Dear Clients and Friends,

October saw a return of volatility to risk markets with the S&P 500 down by 6.9% for the month. Interestingly, the U.S. fixed income market did not provide any safety as it posted a loss of 0.6% (as measured by the Bloomberg Barclays US Aggregate Bond Index).

Corrections never feel good, but they are a normal part of market behavior and rarely evolve into a major bear market. Since 1980 the average intra-year decline in the S&P 500 has been 14%, slightly greater than the 11% decline from high to low in September-October and the 12% decline in January-February of this year. We firmly believe that equities will continue to provide the best intermediate- to long-term gains in spite of regularly occurring, emotion-inducing short-term declines. Over the last 100 years (a period which included the Great Depression, the Great Recession, 9/11, and multiple wars), the U.S. stock market generated an average total annual return of 10% and there were only four rolling 10-year periods that showed a negative return. We expect the future will be similar.

Future returns are closely correlated with starting valuation levels so corrections can serve to set the stage for healthy recoveries. With the recent pullback, the S&P 500 is currently trading at only 15.3 times estimated 2019 earnings and was at only 14.6 times at the low earlier this week. Those multiples are among the lowest since 2014 yet they are occurring at a time of strong expected earnings growth. We find it interesting to note that six weeks into a market correction, consensus earnings estimates for next year and the balance of this year have remained very stable and consumer confidence just hit a 19-year high (as reported by the Conference Board).

As we highlighted in our recent quarterly letters, the markets have been facing a growing set of cyclical headwinds with increasing global monetary tightening, trade frictions, and mid-term election uncertainty among the most significant. We had been positioning portfolios more defensively (where practical in light of tax implications) since midyear with an increased emphasis on value versus growth and on less cyclical, higher yielding stocks and sectors. Although those headwinds remain, we feel that the market has more appropriately discounted those risks at current valuation levels and may begin adding a little more risk back to portfolios.

As always, we welcome your comments and questions. Please don't hesitate to call, visit or email at any time.

Scott, Brett, & Dave

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