GAMBLE JONES | CAPITAL MANAGEMENT
A Division of Gamble Jones Investment Counsel

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Throughout the first half of 2019, investors have been inundated with news about trade wars, government shutdowns, and Iran-US tensions. Despite these many anxious moments, the market has continued to climb the proverbial "wall of worry." Many different factors are likely responsible for this recent climb; however, in our view the most significant one appears to be changing monetary policy expectations, both domestically and globally. Global central banks have backed off their calls for tighter monetary policy and have instead adopted a more dovish outlook. The shift is a key driver of the exacerbated price movement of the US equity market seen in Q4 2018 and the first half of 2019.

As recently as December of 2018, the Federal Reserve hiked its benchmark interest rate to 2.25-2.5% and signaled for at least 2 rate hikes in 2019. This hawkish stance on the heels of 4 rate hikes in 2018 led to a precipitous decline in the US equity market during Q4 2018, as many feared that higher rates would send the economy into a rapid slowdown and possible recession. During the beginning of 2019, Federal Reserve Chairman Jerome Powell signaled a change of course regarding monetary policy as he conveyed during a speech that the Fed would remain patient with future rate increases. This sparked the significant move higher in the US equity market that we have seen year-to-date. During its latest meeting in June 2019, the Federal Reserve capped off a complete U-turn in monetary policy, signaling a strong chance for at least one rate cut in 2019. Many market participants believe the Fed will be forced to cut rates up to 3 times before the end of 2019. This dramatic change appears to signal that easy monetary policy and low interest rates are likely here to stay for the foreseeable future.

Accommodative monetary policy is not unique to the United States, as central banks across the world attempt to fight deflation and stimulate their economies. As of June 2019, over $13 trillion of global government debt is negative yielding. Rising debt loads and an aging demographic are likely to continue to spur more radical monetary policy. While global equity markets have been rejoicing over easy monetary policy, we remain concerned about the longer-term ramifications. The low interest rate environment penalizes savers hoping to generate income on their assets and forces them into riskier assets in search of a higher return. As investors reach for return, the excess risk they take on may expose them to greater harm during any unexpected turbulence in the market. Interest rates also serve as a hurdle rate when making a potential investment and a way to price risk. With rates near zero, heavily indebted and inferior companies are able to survive longer while depleting the productivity of healthy companies by competing with them for capital, materials, and labor. Valuations of risk assets, such as stocks, are based on risk free rates such as the interest rate on US Treasuries. As rates approach zero, asset values become distorted and price movement is less correlated with actual business fundamentals. Policies being utilized by global central banks are historically unprecedented, making it difficult to predict what the future may bring.

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A reader may be asking themselves what he or she can do in today's environment. We have outlined a handful of important steps:

1. Review your investment goals and objectives, time horizon, and tolerance for market volatility. One's financial picture and priorities can change over the years. It is best to optimize your asset allocation accordingly.
2. Stay diversified across multiple asset classes and securities. Diversification amongst uncorrelated asset classes can provide downside protection during market corrections.
3. Own quality assets. For example, we seek companies that have strong competitive advantages, strong balance sheets, and generate a lot of cash.
4. Allocate to riskier assets only when you are being properly compensated to take on the additional risk.
5. Temper return expectations going forward. Over the last decade, the US stock market's average annual percentage return has been in the double-digits, significantly above its historical high-single-digit average annual return. This recent trend is not likely to continue forever, and returns over the next decade are likely to be more modest. In fact, some large institutional investors are forecasting mid-single-digit returns over the next ten years.

If you have questions on any of these above-mentioned steps and how they can be incorporated into your financial plan, please feel free to give us a call. A member of our team would be happy to help. We take pride in working with our clients to help them achieve their financial goals, regardless of the macroeconomic environment.

Sincerely,

Alison Gamble, President
Gamble Jones Capital Management