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From the Curb

Letter to Clients

Quarter Ending June 30, 2018

Following an extended period of low volatility, its reappearance is center stage. Typical dictionary definitions for volatility include the following: “tending to fluctuate sharply and regularly; liability to change rapidly and unpredictably, especially for the worse”. Investment professionals have numerous sophisticated measures of volatility, but the r eality is that the concept rises to prominence in the press more when market volatility is perceived to lead to an increase in downside risk for investors. In 2017, the major stock indices moved in one direction, up, and, the markets avoided even a 5% correction during the year. In fact, the S&P500 had eight 1% moves in 2017 yet has already experienced at least twenty-eight 1% moves and traded down by more than 10% in early February resulting in a very different trading environment for 2018.

The recent increase and interest in volatility is fueled by what markets dread most – uncertainty. Although the economy and corporate profits are robust, the reality is offset by changing policies that impact a number of the fundamental underpinnings supporting the health of global companies. The Federal Reserve has given a clear indication of higher interest rates but fears linger concerning the potential for too much, too soon. Currently, trade war discussions seem to be more about political bluster and less about policy; the possibility is certainly there for a serious misstep that would cause shocks throughout the global economy. Stock market performance has been driven by a small handful of companies, largely from the technology sector. Should their performance stagger or stumble, the overall climb of major indices may stall. So, what started out on a hopeful note has quickly turned into a year defined by uncertainty.

As advisors, we consider our disciplined approach to portfolio management, with a focus on asset allocation, fundamental in addressing market volatility. Several academic studies suggest that over 90% of returns achieved by investors are based upon the allocation of money among the investment of stocks, bonds and cash or cash equivalents. Without question, asset allocation is one of the most important inputs into the portfolio construction process.

As clients, you have shared your financial objectives and your tolerance for risk and we have constructed a portfolio for the long-term that aligns with a return necessary to help you achieve those goals. Portfolio management is a fluid process and the asset allocation will shift to take into consideration changes in your needs, the relative valuation between

741 Chestnut Street, Manchester, New Hampshire 03104 603-624-8462 FAX: 603-624-8274

the major asset classes, along with cyclical and secular trends in specific areas of the markets. Changes to policy that might impact the economic well-being of the US and global economies also come into play.

Presently, we have slightly reduced our exposure to the stock market due to a higher degree of uncertainty that has been created by unsuccessful trade negotiations and the introduction of trade tariffs. Harvesting gains is a regular and timely activity and helps maintain an appropriate exposure to risk assets. We continue to favor short to intermediate term bonds and/or high quality, short duration bond funds in the face of rising interest rates. A positive side effect will likely be an increase in current income from both higher money market fund and bond yields.

Although we pay attention to short-term market action, we do not over react to these shifts. We structure broadly diversified portfolios based on your goals and our strategy thus limiting undue exposure to any one asset class or individual asset. While volatility is inherent in the markets, asset allocation is intended to temper the impact of both upside and downside market moves. It is a long-term strategy which, through historical market cycles, has typically achieved the desired results.

Earnings season is set to begin the second week of July and will likely provide a clue as to the short-term direction for the markets. If we hear a consistent message of concern from corporate leadership about the impact of trade discussions and the potential for a trade war, sentiment may shift meaningfully toward caution. If earnings are robust and concerns are minimal moving forward, the view will be more optimistic. Either way, our disciplined approach to investment management and asset allocation will adjust to reflect current conditions.

We appreciate the opportunity to serve as your investment advisor. We wish you a safe and enjoyable summer season!