



September 21, 2018

Running a few days behind on being focused enough to write after Hurricane Florence blew through the area. We on the North Banks were spared most of the storm's wrath. We have flooding in the sounds and schools were closed for over a week, but we're largely intact and counting our blessings. Just heard that Ocracoke is cut off from Hatteras due to damage to Highway 12- hope that situation gets repaired quickly. (Consider visiting Ocracoke via the Swan Quarter ferry in the meantime-sure the O' Cockers would love to see you!) Southeastern NC is quite another story and is going to be disrupted for a while.

**Snapshot:** The second quarter of 2018 was a largely positive quarter for our investments. The star of the show has been excellent corporate earnings, especially in several secular growth areas (video games, certain technology companies, companies leveraging the Cloud, marijuana- as opposed to the marijuana cloud, har-de-har-har). Some of these stocks have had major multi-year advances and we've been fortunate enough to be riding along with a few of them.

The hallmark of the 2018 market has been rolling bull and some shallow rolling bear markets in different US economic sectors. There has been good breadth in the market, meaning that more stocks are gaining than are declining and that many sectors are participating in the advance. This has tended to reward good portfolio diversification and, especially, ownership of well-run companies in a variety of sectors.

Thus far the underperformers in 2018 have been long Treasury bonds due to rising interest rates, companies with embedded execution problems or dwindling outlooks, and emerging international markets, especially those with exposure to the Chinese market.

**Trade War?** Trade war jawboning has hurt the Chinese stock market, causing it to teeter on the verge of an intermediate-term bear market. 45's methods are certainly unorthodox, but a consensus has formed among corporate leaders and the investment community that the US needed to act to stop China's rampant intellectual property theft.

As an interesting side note, there appears to have been a huge sell program working against the Chinese financial markets the last few months, causing me to wonder out loud if Treasury Secretary Mnuchin is using the US balance sheet to sell Chinese securities. A savvy Goldman Sachs alum would probably know how to do that in whatever size deemed necessary. Disclosure-As readers know, Goldman Sachs (GS) is one of our largest positions.

Additionally, China does not have the same rule of law as the US and Chinese accounting standards are not as rigorous as US GAAP accounting rules, making ownership of Chinese equities an investment exercise confined to those willing to accept the enhanced risks. We have stayed away from Chinese stocks except for ownership of an emerging markets international index that is a core holding in most client portfolios.

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Trade tariffs have affected certain sectors of the US market- namely autos, appliances, stocks tied to commodity production, and select currency and commodity markets-soybeans are in the crosshairs, for example- but the scope of tariffs could change in 280 characters or less. Consumer products stalwart Procter and Gamble warned this morning that tariffs may cause price increases in its product line.

### Support and Resistance-



The above charts of the SPDR S&P 500 Index ETF show two-year (left) and five-year (right) time frames. The charts feature 10 and 40 period simple moving averages, volume bars, and a basic relative strength (RSI) study, and I added a black line in the upper right of the chart to show price movement versus the late January highs.

Folks, this is what a bull market looks like. In the left chart we can see the multi-year advance culminating with the January highs and the subsequent consolidation before returning to make new highs. In the right chart we see that the volatility of February and March 2018 was just chance to return to and retest longer-term uptrend lines. The five-year chart certainly helps put temporary drama into perspective and serves to remind us of longer-term objectives of sensible capital appreciation.



The charts above track the long-dated US Treasury Bond price with simple moving averages, volume bars, and my two black trend lines added. The long US treasury bond is one of the most interest rate sensitive of all bonds. As such, it is a good security to track interest rate moves in real time. This bond ETF will sell off as interest rates go higher, and indeed the security's price action reflects that. Sellers continue to have the upper hand in this market as interest rates tick higher from historic lows. As the left chart shows the TLT is at the bottom of its one-year range, while the right five-year time frame chart shows the TLT is nearing a 20% drop from its 2015 price highs. The ten-year Treasury bond is currently yielding 3.07%, and thirty-year fixed mortgage rates are in the 4.75-4.95% range.

### **On My Radar-**

Wanted to circle back to two stocks I highlighted in my last newsletter- Dominion Resources (D) and Johnson and Johnson (JNJ). Both have rebounded from the price levels they were at when I mentioned them as likely oversold- Dominion is up to \$70.96 from \$62.60 and Johnson and Johnson trades today at \$142.73 up from \$124.75.

Since we last convened we've added to our Nike (NKE), Johnson and Johnson (JNJ), Take Two Interactive Software (TTWO), Apple (AAPL), TD Ameritrade (AMTD), Facebook (FB), and Goldman Sachs (GS) holdings. We lightened up on long-time portfolio holding Altria (MO).

### **A Note on Partisanship-**

It's interesting interacting with clients and other investment managers on an ongoing basis. In the past few months I've heard from many clients regarding the state of things in Washington. The viewpoints have spanned a spectrum. Some notes have been largely calm and rational and others have been more emotional and intense.

I appreciate the ongoing dialogue. As you all know, I have my own, fairly public, feelings about leadership in our country, but I also recognize that economic dogma and capital appreciation are two very different things. Trying to build a portfolio to capture one economic scenario and then say "I told you so" is a sucker's game. We're long-term investors fortunate enough to be enjoying one of the longest bull markets in history. Let's not talk ourselves out of it. Now go vote!

### **A Note on Taxes-**

The 2017 Tax Cuts and Jobs Act (TCJA) has made significant changes to tax policy. Tax rates, standard deductions, capital gains rates, itemized deductions- all have been affected. Now is a good time to review your 2018 tax picture while there's still time to consider tax-planning options.

### **TCJA Resource Links:**

Investopedia has compiled a handy summary of the 2017 TCJA- <https://goo.gl/wgnpKB>

Here's a Motley Fool piece on capital gains rates under the TCJA- <https://goo.gl/KKZZkc>

TCJA Self-Employed and Entity Tax Changes from Inc.com- <https://goo.gl/Ag7CLz>

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