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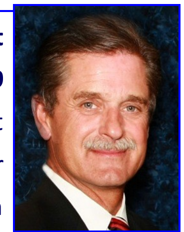
Scott's Thoughts —

INSIDE:



Scott Husband

If you bought the stock market in 1906, adjusted for inflation, it took **22 years to get your money back**. Within a year, 1929 happened and a 90% loss was suffered. **29 years later (1958)** you were even. Good returns were had until 1968 when the next bear market cut the value of your stocks in half. **24 years later**, you were back to your old highs of 1968. The Dot.com craze was in full force, lots of money was made in these "money years", but stocks were more than cut in half when the market busted. In 2014 (**14 years**), you were even once again. Our past 4 years have been the "money years". None of this accounts for capital gain or income taxes and interest you could have earned in the bad years. The point is, it takes nearly a generation to get even after a bull market. Most investors have no money **of consequence** until a generation is all we individually have left. This is the foundation of why, as we age, we desire less risk and more predictability.

Foundations, endowments, trusts, and the like aren't people so their investment time horizon can be much longer. However, for the rest of us, meeting the financial demands of aging while the value of our assets decline, is at best, very unpleasant. Naturally, our individual desire to maintain a life style in our retirement years is more compelling than any desire to "swing for the fence" and perhaps get rich (or not) overnight. This leads us to allocation. Waiting a generation to get even on your full equity exposure is not nearly as beneficial as having less stocks as they become expensive and the proceeds available (from the selling of stocks) when stocks decline. It's hard to do though. At its' core, all selling of stocks prior to a peak will cause you to under-perform. And every time you sell, you under-perform even more. There is no satisfaction in selling when all it seems to accomplish is lessening our gains. Those that make the most in a bull market sell nothing. But just as every bull market is followed by a bear market, all pigs are eventually slaughtered. It is hard to raise cash when the market is expensive, but what is difficult to do is normally the right thing to do.

Two years ago interest rates bottomed and bond prices peaked. Since early July of 2016, the Barclays Aggregate bond index has lost (net) 2.1%. Cash in your pocket did better than owning the bond index. CDs did the best. Normally rates are double what they are today. And I think rates are going higher. But on the other hand (Harry Truman wanted a one handed economist so he would never have to hear "on the other hand"), there is a concern. From FINSUM (June 20, 2018) "the strongest predictor of recession has just rung its bell. An inverted yield curve has predicted all six of the US recessions going back 60 years. And while all of investors' focus has been on whether the Treasury yield curve will invert, the global yield curve already has. The yield on the ICE Bank of America index of government bonds due in 7 to 10 years has already inverted, with such yields being lower than for 1 to 3 year bonds. While the US economy is currently looking strong, there is growing weakness in Europe, China, and emerging markets, which seems to have inverted the curve. The IMF says the clouds over the world's economy are "getting darker by the day". And analyst Gave (dated May 1, 2018) "The private sector yield curve reading stands at zero, or right on the threshold where trouble can be expected to begin," Gave wrote in a note published on Tuesday. "Should this spread move into negative territory, I would expect a financial accident to occur outside of the U.S., a U.S. recession, or possibly both." Either a U.S. recession has taken place within a year of the private sector yield curve inverting, or a "financial accident" has occurred in other economies with currency links to the greenback, according to Gave's data."

