LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

After a year of unusually low volatility in the stock market, a shift may have occurred. The first quarter witnessed rapid price rises and falls, with the S&P 500 ending up 1% lower than the start. Stock prices have been rising for long enough that the pain of the last bear market is a distant memory, and perhaps not a memory at all for some younger 401(k) owners. Later in this newsletter we hope to remind everyone of the emotional responses to typical market cycles, so that you can recognize them and be prepared.

The Economy

The Federal Reserve embarked upon an apparent change in philosophy and policy coincident with Jerome Powell becoming chairman. The days of monetary support for the economy by the Fed appear to be numbered as the central bank unwinds the inventory of Treasury Bonds they accumulated during the massive Quantitative Easing experiment earlier this decade. A policy of accelerated interest rate increases has also been advertised.

Some of the monetary stimulus will be replaced by excessive government spending, financed by more borrowing and more debt. This raises the question, if the Fed is unloading bond holdings and the Treasury needs to issue even more, where will the buyers come from? The assumption is it will be domestic and international investors, as it has been in the past, but interest rates may need to rise further to counter a supply / demand imbalance. The higher rates from this effect, as well as the Fed raising short-term rates will likely put a damper on economic expansion.

For now though, the economy remains strong relative to the lethargy of late 2015 and 2016. GDP grew 2.9% in the 4th quarter of last year. Employment is strong. Leading economic indicators and housing prices continue to gain. There is no hint of recession yet.

The Markets

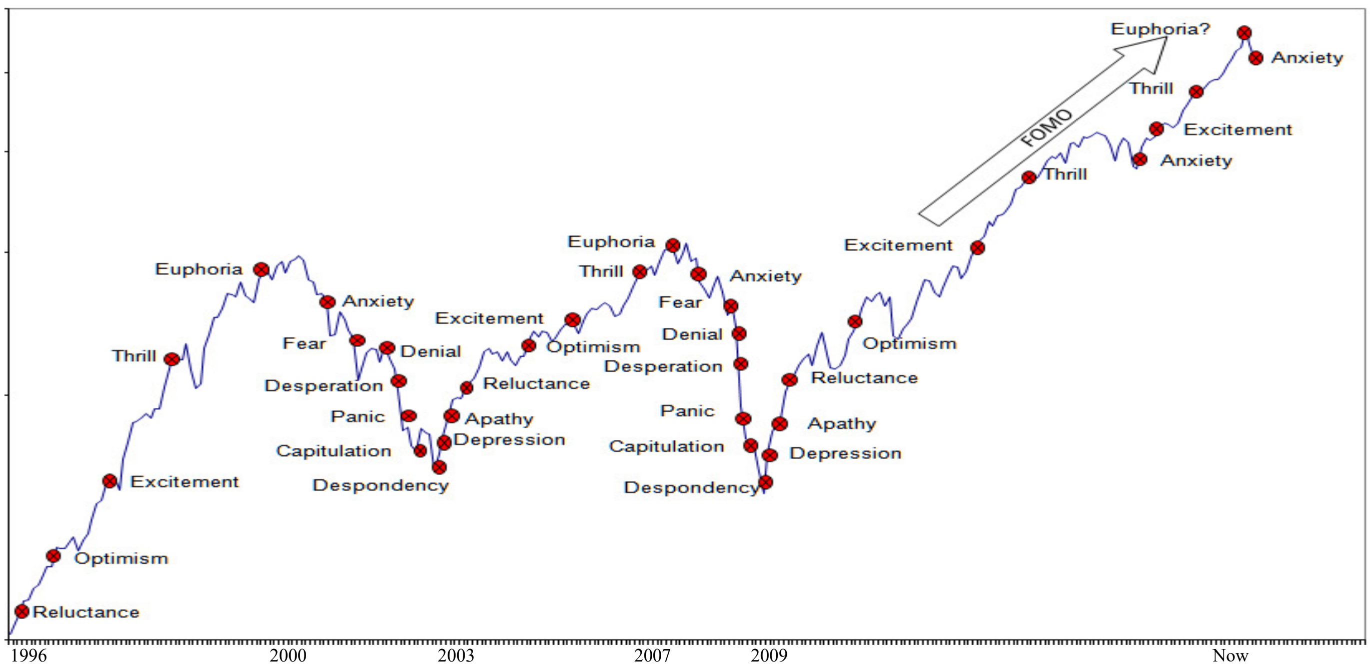
The stock market ran up sharply in January for no good reason other than excitement about tax cuts, and then fell back even more rapidly in early February. Prices are currently near the February lows after a bumpy stretch in March. These kinds of bumps are characteristic of a market that has no strong trend. This would be in keeping with the historical performance in the 2nd and 3rd quarters of the second term of a presidential term. This has historically been the weakest two quarter stretch of the four year period with an average loss of 1% since 1900. It is probably safe to say that, at current valuation levels, the stock market is trading on investor emotions rather than fundamentals, suggesting that it will continue to be positive so long as the collective psyche of the crowd remains undisturbed.

