October 13, 2017

Dear Friends and Clients,

How does one write something that other people want to read? I'm sure it is a learned skill but I've never taken a writing course, all but flunked literature (dyslexia), and avoid the humanities like the plague. Our quarterly letters have always tried to educate with liberal doses of entertainment and humor. Dumbing things down sometimes improves edification but can make the story not worth finishing. Believe it or not, each of my letters is edited by staff and corrected by compliance. When you see broken English and poorly constructed sentences, they are there for effect.

I did take a two-hour class in salesmanship during my sophomore year; it was easily my favorite. Although turned off by what I viewed as a commoner's profession, I became fascinated by the skillsets and found that what I thought was a natural gift was actually a "learned" discipline. I have been studying salesmanship and behavioral science ever since and one thing is for certain, to succeed in changing a client's mind or delivering unwelcome information you have to be able to keep people's attention. So when I entered the working world and had to communicate for a living, I made the assumption that the skills I learned in my salesmanship course would apply in these venues as well. I started breaking my public speaking, writing, and research problems into manageable pieces. I've always hated run-on sentences, mono-tone dissertations, and legalese. Making things fun has always come second nature to me, so problems became opportunities and I relished each of them. The following are a few of the writer's tools I have picked up on in an effort to make things fun and keep your interest.

The rule of three…

A writing principle that suggests events or characters grouped in threes maximize the acceptance or engagement of readers. Elements of three are known as a triad, which is identified by the Latin phrase "omen trium perfectum" (everything that comes in threes is perfect).

> Three Little Pigs, Three Musketeers, Three Blind Mice….
> Life, Liberty and the Pursuit of Happiness
> Stop, Look and Listen…You get it.

So as I often find myself in pursuit of threes, trying to create a pleasing dialogue, along the way, strings of four seem to pop up…eenie, meenie, miney, moe. How about three nouns chasing a verb…one, two, buckle my shoe? And of course, there's the ever popular series of seven….Doc, Grumpy, Happy, Sleepy, Bashful, Sneezy, and Dopey. The alert reader will notice that these exceptions to the rule of three are presented in a triad.

Surprise and misdirection….

Everyone likes to be "hooked" by a mystery, head faked, or humorously deceived. Lots of times these sleight of hand events will cause the reader to retrace their footsteps, review the story, and allow the author's point to be driven home a little harder. Guess you could think of it as an increase in the educational component.

Comic relief and rhymin' Simon….

Poetry captures people's attention and jokes make us smile. While some poems have dimension and rhyme, others are free verse and Dylan-esque. I've tried both with varying degrees of success. Oddly enough, it takes a degree of courage to tell a joke. If you fail the audience will heckle you, and if you succeed the same group wants more….better have an inventory. Comedians lay eggs and bards stub their literary toes. If either group grows afraid of trying, our collective world becomes a duller place. I've tried rhymes, philippics, 12-bar blues, limericks, riddles, Sven & Ole's, knock-knocks, and the ever-popular socially marginal….I'm a fan of delivery as well as content.

Onamonapia….

I actually learned this one in an English class where my scores were middle of the pack….it's a Latin/Greek term describing words whose pronunciation imitates their sounds. The water balloon ***splattered***. She ***smacked*** her lips. The bacon ***sizzles***. Readers who like onamonapia would also like American Ninja, Dumb and Dumber, and The Gong Show. That's ok, there's a little slapstick in all of us.

Iambic pentameter….

During our Dean Witter years, I wrote my first poem for our Christmas card and cringed as it was mailed to our clients. It played to no comment with the exception of one of Dan's customers, a retired English teacher. She said, "Tell your partner he has perfect iambic pentameter." That sent me scurrying for the Daniel Webster (mid-'80s…no Google). Here's the definition: A line of verse with five metrical feet, each consisting of one short (or unstressed) syllable followed by one long (or stressed) syllable. I really liked this gal but she was an army of one attacking a culturally bankrupt and erstwhile poet. I wasn't about to enroll in a lit class and felt my adventure into iambic pentameter had already run its course.

