Cambridge ADVISORS inc.
INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE — MARCH 2019

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MARKET COMMENTARY

Stocks rebounded sharply after their plunge last quarter thereby reporting their best quarterly performance of the last ten years. Although not enough to reach a new high, the large cap US stocks of the S&P 500 gained 13.7% in the quarter. Small cap stocks in the Russell 2000 are were up 14.6%. International stocks of developed markets in the MSCI EAFE had a gain of 10.0%. Meanwhile, emerging market stocks reported a 9.6% gain. Bond yields sharply retreated again this quarter resulting in the Barclays US Aggregate Bond Index posting a 2.94% return in just the first quarter after flat returns for 2018.

Many analysts have been expecting value stocks to perform better than growth stocks, but so far that has not happened. Technology stocks have continued to post the best performance; however, industrials and energy are close behind. Healthcare and financial stocks have lagged this quarter.

The rebound in the US stock market better reflected the strength in the economy. GDP growth for fourth quarter was lower than the 3.4% of third quarter but was still 2.2% which is not near recession. Full year growth for 2018 was 2.9%. Analysts and economists are expecting GDP growth to slow to around 2.0% in 2019. The government shutdown may negatively impact growth resulting in a disappointing number for first quarter.

Corporate profits in 2018 were impressive with full year earnings growth near 22%. Fourth quarter growth slowed to about 13% as the benefits from tax reform were mostly already incorporated. Looking forward, earnings comparisons will be much more difficult in 2019 since there will not be another huge boost from tax-cuts. Zacks notes that first quarter may show a negative earnings growth rate and second quarter may be flat even though revenues are expected to be higher.

2019 BENCHMARK RATES OF RETURN

INDEX	FIRST QUARTER	YTD
S&P 500	13.65%	13.65%
DJIA	11.81%	11.81%
NASDAQ	16.49%	16.49%
Russell 2000	14.58%	14.58%
International	9.98%	9.98%
Fixed Income	2.94%	2.94%

Unemployment is still low at only 3.8% as of February. Inflation remains below the Fed's 2% target.

The tariffs and possible trade war concerns have also weighed on the markets but the negotiations between the US and China appear to be making progress. Brexit, though, continues to struggle.

The 10-year Treasury bond yield peaked at 3.23% last year before ending the year at 2.69%. It was yielding just 2.41% at the end of the first quarter. The yield curve is basically flat right now as the 3-month Treasury has a yield of 2.40%.

Concerns of an inverted yield curve have continued to plague the market as inversion can be an indicator of an impending recession. The Federal Reserve's rate hikes have left some investors and analysts fearful that they have gone too far and that higher short-term rates may result in recession. The stock market reflected these fears when it plunged following the Federal Reserve's December rate hike. Since then, the Fed has changed its commentary to be more dovish and now say they do not expect further rate hikes in 2019. Some analysts believe the next movement in rates will be lower rather than higher. President Trump has voiced his wish for the Fed to pause on rate hikes and stop reducing its balance sheet. Larry Kudlow has been calling for the Fed to cut rates immediately by 0.50% to keep the economy growing.

The flat yield curve gives investors reason to be cautious. Although the equity markets have rebounded strongly, investors should not assume that stocks will continue to advance without incident. Volatility is likely to continue, especially as a new election year is looming and stocks are again trading at above average valuations. Diversification can help investors stay invested during turbulent times. Choosing an asset allocation appropriate for an investor's risk tolerance is key so that downturns can be weathered and emotional trading can be avoided. Please contact your advisor if you have any questions about your asset allocation or account.

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have. Also, if your situation has changed, please contact your advisor so we can determine if any changes are needed in your account.

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FINANCIAL PLANNING

Setting an asset allocation you can live with

Market timing is almost always a losing strategy over the long term. It seems reasonable enough that sometimes stocks are overvalued and you should sell while at other times they are selling at a good valuation and you should buy. However, figuring out exactly how to determine an asset's value and when exactly the market will return to "proper" pricing is much more difficult than it sounds. If you miss being in at the right time and out at the right time, your returns versus a buy and hold strategy are usually less. According to studies by William Sharpe and others, a market timer must be correct 70 to 85% of the time to beat a buy and hold strategy.

Some market timers may get out before a decline, but then they are forced with the decision of when to get back in to the market. The reasons they sold likely haven't been resolved entirely before the market goes back up leaving them nervous to re-enter the market. However, markets typically anticipate what's coming down the road and will already start moving higher before things actually feel better. It could be easy to miss a big rebound. University of Michigan Professor H. Nejat Seyhum found that "between 1926 and 1993, more than 99% of total dollar returns were earned during only 5.9% of the months. For the 31-year period from 1963 to 1993, 90 trading days accounted for 95% of the market gains". If you were out of the market those days, your returns were significantly lower. JPMorgan notes that "six of the best 10 days occurred within two weeks of the 10 worst days" over the last 20 years which makes it even more difficult to time the market correctly.

JPMorgan's Guide to the Market shows 20-year annualized returns from 1999 to 2018. Over that time period, stocks in the S&P 500 earned 5.6% per year. A diversified portfolio of 60% stocks and 40% bonds earned 5.2% while a diversified portfolio of 40% stocks and 60% bonds earned 5.0%. However, the average investor earned only 1.9% as measured by Dalbar Inc (who tracks net mutual fund sales, redemptions and exchanges as a measure of investor behavior). The takeaway is that the average investor may make decisions based on emotion and end up selling low and buying high instead.

We believe a better strategy than marking timing is to choose an appropriate asset allocation based on your risk tolerance and then stick with it. Investors who are less risk tolerant would likely have more fixed income in their asset allocation. As you can see, measuring risk tolerance is as important as choosing securities because in order to have the right asset allocation, we need to have an appropriate measure of risk tolerance so that emotional selling is minimized.

Our new Riskalyze software that we have been rolling out, helps to measure risk tolerance. Prior to meeting, your advisor may ask you to complete an electronic survey through Riskalyze. Your advisor may also send out a periodic "check in" to check your risk tolerance. Advisors will be able to compare your risk tolerance to the risk in your portfolio at any time to make sure the two are in line and your allocation is still appropriate.

QUESTION: How do I make a charitable gift from my IRA?

ANSWER: With the latest tax reform, it has become more advantageous for some people to make charitable gifts from their IRA. To do so, the person must be over age 70 1/2. Gifts of up to $100,000 per year can be made directly to the charitable organization from the IRA and excluded from ordinary income. Therefore, someone who does not itemize their deductions can take the standard deduction and make their gift without it being included in their income.

Some eigible clients may want to make both large and small gifts from their IRAs. To simplify the process, clients can have a checkbook linked to their IRA. They could write checks from this checkbook to any qualified organization whether it be annual gifts to their church, a once a year donation to a community foundation, or a gift to fulfill a pledge. For larger or ongoing gifts, clients should contact their advisor so we can make sure that cash is available in the account. If you would like to have the checkwriting option on your IRA, please contact your advisor to see if it is appropriate for you.

CAMBRIDGE ADVISORS NEWS

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Did you know? As a client of Cambridge Advisors, we want to help the people who are important to you and we will waive our account minimum to be able to work with them. If a family member could benefit from our services, please let them know that an initial consultation is free of charge to see if we would be a good fit for them and what they need. Also know that we would never share your personal or financial information with any referral or any other client. Please reach out to your advisor and let us know if there is someone we should be talking to.