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the Lonely Bull

October 2017 | *a market **perspective** by Riverplace Capital* | Number 77

THIRD QUARTER

ONE MORE FOR THE RECORD BOOKS

Over forty new highs have been recorded this year and hopefully there will be many more. This past quarter was a good one which is remarkable considering that the third quarter of the calendar year has historically been a difficult one. Many past corrections or even crashes started in September and culminated in lows during October, but not this year.

Part of the reason for the excellent performance for U.S. stocks this past quarter was the excellent earnings growth so many firms are posting. **Earnings growth for the S&P 500 was over 10% for the second quarter over the same period the previous year**. The third quarter earnings that will be reported over the next month should show similar results.

As Riverplace Capital has stated many times before, earnings drive equity values more than any other factor. That is one reason in spite of a tumultuous political and geopolitical environment, stocks did so well. In fact, this period has been one of the most placid periods for stock market volatility; who would have thought?

Bonds over this period have been much more reactive to the news cycle and geopolitical worries. Even though the Federal Reserve has clearly signaled that they will continue to raise short-term interest rates, longer dated bonds rallied as some investors seeking a safe-haven bought these. Also, U.S. rates, compared to many international ones, are much higher and still attract international money flows. This will, of course, eventually change, but bonds, for the time being, still trade at very high valuations and historically low interest rates.

With stock market volatility so low there is only one way to go and that is higher, at least at some point. Money flows into stocks have waxed and waned throughout the year, but recently show signs of positive increases. Stocks and bonds can go higher without an avalanche of new money coming in, but nothing works better than more money chasing the same issues. We track these flows to give us indicators of risk and opportunity. We also track these flows on a stock by stock basis.

So, what now? The geopolitical risks may be increasing. For instance, our standoff with North Korea over their nuclear program is disconcerting. We hope for a peaceful resolution, but there may not be one. Such an event or unforeseen others can certainly derail stock market trends. **However, if investments represent true value, then over time those values will prove to be enduring**. **That is exactly how we build portfolios.**

> *"Success in investing doesn't correlate with I.Q. once you're above the level of 25. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble investing."*
>
> ***- Warren Buffet***

TALK WITH US

If you do not like change, you are not going to like the future. Think of all the change humanity observed throughout the twentieth century. Can you even imagine what the new century will bring? Change is accelerating! Technology is the biggest driver, but customs and tastes also evolve and from time to time make dramatic shifts. And remember, all change is not manmade; nature periodically dictates minor or major upheavals.

Business reflects all of this. Investing involves looking for opportunity in this fast-paced environment. The fundamentals of business are pretty durable. Companies need to offer products and services to the market and make a profit. Good businesses grow, bad ones' wither. However, where to find those opportunities changes all the time.

Another fact is that as change has accelerated, a business model may not last as long as in the past. As examples there are department stores, malls, and big box "category killer" stores that now seem quaint; certainly not great investments anymore. The smart phone only became popular a decade ago, but will it still be important a decade from now? Cable television is being overtaken by streaming services and landline telephones are disappearing.

Did you know that trucking is about to undergo upheaval? Instead of trucking companies contracting to move freight, increasingly independent truckers can individually bid for loads through an "Uber" type system. This new approach allows companies needing goods transported to list a load online and at the same time a trucker can bid to offer his services; a type of auction market; cutting out the middleman. So, are trucking companies good investments? There are increasingly more examples like this.

One of the potential biggest drivers of change, that is already here and not yet well understood, is artificial intelligence (AI). Think how the computer changed our world. Multiply that many fold for AI. This will drive opportunity as well as risk. We love the intellectual challenge of investing in such a dynamic environment. Someday soon Riverplace Capital may be using AI tools to enhance our efforts too. If you would like to work with a firm invested in the future and dedicated to performing in an increasingly dynamic future, ***Talk with Us.***

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ECONOMY

So far so good; the U.S. economy continues to expand. In fact, it may be modestly accelerating. This is good news for jobs, wages, profits, and investments. We have hoped this would be the case for some time. If tax reform has a chance of enactment, that could be a further stimulant for still greater growth. Reducing regulations also helps, as well as initiatives such as increased infrastructure spending. However, what has been remarkable is the steady economic growth over the past nine years.