So what happens when the subject matter is not funny?

This is a perpetual problem for a financial writer since all the numbers and graphs are impervious to chuckles. It's not easy to be the life of the party, and with subjects that often produce egg-on-the-face, it's an ongoing problem. You guys are not a lonely audience. I try out my material on the cable guy, deli butcher, cashiers…pretty much any stranger forced to deal with me. Sometimes I have to tell them, "that was a joke." I get the message pretty quickly; I'll the same gag a couple of tries and then give up when it continues to need an explanation.

New subject…..does this market need a correction?

Rewind to 2008 and you will find the origins of what has become known as the "Great Recession." It was more than a correction, it qualified as a roaring bear market using every imaginable definition. The S&P dropped from 1,293.37 to 676.53 in a little over a year…that's one of the nice things about bear markets, they don't last as long as the bulls. Since the beginning of their existence in the late 1900s, the Dow and S&P have moved across a graph from lower left to upper right. As the reader well knows, this price action does not occur in a straight line….it

tests our emotions. When all the industry groups correct at one time, the stage becomes set for a bear market and stocks move from weak hands to strong hands almost overnight.

We now know this event began with the bursting of an $8 trillion housing bubble, financed by subprime mortgages, which generated widespread defaults and sharp cutbacks in consumer spending. In order to maintain solvency, overextended investors were forced to sell everything with a bid that wasn't nailed down. In time-honored Wall Street tradition, the baby was thrown out with the bathwater. On 3/09/09 a bottom was put in. We didn't know that on 3/10, or for that matter for several months down the road. Eventually a few brave souls tested their mettle and decided the ice was thick enough to walk on. Part of the market's strength was the typical "wall of worry" it was forced to ascend. Between 3/09/09 and 7/07/11 the market rose 98.74%, a pretty convincing victory spanning a little less than two years.

Now the know-it-alls wanted a correction. So how deep a correction is required to satisfy these guys? That's hard to say, we hear almost every number between 10% and 20%, with some outliers asking for even more. According to DowTheory.com, a 16% drop in both the S&P and Dow over any timeframe qualifies as a full bear market and has preceded an economic recession (two negative quarters of GDP, a 1.5% rise in unemployment, and/or a significant slowdown in economic activity) 73% of the time since 1900. We think down 16% is a good number to use. The financial disaster of 2008 met this requirement as did the correction we are about to describe in 2011.

However, in an effort to prove they can't listen, the Street called for a correction after the 2009–2011 rally and then didn't like the one they got. Let's take a look at why this correction failed its beauty contest:

Calendar Year 2011

	Market Weight	High Price	Date	Low Price	Date	% Price Chg		Market Weight	High Price	Date	Low Price	Date	% Price Chg
Info Tech	22.4%	26.60	07/07/11	22.52	08/19/11	-15.34%	Industrials	10.9%	38.30	07/07/11	28.40	10/03/11	-25.85%
Telecom	1.9%	136.34	05/31/11	115.22	08/08/11	-15.49%	Materials	3.3%	40.91	04/05/11	28.53	10/03/11	-30.26%
Health Care	13.8%	36.42	05/18/11	29.96	08/10/11	-17.74%	Utilities	3.2%	33.89	07/07/11	32.82	10/03/11	-3.16%
Energy	5.7%	80.48	04/29/11	56.62	10/03/11	-29.65%	Consumer Staples	8.5%	32.42	05/19/11	28.35	08/10/11	-12.55%
Finance	14.5%	13.95	02/18/11	9.16	10/03/11	-34.33%	Consumer Discr	12.3%	41.62	07/07/11	33.84	10/03/11	-18.69%
Real Estate *	3.5%	244.05	07/07/11	186.86	10/03/11	-23.43%	S&P 500	100.0%	136.43	04/29/11	109.93	10/03/11	-19.42%

*real estate did not become an industry group until 8/17. We have used both ETFs and indexes as a resource to describe these price actions.

