

March 2019 Client/Prospect Letter

Topics for this month:

Buffett (Warren)

Market Recap

Personal Note

March is Warren Buffett month

It's common practice for the president or CEO of a company to include a letter to shareholders in the annual report. Berkshire Hathaway's chairman and CEO, Warren Buffett, is famous for many things, but his annual letter to shareholders is an event many investors anticipate most eagerly.

This year's letter (<http://www.berkshirehathaway.com/letters/2018ltr.pdf>) captures plenty of attention. The focus is on the investments and operating performance of Berkshire Hathaway, but the Oracle of Omaha also includes many sound principles for wealth creation as well as his general thoughts about the U.S. economy.

Buffett's record

From 1965-2018, the market value of Berkshire Hathaway has posted a compounded annual gain of 20.5%, more than double the S&P 500's advance, which averaged 9.5%, including reinvested dividends.

There are two things that pop out here. First, Buffett's enviable record and his ability to create long-term wealth using time-tested principles. Second, the S&P 500's record illustrates that a well-diversified stock portfolio has been a critical component of a long-term financial plan.

In case you're wondering, Berkshire Hathaway's overall gain has been 2,472,627% vs. the S&P 500's still-impressive 15,019%.

One more data point – Buffet continues to perform well, topping the S&P 500 Index in eight of the last 11 years.

Focus on the forest-not the trees

Your financial plan is comprised of many parts. This would equate to what Buffett calls the "economic trees." In other words, let's not get caught up on any one investment.

"A few of our trees are diseased and unlikely to be around a decade from now. Many others, though, are destined to grow in size and beauty," Buffett writes.

He won't get every investment right. Neither will we. Berkshire holds a substantial position in Kraft Heinz (KHC), whose shares recently tumbled after the company delivered poor results and slashed its dividend.

But, if we review the portfolio as we'd view the forest, we find a diversity of trees, wildlife, and plants. It's a work of beauty. Your portfolio is the same. Like the forest it's very diversified, and it is created with your financial goals in mind.

As Buffett opines (and we agree – see my January letter), “I have no idea as to how stocks will behave next week or next year. Predictions of that sort have never been a part of our activities.”

That said, how did the 19.8% drop in the S&P 500 Index (September peak to Dec 24th trough) sit with you? With your input, we do our best to gauge your tolerance for risk. If you found yourself fretting a lot over the volatility, let's talk and recheck your risk appetite.

On the other hand, if you slept soundly, it would suggest your investment mix in relation to risk is on target.

“At Berkshire, the whole is greater—considerably greater—than the sum of the parts.” We feel the same way about your financial plan.

The American tailwind

Warren Buffett is bullish on America.

In 1942, he invested \$114.75 in three shares of Cities Service preferred stock. At the time, the country was mobilizing for what would be a massive war effort.

If Buffett had invested his \$114.75 into a no-fee S&P 500 index fund, and all dividends had been reinvested, his stake would have grown to \$606,811 (pre-taxes) on January 31, 2019 (the latest data available before the printing of his letter).

The U.S. was victorious in WWII, but challenges never cease.

We've endured the cold war, the divisiveness of the 1960s, OPEC's oil embargo, double-digit inflation, soaring interest rates, a rising federal deficit, the tragedy of 9-11, the war on terrorism, the financial panic of 2008, the ensuing Great Recession, falling home prices, and more.

Let's say that you had had the foresight to see the oncoming explosion in the federal deficit, one that is up 40,000% over the last 77 years.

“To ‘protect’ yourself,” Buffett said, “You might have eschewed stocks and opted instead to buy three ounces of gold with your \$114.75. And what would that supposed protection have

delivered? You would now have an asset worth about \$4,200.” Compare that to the performance of the S&P 500 and you see that stocks did 144 times better!

What is this nation’s secret sauce? The answer is complex and difficult; yet, the overarching theme lies in front of us.

The experiment called the United States has birthed and attracted the best and the brightest. Freedom and opportunity are its calling cards. Today, we are, in aggregate, the wealthiest nation on Earth, and we continue to ride the wave of innovation and enjoy the benefits.

But, is that wave about to crash on the shore?

A recent piece by Morgan Stanley entitled, *Millennials, Gen Z and the Coming ‘Youth Boom’ Economy*, complements Buffett’s optimistic viewpoint. The population of the Millennials will overtake the Baby Boomers this year, and “Gen Z, born between 1997 and 2012, will overtake the Millennials as the country’s largest cohort by 2034,” it said. For the U.S. economy, “The demographic tailwinds created by these high-population cohorts could be significant, delivering the kind of ‘youth jolt’ that the Baby Boomers were famous for.”

