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PORTFOLIO WATCH

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Halloween is Over, but…

If there is any holiday that I could be accused of being a scrooge about, it's Halloween. After about the age of 10 I stopped enjoying wearing costumes, and as an adult the last thing I want to do after work is hand out candy…while trying not to eat it. When the doorbell rings what often ends up happening is the dog starts barking incessantly while my wife and I see who can say "not it" first. I know, that makes me a Halloween scrooge, but at least it's over. The scary stuff, however, is not.

What Is Going On With the Market?

The U.S. stock market is up…way up…since the presidential election. I don't think this is because of the calm and steady leadership of the president, or global peace and prosperity breaking out across the globe. North Korean tensions continue to rise, Congress can't agree on when to take a bathroom break, and the U.S. position in the world is clearly changing. And yet, stocks climb higher, volatility is at near all-time lows, and inflation is non-existent. What's going on? From a risk standpoint, what's going on below the surface is truly scary.

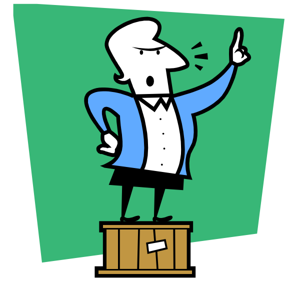
Surprises Everywhere

It's a little surprising, at least to me, that a third of S&P500 stocks are down this year. It turns out, there have been few times in history when so much of the market gains are concentrated in so few stocks (perhaps 1999/2000). It's also surprising that individual ownership of U.S. stocks is slightly lower than in 2009, and institutional ownership of U.S. stocks is lower by more than 5%. Wait, what? How could that be? Who's buying stocks, then? By far, the largest purchaser of U.S. stocks since 2009 has been companies buying back their own shares. $3.8 trillion worth. With interest rates so low, corporations have been borrowing money and using

it to buy back stock. With less stock on the market a company can grow its earnings-per-share without earnings going up. Share buybacks have accounted for over 70% of the total earnings "growth" over the last 5 years, and this is one reason there has been so little volatility. Every small dip has been bought by companies that really don't care about the price. If you own the stock, who cares? The price is still going up. But the risk goes up as well. Some other scary facts: there is currently about $9.5 trillion of global debt with *negative* yields. Austria recently issued a 100-year bond with an interest rate of 2.1%. The Swedish government pays 0.6% interest on over-paid tax accounts, so Swedes are intentionally paying too much tax in order to avoid the cost of negative interest rates at the banks. Something is seriously wrong in the financial world.

History as our Guide?

Given the extent of financial engineering in the world, can we apply lessons from the 60's or 70's? How about the 80's and 90's? I don't think so. I think we're in uncharted waters that require more thought than just sticking with the strategies that worked when stocks were at a low point. Risk doesn't mean things are about to fall apart, any more than driving around with a trunk full of dynamite means your car will explode, but higher risk means a bigger chance of a catastrophe. It shouldn't be controversial to say that the risk/reward benefit today is not nearly as good as the historical average. There is some weird and scary stuff going on in the global markets, and it's probably not a good idea to ignore it.



Market Comments

The entire feature article this month was focused on the market. I don't usually like to do that, but I think it's getting more and more important to understand some of the forces that are driving the market higher. It's very easy to simply watch prices go higher and think it's a sign of market health. Low volatility and high investor confidence are typically signs that the stock market is strong, and it has been, but there are underlying issues that are very concerning. The latest rise in stocks is creating a feeling of panic, or at least uneasiness, for investors who are diversified. I'm seeing it with my own clients. In these conditions it's very tempting to abandon the steady march towards long-term goals and turn investing into a competition.

It's important to keep in mind that the stock market should not be viewed as a benchmark, unless your true goal is just to beat the market in the short-term. If that's the case, this is probably the wrong newsletter and Veripax is the wrong advisor. Stock prices move up and down because of a wide variety of factors, but not one of those factors includes your long-term financial objectives such as retirement. Stocks are simply an asset class, but only one of many. Although that seems obvious when developing a long-term strategy, it's easy to forget when the market seems to defy logic by going a little higher every day.