SIGNATURE RESOURCES CAPITAL MANAGEMENT

Commentary: December 2017

FUTURE FRET

As the year comes to a close, prognostications for 2018 already are filling up our inboxes. We hope to spare readers another choice of whom to believe. Any meaningfully specific views we might share are no more likely to come true than the various others we'll read over the next few weeks. The question on many minds, of course, is, "how will my portfolios perform next year?" We can only be abundantly honest and suggest that it's impossible to know in absolute terms. Instead, we think a better idea would be to establish a level of ease with a range of market outcomes and align portfolios such that they might fall within that zone of comfort. Though the if-we-only-had's are somewhat unavoidable, acknowledging potential fears and regrets in advance may leave us better off in the longer run and more relaxed in between.

Too Far, Too Fast?

From what we've read so far, broader-market bullet points for 2018 generally include takes on three topics: market momentum, market valuation and market catalysts. All touch on the idea that the plot of medium-term equity market returns in Figure 1 seems rather too diagonal. Such up-and-up-and-up trajectories are rare. It's not so contentious to suggest enough's enough, this is nuts, we're due a correction.

Figure 1: Russell 3000 Total Return Index

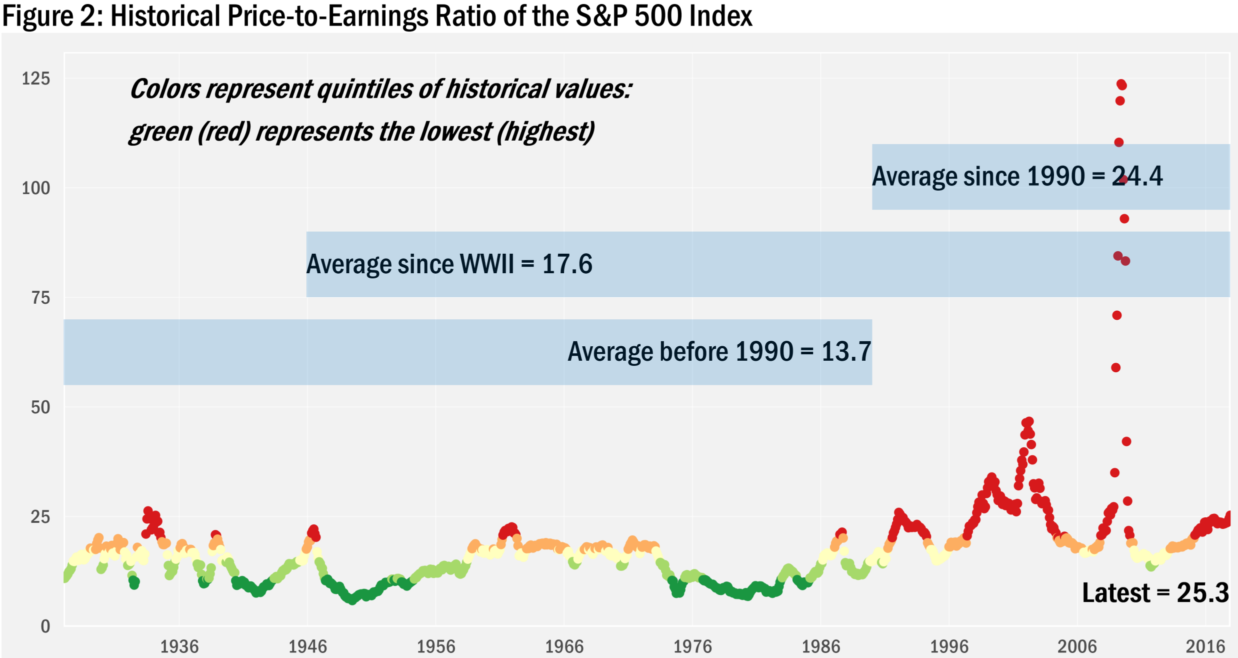
From 11.30.12 to 11.30.17. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

But, such comments are echoes of similar sentiments from 2013, 2014 and 2015. While early 2016 saw a pause, there's been no let-up since. We think imminent-correctionists eventually will be proved accurate in hindsight, but we wonder how much ground may be lost until then. Perhaps worse might be the consequence of any eventual downturn on the desire for those then uninvested to march back into the market. As we often note: deciding to get out is easy…it's the getting back in that's the truer challenge.

Too Much for Not Enough?

Supporting such arguments for at least reducing market exposure is the fact that present market valuations are among the richest ever experienced in the U.S. As an example, we can look to the price-to-earnings ratio of the S&P 500 Index, which is a measure of the value of the shares of S&P 500 Index members relative to the trailing profits those companies make in the aggregate. The basis for the metric is the idea that the value of those shares ultimately is tied to the potential profits to be earned over time. The more we pay for future profits now, the less we're likely to be rewarded over time as those profits are realized. That understanding seems intuitive enough, and history suggests that there's an indirect relationship between starting valuations and eventual returns (a higher starting valuation suggests lower longer-term returns). Even so, there's no absolute rule we have found that states now's the time to take our leave from the market. Present values aren't so far removed from those of even a few years ago, and look how far markets have come since. That is, market valuations are generally understood to be tools insufficient for the task of timing the market.

