The Investment Counsel Company
Investment Management Consultants

Quarterly Insights July 2018

Investors are aware that the U.S. stock market's upward momentum has temporarily ceased and is now in a sideways trading range. However, many, including Wall Street professionals, were caught off guard by U.S. stocks continuing to outperform their foreign counterparts during the first half of 2018. Institutional and retail investors alike took profits in U.S. stocks earlier this year after last year's stellar performance and reallocated sales proceeds into foreign securities. This decision was supported by rational logic, "sell high and buy low", since valuations of U.S. securities are higher than foreign securities. This year, as of July 3rd, U.S. stocks have outperformed foreign stocks by +6.92% (S&P 500 +2.46% versus All Country World Index, excluding U.S. -4.46%). One of the biggest reasons for this unexpected disparity in performance is another surprise to investors…the strength in the U.S. dollar. A stronger domestic currency increases the value of domestic assets and vice versa. The consensus among economists and others was that the U.S. dollar was in a long-term declining trend relative to other currencies. Fortunately, forecasting currency trends runs counter to our firm's investment philosophy, and thus our clients' portfolios benefited from limited negative currency effects relative to other investors who speculate on currencies.

A second surprise is that small U.S. companies have outperformed large companies by +6.35% year-to-date as of July 3rd (Russell 2000 +8.81% versus S&P 500 +2.46%). Again, investors were astonished because large companies often lead during later stages of an economic cycle (the beginning of the current U.S. economic recovery was early 2009). More recently, investors have increasingly embraced index investing. The missed opportunity is that most popular stock indexes (and therefore many investors' portfolios) have little or no exposure to small companies. Thus, set-it-and-forget-it investment strategies such as index investing have not worked as well as some investors hoped. This lesson validates the precept that a single investment style (i.e. investing solely in indexes) is only one of many tools in a toolbox and no one tool serves every need.

These unexpected trends and investment opportunities are a direct result of the number one obstacle and/or opportunity facing the global stock market today…President Trump's threat of trade wars with foreign countries. Uncertainties related to rising costs for multinational companies buying and/or selling products with the U.S. make smaller domestic companies that are less dependent on importing/exporting more attractive to investors. The consensus among investors is that new tariffs will have limited significance or won't materialize. Most believe that the probability of a full-blown trade war is low, but the risks are rising. What is most important is not what investors believe, but if actual results prove better or worse than what investors expect. The difference between investor perception and reality creates market volatility. The greater the difference, the greater prices swing.

10000 West Charleston Boulevard
Suite 280 • Las Vegas, NV 89135
P: 702.871.8510 • F: 702.871.4052
iccnv.com

Also surprising to investors is that the stock market seems almost impervious to bad news. Not even rising interest rates, increasing signs of inflation, tensions with North Korea, a looming trade war, "America Comes First" anti-Europe sentiment, mid-term elections, and more have forced the stock market into a downtrend. Holding up the U.S. stock market is a robust domestic economy supported by improving corporate profit levels unmatched for six years. According to FactSet, an aggregator of financial data on public companies, profits are expected to grow at 19% for second quarter and 21.4% for third quarter 2018. If actual profits reported are better than forecasted, then further market gains can be expected, and vice versa. The downside to such positive news is that two major headwinds are approaching by 2020. First, the economic stimulus of last year's tax cuts will be fading, making sustainable growth in profits harder to achieve. Second, Fed Chairman Jerome Powell must manage further anticipated interest rate hikes at a pace that is neither too slow nor too fast. While consumers are worried about higher inflation and interest rates, most economists believe if these conditions do occur, they are not likely to persist. Conversely, they are watching for an end to the current economic cycle and a moderate recession around 2020 caused by a Fed error in judgment. But investors need to get through mid-term elections first. Always a nervous time for the financial markets, elections are filled with unforeseen surprises. Polls continue to show the Republican Party losing control of the House of Representatives in November, but the margin is narrowing. Nevertheless, with Senate control and Trump in office, the Republicans can maintain substantial influence.

So many known challenges as well as surprises, including false alarms, make for an infinite number of possible outcomes and consequences. Preserving and growing wealth in a sustainable manner requires consistent adherence to a process designed to work effectively under such conditions and uncertainties. We strive to continually provide our clients every advantage available. Our firm's heritage is built on challenging industry consensus, and never being satisfied with popular or widely held views. We are grateful for our clients' trust.

Sincerely,

Randy Garcia
Chief Executive Officer

Important Disclosure Information

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by The Investment Counsel Company of Nevada ("ICC"), or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from ICC. Please remember to contact ICC, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. ICC is neither a law firm nor a certified public accounting firm and no portion of the commentary content should be construed as legal or accounting advice. A copy of the ICC's current written disclosure Brochure discussing our advisory services and fees continues to remain available upon request.