Nine years is a long expansion period. This leads some investors to be wary that this may soon come to an end. **However, time is not what kills expansions; it is the overheating and imbalances that need to be corrected.** The corrections are either natural or induced through policy. That is not the case so far, so there is no need to over-analyze this.

The U.S. expansion is supported by like expansions among our major international trading partners. Europe is several years behind us, but now expanding nicely. Japan has shaken off a recession and looks much healthier. South America is turning around, so we have reinforcement for our own growth. Yes, there are weak spots, but there always are. Economies constantly change so do winners and losers. The overall trends are still good.

EQUITIES

With a steadily growing economy reinforced by international trends, there is every reason to stay positive for business investment. Growth provides opportunity for increasing profits and the creation of value. In short, we are optimistic for positive returns on these investments. The last few years have been outstanding; far better than most analysts forecasted. The advance of future returns may not be as lucrative, but should still be attractive given the alternatives available.

International equities are also advancing. In some cases, there may be more upside potential in some of these because they may be in markets earlier in their recoveries from their own financial crises. Here individual analysis is crucial. We include some of these opportunities in our portfolios.

FIXED INCOME

The one area that may be entering a new bear market or long-term downtrend is the fixed income arena. Interest rates are rising, if only in an irregular fashion. They will be rising for years to come. This means that bonds are not the safe-haven many think they are. Indeed, there is more risk than reward in most cases.

Inflation has been very low for an extended period, but that is not permanent. Pressures are mounting for higher rates. Wages are finally increasing, commodities are rising in price, and demand is pulling at supply; inflation will rise and inevitably interest rates. **Even without higher inflation rates, interest rates are structurally too low.** Except for positive international money flows into our fixed income market, rates would already be higher reflecting a healthy economy.

INVESTMENT STRATEGY

EQUITIES

Even though the stock market has been exceedingly calm as viewed by the popular averages, there is much change going on under the surface. Groups and sectors come in and out of favor. That is happening now as many large growth stocks have reached high valuations and offer little future value. These may be going into prolonged corrections while better value stocks come to the fore.

Until recently, the stock market advance was dominated by a narrow group of outstanding large growth companies. That may now be changing. A much broader list of companies is now catching the attention of investors. There is significant value among many of these that is now being recognized. We are invested in many of these and continue to seek out exceptional value wherever we can find it. **Value stocks appear to be taking the investment lead from growth issues**. We are already there.

FIXED INCOME

With interest rates inexorably rising, fixed income management has no choice except to keep maturities short. To commit to long-term rates when they are at historic lows is foolish at best. As rates rise, we can find value in some short to intermediate issues. We are looking.

WEALTH MANAGEMENT

There is now a broadening out of returns from a narrow large-cap growth orientation to other sectors. Mid-sized and smaller companies, in many cases, offer more value and potential. We expect good returns from international markets too. We are adjusting sector weightings to accommodate these trends.

MAJOR INDICES

as of 9/30/2017

Large Cap Stocks (S&P 500)	12.5%
Dow Jones Industrial Average	13.4%
Mid Cap Stocks (S&P 400)	8.15%
NASDAQ Composite	20.7%
Small Cap Stocks (Russell 2000)	9.9%
MSCI EAFE	17.21%
Barclay Aggregated Credit Index	5.27%
Inflation	1.9%

Equity indices are nine-month returns excluding dividends.

NOTICES

Check out our website *www.riverplacecapital.com*. It offers a lot more information including a blog with weekly insights. Also, follow *Riverplace Capital Mgmt., Inc.* on Facebook.

Riverplace Capital offers our clients free financial planning. We believe strongly in the value of planning as it helps document goals and objectives, and provides a benchmark to measure progress. Planning helps us provide better, more targeted financial service to you. If you would like a financial plan, contact your portfolio manager at (904) 346-3460

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