



A Review of 2018

A Recap of My Investment Philosophy

- It will be worth restating, even in the context of a letter primarily focused on the year just past, my overall philosophy of investment advice. It is goal-focused and planning-driven, as sharply distinguished from an approach that is market-focused and current-events-driven. Every successful investor I've ever known was ***acting continuously on a plan***; failed investors, in my experience, get that way by ***reacting to current events in the economy and the markets***.
- I neither forecast the economy, nor attempt to time the markets, nor predict which market sectors will “outperform” which others over the next block of time. In a sentence that always bears repeating: I'm a planner rather than a prognosticator.
- Once a client family and I have a plan in place—and have funded it with what have historically been the most appropriate types of investments—I'll hardly ever recommend changing the portfolio ***so long as your long-term goals haven't changed***. As a general statement, I've found that the more often investors change their portfolios (in response to the market fears or fads of the moment), the worse their long-term results.
- In sum, my essential principles of portfolio management are fourfold.
 - (1) The performance of a portfolio relative to a benchmark is largely irrelevant to long-term financial success.
 - (2) The only benchmark we should care about is the one that indicates whether you are on track to accomplish your financial goals.
 - (3) Risk should be measured as the probability that you won't achieve your goals.
 - (4) Investing should have the exclusive objective of *minimizing that risk*.

Current Observations

- 2018 was perhaps the strangest year I've experienced in my career as a financial advisor. Most importantly, it was one of the truly great years in the history of the American economy, and by far the best one since the global financial crisis of 10 years past. Paradoxically, it was also a year in which the equity market could not get out of its own way.
- It is almost impossible to cite all the major metrics of the economy which blazed ahead in 2018. Worker productivity, which is the long-run key to economic

growth and a higher standard of living, surged. Wage growth accelerated in response to a rapidly falling unemployment rate. Household net worth rose above \$100 trillion for the first time, yet household debt relative to net worth remained historically low. Finally—and to me this sums up the entire remarkable year—for the first time in American history, the number of open job listings exceeded the number of people seeking employment.

- Earnings of the S&P 500 companies, paced by robust GDP growth and significant corporate tax reform, leaped upward by more than 20%. Cash dividends set a new record; indeed total cash returned to shareholders from dividends and share repurchases since the trough of the financial crisis of 2008 & 2009 reached \$7 trillion.
- But the equity market had other things on its mind. Having gone straight up without a correction throughout 2017, the S&P 500 came roaring into 2018 at 2,674—probably somewhat ahead of itself, as it seemed to be discounting the entire future effect of corporate tax cuts in one gulp. There ensued in February a 10% correction, followed by several months of consolidation. The advance resumed as summer waned, with the Index reaching a new all-time high of 2,931 in late September. It then went into a savage decline, falling to the threshold of bear market territory: S&P 2,351 on Christmas Eve, off 19.8% from the September high. A rally in the last week of trading carried it back up to 2,507, but that still represented a solid six percent decline on the year, ignoring dividends. 2018 thus became the tenth year of the last 39 (beginning in 1980) in which the Index closed lower than where it began. At the long-term historical rate of one down year in four, that's actually just par for the course.
- The major economic and market imponderable as the year turns is trade policy, which in the larger sense is an inquiry into the mind of President Trump. I think it fair to say, as the economist Scott Grannis recently did, that “Trump has managed to reduce tax and regulatory burdens in impressive fashion, but his tweets and his tariff threats have created unnecessary distractions and unfortunate uncertainties, not to mention higher prices for an array of imported consumer goods.”
- These and other uncertainties—perhaps chief among them Fed policy and an aging expansion—were weighing heavily on investor psychology as the year drew to a close. For whatever it may be worth, my experience has been that negative investor sentiment—and the resulting equity price weakness—have usually presented the patient, disciplined long-term investor with enhanced opportunity. As the wise and witty Sage of Omaha (ie. Warren Buffet) wrote in his 1994 shareholder letter, “Fear is the foe of the faddist, but the friend of the fundamentalist.”

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