Equity Commentary

January, 2018

Whether it was the broad improvement in the market's view of global growth, the return of corporate earnings growth, or the spark provided by the easing of regulatory burdens and corporate tax reform, 2017 was a year of rising confidence. In fact, it is hard to find a measure of confidence that did not improve last year or is not currently sitting near a multi-year high. According to the December NFIB report on their small business optimism survey, "… 2017 [was] the strongest year ever in the history of the survey. The average monthly Index for 2017 was 104.8. The previous record was 104.6, set in 2004." Consistent with or as a result of this confidence, 2017 did mark the real start of the rate hiking cycle with the FOMC raising rates three times, and the consensus view is that we will see a similar pace in the year ahead. While the equity market soared again in 2017 as it did in 2016, there was a different feel to this ascent, as the mega-cap tech companies like Apple, Google and Amazon led the charge, and talks of who will be the first to reach the $1 trillion-dollar mark graced the headlines. The largest 5 stocks in the S&P 500 finished the year with a combined market cap of $3.3 trillion. These 5 stocks are now collectively larger than the smallest 257 stocks in the index. Apple (AAPL) alone is larger than 4 of the 11 GICS sectors within the S&P500!

As we turn the page to the new year it is worth remembering that we are roughly 10 years from the end of the prior decade's great expansion. Back then, the view of the markets was very different than what we see today. At the end of 2007, concerns were focused on domestic issues with home prices declining and stresses appearing within our banking system. Oil and gold had roughly doubled during the prior 3 years, and the rapidly expanding economies of Brazil and China were the focus of the investing community with their 6.5% and 14% annual GDP growth, respectively. The following year of 2008 was something that no one will forget, as several years of weak growth, inventive monetary policy, dissipating inflation everywhere and lower commodities were set in motion. While the global economy has been emerging from the great recession for several years, today China is growing at half its 2007 rate and Brazil has only recently emerged from one of its worst recessions ever. In the meantime, US banks are solid and profitable and home prices have been on the rise for several years. In short, the picture we were looking at 10 years ago was very different from what we see today. In a similar vein, the top businesses have been shuffled around and hardly resemble the leader list of 10 years ago. A list composed by brandirectory.com ranked the value of the top global brands in 2017 and 2007. Only one brand, Microsoft, made the top 10 on both lists. Coca-Cola and Citi joined Microsoft at the top of the 2007 list, whereas today it is the tech giants Google, Apple, and Amazon.com. The lesson we take from these two observations is that we should expect change, and do not get too comfortable with the current view.

This fall we read the book, *The Rise and Fall of Nations*, by the Morgan Stanley strategist Ruchir Sharma. In it he shares some of his principles for investing in what he calls this, "noisy jungle." The first principle he teaches is impermanence, guiding his readers to not look too far down the road when investing, since the world changes so often. Additionally, most long-term forecasts simply take the current trend and project it out for several more years. While we keep a close eye on the macro environment in order to help us position the portfolios, and we constantly discuss how various scenarios could affect our holdings, we are skeptical of and shy away from big conclusions about what the future holds. We do this not only because we know our personal limits, but because we know how dynamic the economy and markets have been. Heeding Sharma's advice and reflecting on the reversals that have transpired over the last 10 years should keep us all a bit hesitant from making big predications about what the picture will look like 10 years from now.