Figure 2: Historical Price-to-Earnings Ratio of the S&P 500 Index

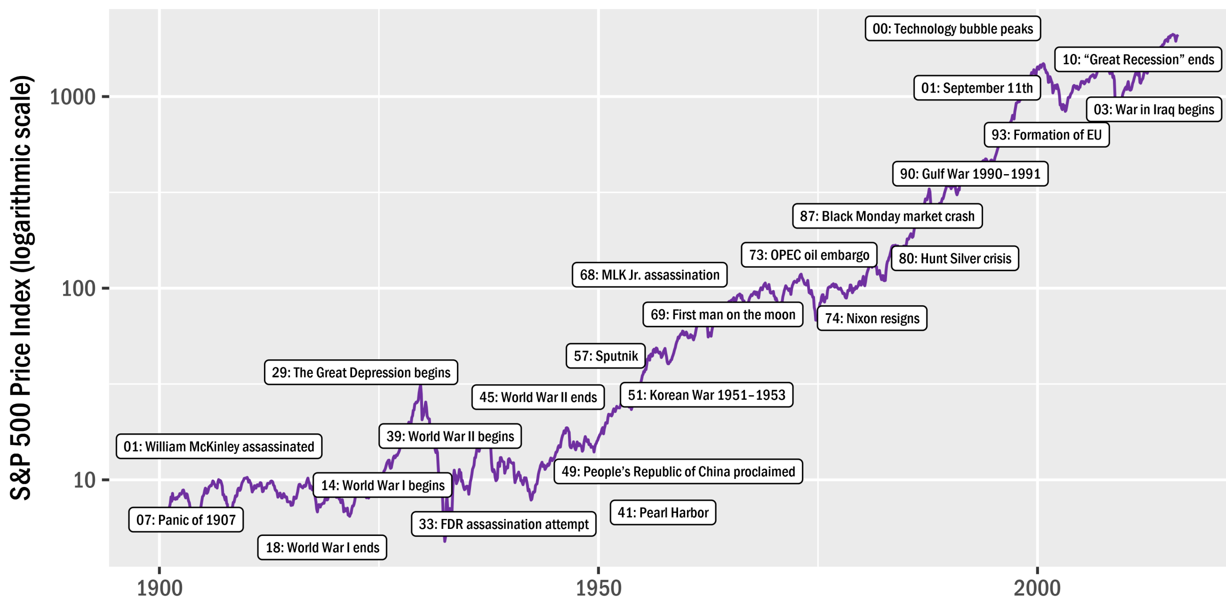


Average of monthly values from 12.30.26 to 11.30.17. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg and Professor Robert J. Shiller of Yale University

Everywhere Tinder Boxes?

Combining these two observations is the fact that such strong market momentum amidst such high valuations need only a spark to ignite a downturn. Many see potential geopolitical catalysts flickering all about. Commentators remain worried that roiling regional conflicts may present more uncomfortable consequences for markets in 2018, while increasingly heated rhetoric from and toward North Korea may devolve into a fight near for sure to upset the market cart. Meantime, as internal political dynamics in Europe and here at home remain dicey, various unexpected results during 2016 leave many to worry of more such surprises in store. History has shown, however, that markets have endured a wide range of geopolitical incidents and accidents. While near-term impacts are surely felt, longer-term results still have proved rewarding. Here, again, timing the catalyst and gauging its impact remains a game of guesses no matter the approach.

Figure 3: Market-Moving Events and Long-Term Performance



From 01.31.1900 to 12.30.2015. Events point to year, not specific date. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from various sources. S&P 500 Price Index data from Professor Robert J. Shiller of Yale University. Event list provided by BlackRock

The Upshot: Who Can Be Sure?

Folks believing markets are richly valued and due for a dump may be proved prescient. And folks singing a chorus of “we’ve only just begun” could see yet another year of bumper returns. Tax cuts nearly confirmed, we may be setting the stage for stronger growth ahead. Or, we may be setting ourselves up for fiscal disaster down the road. Political coalitions may find firm footing in Europe or governments may fall to disarray as factions fight for attention. The current year, of course, is not yet over, so there’s still time for tunes to change. We should trust that while thoughtful, reasonable opinions regarding the range of potential drivers for market performance abound, many are possible and none is assured.

And so, we turn again to the primary question we should ask ourselves when it comes to establishing a level of exposure to market risk: how much can we stomach? The answer may depend on a range of inputs to be devised and considered that include our present financial situations and projections in addition to our emotional responses to market rally and valley. A trusted advisor may help to define those inputs and resolve that complexity into an allocation geared toward meeting long-term life goals.

Important Information

The S&P 500 Index represents 500 U.S. companies and captures approximately 80% coverage of available market capitalization.

The Russell 3000 Index represents approximately 98% of the investable U.S. equity market.

Publication: 12.06.17

2017-SRCM-15