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VIEWS FROM CAMELBACK MOUNTAIN

The Groundhog Day Correction

The market declines on Friday, February 2nd and Monday, February 5th were unsettling after a long period of calm, but investors need to keep these declines in perspective. Market corrections normally occur every 12-18 months. It has been over two years since the last correction occurred in January 2016. That correction didn't last long and it was followed by two years of the market moving essentially straight up.

A correction is defined as a market decline of 10% or more from a previous high, while a bear market is defined as a decline of 20% or more. Corrections that last three to six months often cause little damage to long term investors who can ride out the decline. Corrections can actually be healthy for markets as they can reign in irrational exuberance. Individual stocks or even market sectors can rise to unsustainable levels that are not supported by fundamentals. We are hopeful that this market correction will take a toll on some of the wildly over priced stocks.

Bear markets with declines of 20% - 30% or more can last several years and can do major damage to long term investors. They are normally caused by economic recessions or other disruptions to economic fundamentals. We see little risk of these phenomena at this time. We believe that the market is in the midst of a normal correction with a very rapid onset. The Standard & Poor's 500 was at a brand new all-time high on January 26th, eleven days ago. This decline could potentially continue for at least the next few weeks and the market may decline an additional 5% - 8%. It is likely to take several months for the full effect of the decline to cause most stock valuations to readjust to the changing conditions. Based on the strong fundamentals for the U.S. economy and for most economies around the world, and our expectations for healthy earnings growth, we expect the market to recover and once again hit new highs later this year or early next year.

We believe the primary cause of the decline has been a modest but steady increase in interest rates over the last two months as the bond market has begun to understand the strength of the U.S. economy and the positive effects of corporate tax cuts. It is clear that the very low interest rates over the last ten years have acted as a strong tailwind for the stock market. Rising rates from historically very low levels will eventually shift that tailwind to a headwind. We expect interest rates to continue to rise with the Fed increasing rates at least three times this year beginning in March and perhaps four or five times as the economy continues to strengthen and inflation picks up. Even if the Fed raises short term rates five times this year and five times next year, it would put the fed funds rate near 4%, which is still low by historic standards. Depending on how long this correction lasts the Fed could become more cautious about the pace of interest rate increases.

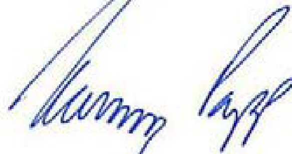
The recent declines were also likely triggered by very slight disappointment in a few individual stocks. For the past month it has been increasingly clear that iPhone X sales were slightly weaker than the markets had come to expect last fall. Amazon's announcement that they were partnering with Berkshire

Hathaway and JPMorgan Chase to change the future of healthcare has caused a disruption in drug, biotech and healthcare stocks. Google, Chevron and Exxon also reported very modest disappointment in their earnings announcements last week. We remain confident in these companies.

We continue to believe that this is likely a short term correction that will run its course and will be followed by a period of stabilization and a market recovery. We own good quality companies with solid fundamentals and strong outlooks for earnings growth. We are advising clients to simply ride through this period of disruption. We are watching closely for investment opportunities that this market may be creating. In particular, we believe that opportunities are developing in some healthcare companies and financial service businesses that will actually benefit from rising interest rates. Many healthcare stocks have been marked down based on irrational fears of Amazon's potential disruption.

We are watching market conditions carefully and will advise you of any changes that we think are appropriate. Please give any of us a call if you have any questions.

Best regards,



Harry Papp
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