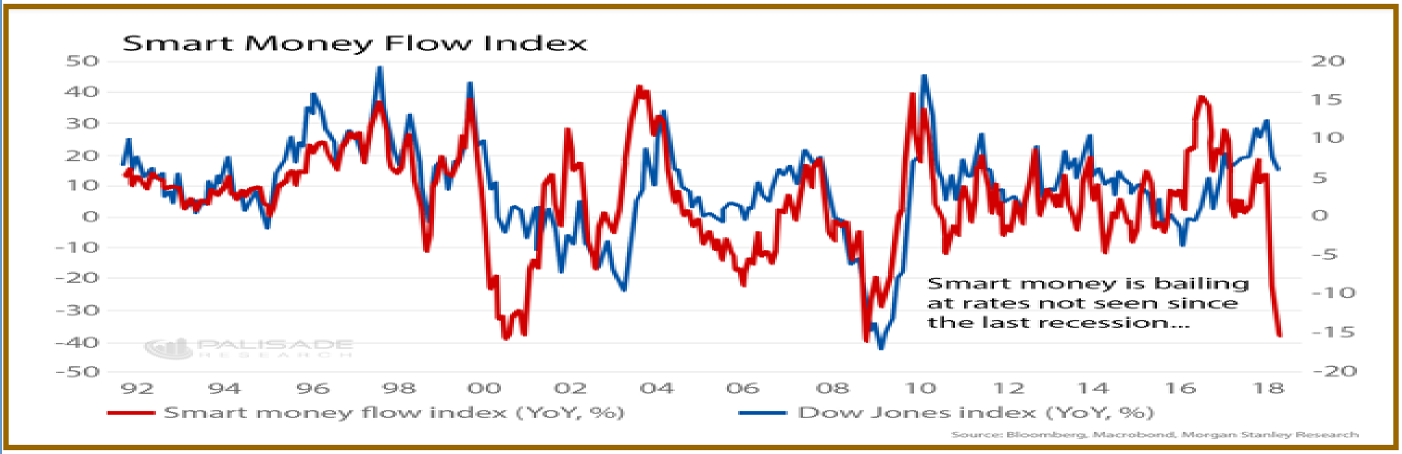
It should be noted, that while the yield curve has inverted every time prior to a recession, not every time the yield curve inverted has there been a recession. To throw a little more uncertainty into the mix, , the morning wire had this to say,

Scott's Thoughts (continued)

"…the fundamentals of the junk bond market are looking terrible….The junk bond market is now about twice the size it was in 2007, and credit quality is lower. Protections for investors, in the form of covenants, are also much weaker as issuers were able to use the ultra-low rate market to their advantage. Now the big worry is that Libor is rising and many companies have floating rate debt ($300 Trillion in total) that they cannot cover once it reaches certain levels." Debt going bad is wealth lost; a transfer of wealth from the investor to the borrower (who spent it). Bad debt is a very common component of the cause of market declines. And in the broad scheme of things, in the long run, no government has the funds to pay their promises; without inflating their currency. So the quantity of debt, the quality of debt, rising interest rates, a flattening yield curve, and impossible promises made, should not be ignored.

We are enjoying, with good reason, the second longest recovery, post WW2. GDP is actually expected to approach 4.5-5% in the near quarter. But it should be noted that if the Federal Government's borrowings are subtracted from the GDP, the economy is actually smaller today than 10 years ago. Record low unemployment is causing inflation worries. In fact inflation was recently announced to be 2.8%. The 1980 formula for inflation would state inflation is currently over 10%. The government regularly refigures what impacts the CPI because, being a little cynical, it is in the Government's best interest to understate inflation as so many entitlements are tied to the CPI number.

I found this chart to be rather interesting. I know what "smart money" is, but I do not know how they define "smart money". Perhaps it does not matter in that the chart seems to have been rather predictive.



To continue on with non-secular items, consider the following: "Leuthold investment firm stated on June 8, 2018 that over the past five years, without Tech companies the S&P is actually down about 10%, and if so, the market resembles the 5 years in front of the Dot.com peak where the average stock declined while Tech took the S&P index much higher. However he does note that the current market does not fully reflect the magnitude of the disparity of the Dot.com boom." So today's market is similar to the Dot.com bubble, but not quite there yet. Perhaps we will get "there". In the interim, I will carry on, continuing to do the hard thing, selling in a bull market, under-performing for having done so, and believing in what history has taught us. As Warren Buffet said last month, "Most people get excited by the market after it has gone up. They are enticed by the market at the wrong time". You might take your profits in the bull markets, but the opportunities are in the bear markets.

The economy is doing great, much better than nearly everyone thought was possible just 18 months ago. The unemployment numbers are fantastic, GDP growth is expected to double from what the average of this weak recovery had been. Optimism is the highest in decades and stock investors are happy. Bottom line, the headlines are great and except for some of the fine print and domestic political discord, there seems to be no reason for concern. And perhaps there isn't, but the same was true in late 1999 (Dot.com) and early 2007 (Great Recession).

Enjoy your summer. My project this year is to paint the house with this last week being a hunt for halibut in the Prince William Sound. Thank you all.