The correction satisfied the -16% criterion that we look for, but only seven of the 11 sectors generated a 16% loss. Info Tech did not generate a -16% loss and a correction seems a bit hollow without a good Info Tech bloodletting. Only 64% of the market weight of the S&P 500 experienced a 16% loss. Last but certainly not least, the correction occurred within a calendar year, during which the S&P actually posted a gain of 2.10%. Interestingly enough, there are pundits who have chosen to ignore the 2011 correction entirely and have continued to call for at least a 10% correction during 2017…go figure.

Lest I digress….does this market need a correction? As you can probably tell, we are of the opinion that the correction of 2011 fulfilled the profile and gave the market a decent "burp" after the 98.74% rally that began on 3/09/09. If you do not share that opinion then you are laboring under the impression that the market has rallied the aforementioned 98.74% plus the 88.11% it has earned between 07/07/11 and today, a total of 186.85%. Somewhere along the trail of all these numbers is a reiteration of the lesson that it pays to remain fully invested. Let's analyze the current market using some of the same tools employed to explore the 2011 correction. The setbacks incurred on an industry group basis look like this:

Rolling Corrections Since
Calendar Year 2011

	Market Weight	High Price	Date	Low Price	Date	% Price Chg		Market Weight	High Price	Date	Low Price	Date	% Price Chg
Info Tech	22.4%	43.67	07/20/15	37.70	08/25/15	-13.67%	Industrials	10.9%	58.16	02/20/16	48.04	01/25/16	-17.40%
Telecom	1.9%	167.01	07/29/14	139.55	08/25/15	-16.44%	Materials	3.3%	52.09	02//24/15	37.28	01/25/16	-28.43%
Health Care	13.8%	77.22	07/20/15	63.52	02/08/16	-17.74%	Utilities	3.2%	52.98	07/06/16	46.00	11/14/16	-13.17%
Energy	5.7%	101.29	06/23/14	51.77	01/20/16	-48.89%	Consumer Staples	8.5%	50.82	08/05/15	45.70	08/25/15	-10.07%
Finance	14.5%	20.77	07/22/15	15.96	02/11/16	-23.14%	Consumer Discr	12.3%	81.77	11/25/15	68.36	02/11/16	-16.40%
Real Estate	3.5%	325.45	01/24/15	260.10	02/11/16	-20.08%	S&P 500	100.0%	213.50	05/21/15	182.86	02/11/16	-14.35%

Remember, the definition we use asks for a 16% correction in both the Dow and the S&P over any timeframe. We are using only the S&P in these examples to keep from boring you to death. The S&P did well in 2012-2014, (32.39% & 13.69%) you could feel the track getting heavy in 2015 & 16. Our table lists the most significant corrections by industry group 2012- 2016, most of them started in 2015. Using the same metrics employed by the 2011 example, eight industry groups delivered corrections greater than 16%. Info Tech did not generate a 16% loss. This time 65.9% of the market weight of the S&P 500 experienced a 16% loss. Once again, the backdrop for this price action was pretty mediocre, 2015 was a 1.38% year for the S&P while 2016 weighed in at 11.96%, most of that in the final three months of the year thanks to the Trump rally.

We have always been advocates of the concept of a rolling correction. Cramer might say, "There's always a correction going on somewhere." When several industry groups correct at the same time you can expect a qualifying correction to be reflected in the major indexes. In the scenario at hand, a 14.35% correction in the S&P between 5/21/15 and 2/11/16 is as close as we got, the Dow posted -14.28% in the same period….close but no cigar!

So not only do we recognize the 2011 correction, we see a genuine rolling correction moving through the markets during 2015 and 2016. If you were trying to eke out a living in the materials or energy sector your world would certainly be in correction mode. Pricing power would be negative. Finance would have been rough (amen) and real estate a take no prisoners industry. I know I sound like a broken record (you do remember records don't you?), but one of the market's unsung functions is to move stocks from weak hands to strong hands. If you believe that happened in 2011 and again in 2015, then it goes a long way toward explaining why today's market continues to claw its way over the wall of worry making new highs on a regular basis. Does the rolling correction count? We think so, at a minimum it can't be ignored.