Sure, we can’t know when the next recession will ensue or some of the challenges we’ll face as a nation in the coming years. Yet, as Buffett sums up his annual letter, “Over the next 77 years, the major source of our gains will almost certainly be provided by The American Tailwind. We are lucky—gloriously lucky—to have that force at our back.”

Market Recap

First, let’s go back to December. A headline in the Street.com summed it up well: “Dow Gains on Last Day of Worst December Since the Depression.” Even a 7% bounce in the final week of the year didn’t prevent a performance that was compared to the early 1930s.

When the S&P 500 Index touched its bottom on December 24, the broad-based index of 500 large U.S. companies had shed 19.8% from its September 20 peak. We were barely 0.2 percentage points from officially entering a bear market.

Market turmoil in the fall and December’s action were especially ugly. Steep market corrections are not something we look forward to; they are impossible to consistently predict, but they come with the territory.

As I’ve repeatedly said, your investment plan incorporates the unexpected detours. The disciplined investor, who divorces the emotional component from the investment plan, chooses the best path to meet his or her long-term financial goals.

That said, 2019 has been much better:

- A flexible Federal Reserve has taken its finger off the rate-hike button,
- The economy continues to expand, albeit the pace has slowed, and
- We've been treated to headlines saying the U.S. and China are making progress toward a trade agreement.

Table 1: Key Index Returns

	MTD%	YTD %	3-year* %
Dow Jones Industrial Average	3.7	11.1	16.2
NASDAQ Composite	3.4	13.5	18.2
S&P 500 Index	3.0	11.1	12.9
Russell 2000 Index	5.1	16.8	15.1
MSCI World ex-USA**	2.4	9.5	6.5
MSCI Emerging Markets**	0.1	8.8	12.4
Bloomberg Barclays US Aggregate Bond TR	-0.1	+1.0	+1.7

Source: Wall Street Journal, MSCI.com, Morningstar, MarketWatch

MTD: returns: January 31, 2019—Feb 28, 2019

YTD returns: Dec 31, 2018—Feb 28, 2019

*Annualized

**in US dollars

There are no guarantees a deal will be inked, but a March 4 headline in the *Wall Street Journal* summed up recent sentiment:

"U.S., China Close In on Trade Deal"

Both countries could lift some tariffs imposed last year, and Beijing would agree to ease restrictions on American products

A trade deal that pries open Chinese markets to U.S. products and services, protects U.S. intellectual property rights, and ends forced technology transfers (and one with strong enforcement provisions) would not only benefit the U.S. economy, but a deal between the world's largest economies would sweep away one cloud of uncertainty that has plagued investors.

10 years gone

On March 9, 2009, the Dow Jones Industrial Average closed at 6,547. It marked the bottom of the last bear market. On February 28, the Dow finished the day at 25,916, less than 1,000 points from its prior peak.

The bull market turns ten years old this month. How much life is left in the bull? We are in the latter stages of the cycle, but much will depend on the economic fundamentals going forward. With the Fed on hold, inflation contained, and the economy moving forward, the fundamentals are

currently sound. But never discount volatility. Stocks seem to take the stairs up and the elevator down.

In the spirit of the celebrating the last ten years, let's look at a partial list of the worries that temporarily sidelined the bull, but didn't sideline those with a long-term view:

The European debt crisis...Greece... global growth worries...U.S. growth is slowing...China is slowing...the dollar is too strong...Japan earthquake/tsunami/nuclear disaster...U.S. debt downgrade...fiscal cliff...Obama will be re-elected...Trump will get elected...Hillary will get elected...the Fed will end bond buys...Fed will start hiking interest rates...falling oil prices...Ebola scare...Russia invades Ukraine...North Korea...ISIS...Syria...Brexit...trade tensions...acrimony in D.C....and stocks have risen too quickly.

Shorter-term risks never completely abate. But Warren Buffett's message has been consistent. Don't bet against America.

A Personal Note

This month I am revisiting our family's financial plan. I noticed that we had not made beneficiary designations on some of my wife's benefits. A little thing? Maybe, but then if the worst happens it may not be so little.

Getting this taken care of today reminds me that even the best laid plans can have things missed or ideas that were documented but not acted upon. More often, plans simply get stale over time. It pays to regularly re-visit a financial plan once a year. Read over yours if it's old, and if not I suggest putting a reminder in you calendar to take a look when it reaches its anniversary date.

Please remember that it is my job to assist you. If you have any questions or would like to discuss any matters, please feel free to give me a call.

As always, I'm honored and humbled that you have given me the opportunity to serve as your financial advisor.

All the Best!

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