Markets and Emotions

Over the long-term, investment values are driven by fundamentals. As the time frame gets shorter, investor emotions have an increasing effect. Humans are wired to respond to emotion. The stronger the emotion, the more urgently we feel a need to take action. The motivational strength of emotion is strongest at the peaks and troughs of market price cycles. As prices rise, "FOMO", the Fear Of Missing Out, continues to build. As prices fall, fear of loss and panic become ever stronger. This makes buying near the top and selling near the bottom difficult to resist. Emotions are further amplified by risk exposure. If an investor is over-exposed, above a risk level that is comfortable, emotions become even stronger as the stakes get higher, causing decisions and actions to more likely be error-prone.

Typically investors experience a wide range of feelings during a market cycle. These emotions drive both individual decision making and collectively dictate the character of the market as a whole. They are usually described as:

<u>Reluctance</u>. I don't know if I should risk my savings in the stock market. But how else will I have enough money to retire?
<u>Optimism</u>. Things are looking pretty good. I think I'll increase my 401(k) contribution.
<u>Excitement</u>. Hey, this is a good way to increase my savings, and I don't even have to work for it.
<u>Thrill</u>. This investing thing is even better than I thought. I am in it for the long-term.
<u>Euphoria</u>. Nothing can stop my portfolio gains. Maybe I'll quit my day job.
<u>Anxiety</u>. Uh-oh! What happened to the gains? Is something changing?
<u>Fear</u>. What if this drop continues? I'll lose all my gains and maybe more.
<u>Denial</u>. This is just a correction. I'll sell when I get back to even.
<u>Desperation</u>. This is worse than I thought. It doesn't look like I'll recover my gains. I might even lose principal.
<u>Panic</u>. What can I do? My 401(k) is a 201(k) now.
<u>Capitulation.</u> I can't take this anymore. I'm out of here.
<u>Despondency</u>. This stock market thing doesn't work. How will I ever save enough to retire?
<u>Depression.</u> This rally is another trick. I'm back where I was years ago. What a mistake. What was I thinking?
<u>Apathy</u>. I don't have the time or energy to think about my finances, especially to read my 401(k) statement.
<u>Reluctance</u>. The cycle starts again. My retirement doesn't look so good. Should I risk my savings again?



Recognizing these feelings in advance can allow you to prepare so that you are not overwhelmed and motivated to make a wrong decision when the time comes. You have several choices. If you subscribe to the buy-and-hold strategy, you can steel yourself to be sufficiently dispassionate or make sure your asset allocation is sufficiently conservative to not be overwhelmed at cyclical valleys and peaks. Having a good and updated financial plan can help with this assurance. Alternatively, you can take an active approach, learn to recognize the state of the market, and plan in advance the actions that you will take when the conditions arise. Lastly, you can work with an advisor to manage the risk for you or to act as a sounding board.

If you would like help unemotionally navigating the markets, looking into your financial future, evaluating your risks, managing your investments, or planning to manage your income effectively, please call or e-mail.

Dave
David C. Linnard, MBA, CFP®
President

Barby
Barbara V. Linnard
Vice President

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.
46 CHESTER ROAD
BOXBOROUGH, MA 01719

LFMP@LINNARDFINANCIAL.COM
WWW. LINNARDFINANCIAL.COM
978-266-2958

A Registered Investment Advisor and NAPFA-Registered Financial Advisor