Can you read a racing form?

I have never been very good at handicapping thoroughbred racing, but like most kids growing up in Nebraska the races have always been part of the social scene. My buddies would skip school to catch a few races and several co-workers knew how to schedule client contacts at or near the State Fair Grounds during the season. I have a vivid recollection of driving to Omaha one Saturday to spend the day at Ak-Sar-Ben (Nebraska spelled backwards if you're unfamiliar). I sat through five or six races without cashing a ticket when I spotted a co-worker standing along the rail. Cody was employed by my bank's IT department and like most of his ilk was a heavy thinker with a muted personality. Turns out you just had to dig a little bit, he was a pretty experienced fellow and new his way around a race track much better than I did.

We started to talk and pretty soon the next race started….his horse won.
"How did you pick that one?" I asked.
"Just check her out in your racing form," was the reply.

Don't expect to cash too many pari-mutuel tickets without learning how to read the Daily Racing Form. Available today in a digital format for handheld devices and PDAs, this is a tool the rail birds have worshipped for years. It details past performances, purses, track conditions, split times, earnings, blood lines, jockeys….all you need to know and more. I have always drawn parallels between this database and the information we have access to concerning stocks and bonds.

I ended up buying Cody four beers while watching him win three of four races which I tagged along on. He had a method that I never did figure out because my friend squirmed and changed the conversation every time I got close. We got a little tighter during that encounter and I will never forget my last question. It had rained that week and the track was considered "heavy." The bloodlines of the horses was in the form somewhere but I couldn't find it. I tried to steer the conversation in that direction, trying to be clever without being too obvious.

"So if you knew this horse's muddah was a mudder, her fadduh was a mudder and her brudduh was mudder…aren't the chances good that she is a mudder?"

Cody looked at me pensively and I thought I was about to break the code…."did you know you have perfect iambic pentameter?"

Really Like?

The current bull market may or may not be stretched. One of the hallmarks of a market top is euphoria, we see little of that. Nineteenth hole and cocktail conversation is only lightly seasoned by the stock market….there is little advice coming from cabbies and construction workers. We have had no trouble remaining fully invested since 03/09/09, I would expect a top or bubble to cause clients to retreat….not really happening. As a result, our accounts have fared pretty well. We continue to Really Like equities but have made some concession to the age of the rally by reducing the number of stock positions we hold in favor of owning large, mid, and small cap ETFs. This is old news as we

started doing it in Q1, the strategy has worked pretty well for our accounts. We haven't changed any allocations but we reduced our single stock exposure and feel our portfolios will be a little less vulnerable during a correction.

Here comes the "spend some money" pitch. Have some fun (a request being repeated for about 2 years now). If you are planning a trip, take it, or at least fund it. If a lake or beach home is on your bucket list, start shopping. How about a nice RV? Maybe a cruise is in the offing or perhaps a new car? Move some assets from the investment category to the use category. Reduce your P&A management fee by spending some of that hard-earned. We are at all-time highs so philanthropy has never been cheaper…contributing to a donor-advised fund might just scratch the itch. Who knows, maybe this is our mojo, whenever we recommend spending money the market seems to trade higher.

One more thing, a client of ours recently shared a great article from the Wall Street Journal, which we have linked to here.* This is a repetition from our last letter but I thought it was a good exercise. As I read it, I felt like I was listening to myself. The author had some different ideas, is a pretty good writer, we thought he offered some validation of our point of view.

As Always,

James S. Pittenger, Jr,
Chairman/CEO
CFP®

Dan Anderson
President
CFP®

* - full link to the WSJ article is
http://pittand.com/v2/wp-content/uploads/2017/07/wsj.com-The-Mental-Mistakes-We-Make-With-Retirement-Spending.pdf