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Resources Management Corp

MARKET COMMENTARY

ON MARKET TIMING

"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." - Peter Lynch

As we move through the ninth year of the current bull market, much of the public discourse in the investing landscape surrounds if and when we will have a meaningful correction. While it is a foregone conclusion that at some point the market (and the economy) will experience a material reduction in value, the timing of such a move is nearly impossible to predict. Over the long term, it has consistently been a mistake to bet against the performance of U.S. businesses in aggregate, but markets and economies move in cycles that include periods of both expansion and contraction. Despite the fact that the major drivers of the shift from one to the other are often obvious in retrospect, market participants tend to have a difficult time consistently predicting when the market will turn. Rather than basing an investment philosophy around misguided attempts to forecast broad market shifts, it has long proven more effective to make investment decisions that are grounded in a keen understanding of the intrinsic value of the underlying business that each security represents.

The economy as a whole appears to be operating in reasonably strong conditions, with unemployment at a 17-year low, GDP growth finally approaching long targeted levels, wage growth beginning to increase and inflation remaining in check. This environment, coupled with a Federal Reserve that has remained reasonably accommodative, has driven stocks, in aggregate, to values that appear to be high by many metrics. While broad exposure to U.S. business may come at a price that is higher than historical averages, there is ample opportunity to invest in high quality business at attractive price points. Rather than attempting to predict when the whole stock market will have a correction (or advance higher), we remain focused on deploying cash in securities that offer adequate risk-adjusted return profiles.

Capital markets participation was unique in 2017 with effectively all asset classes and geographies moving higher, including the S&P 500 returning 22%. All of this was done with historically low volatility of 7%, which is half of the historical average and the lowest level since 1964[1]. To this end, the largest pullback the market experienced was approximately 3%, which is the lowest that has been seen in over 20 years. Strong upside price performance with limited downside activity certainly offers an opportunity for capital appreciation, but it also creates an increased probability of market participants shifting their portfolios to riskier asset classes. When there is synchronized price appreciation across a wide variety of security types and countries, investors, as a group, can begin to behave as if the market cannot decline for any sort of extended period. Despite the numerous potential disruptions that exist as we enter 2018 (a monetary policy misstep, geopolitical issues, etc.), trading behavior has generally assumed a continuation of 2017's profile. We view this "it can only go up" mentality as flawed, and would actually welcome a reintroduction of warranted volatility as it would indicate a more fundamentally focused market.

While we make no attempt to predict when the indices will experience a contraction, we remain focused on the risk profiles and valuations of the securities that we own. By focusing on the long term, we aim to manage short-term volatility to drive sustainable capital appreciation over time.

[1] Source: J.P. Morgan Asset Management

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