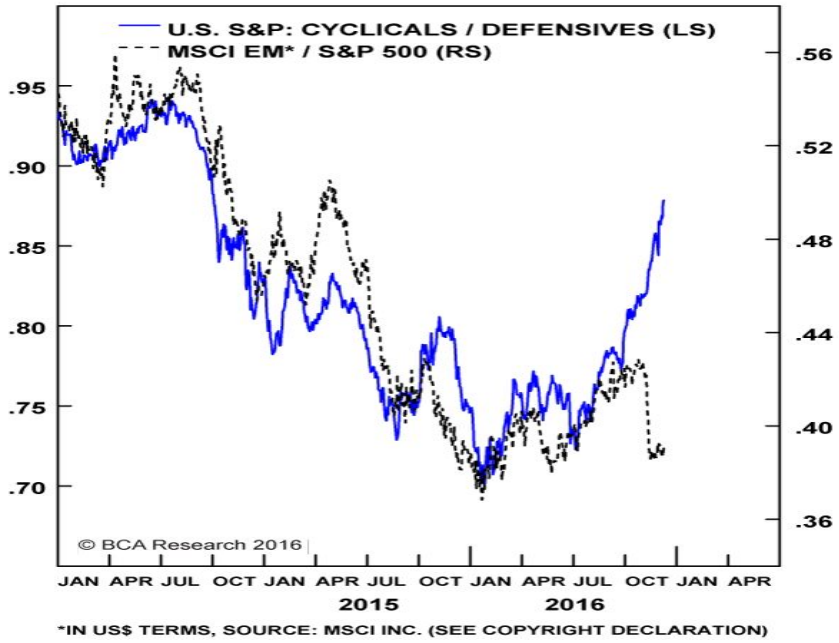
**Any investment made in the equity markets should be long-term in nature and requires patience. Any investing method goes through periods of underperformance that might be classified as long-term by many investors. To make things more difficult, many cognitive biases and outside pressures (that go beyond the scope of this piece) combine to make investing much harder in practice, than theory. As Charlie Munger, Warren Buffett's colleague, put it, "Investing is not supposed to be easy. Anyone who finds it easy is stupid." I am thankful to be surrounded by an experienced, intelligent, and thoughtful team. "**

Enough about us, back to the markets.:

Last month, initial investor concerns of having an unpredictable President-elect *very* quickly (overnight) gave way to optimism and a focus on Trump's economic policies. Talk of increased infrastructure spending via the rebuilding of America's bridges and roads, the prospect of repealing burdensome regulations, and the potential for the repatriation of massive amounts of corporate cash earned from overseas profits are all factors that have driven the equity markets higher post-election.

The media is still making hay of the rally largely because the rally was such a surprise. The "new

highs" (followed by several exclamation points on CNBC or the evening news) are only a couple of percentage points above the summer's highs. It's been a very good year, yes, but there is definitely some media hype to the story. The really big story is a little more nuanced. We've seen a sharp reversal of the "defensive" trade,




as cyclical stocks have rebounded dramatically versus their more defensive peers. The blue line in the chart (above) shows the post-election spike in cyclical stocks versus defensives since the election. (The gray dotted line shows the relative preference for US stocks versus emerging markets—a different subject entirely). Some of our best core holdings unfortunately appear to have become a source of cash for traders seeking to take advantage of this shift. In our opinion, this is a little too much, too fast.

The prospect of fiscal stimulus and a roll back of regulations eased deflation concerns significantly, and the Federal Reserve is widely expected to raise interest rates this month. The rate on the 10-year Treasury, which had fallen as low as 1.3% in July, has almost doubled to 2.5%. While painful for existing position prices, it is a relief to be able to tiptoe back into the bond market for clients with fixed income allocations.

As many Americans had hoped, Trump has backed off much of his rhetoric and is trying to rebuild bridges that may have been lit on fire on the campaign trail. The markets seem to be reacting exuberantly, but not irrationally to the unfolding events and we continue to search for pockets of inefficiency and opportunity. We have never had a "Tweeter-in-Chief" in the Oval Office. We expect volatility to continue, and there will be plenty of opportunities for the markets to react to this new administration.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