NOTTINGHAM ADVISORS
ASSET MANAGEMENT

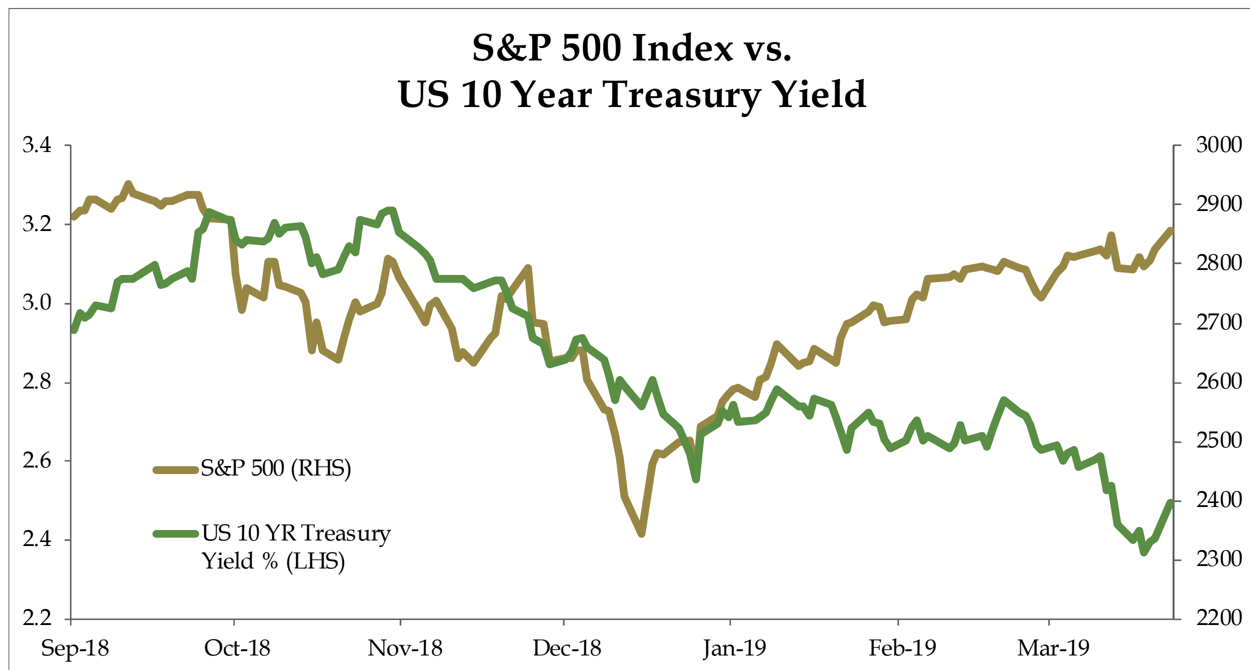
WISH UPON A STAR

"I've missed more than 9000 shots in my career. I've lost almost 300 games. Twenty-six times I've been trusted to take the game winning shot and missed. I've failed over and over and over again in my life. And that is why I succeed."

-Michael Jordan

The first quarter of 2019 is in the books and fortunately for investors, a return to “normalcy” has occurred. Now “normalcy”, as used here, refers to the penchant for stocks to march deliberately higher and bond yields to stay stubbornly low. Last quarters brutal sell-off in equities is but a distant memory and Pollyanna has returned. I guess we can thank Fed Chair Jay Powell for that, and for continuing, under a different guise mind you, the “Greenspan put” that has bailed investors out time and again when markets weren’t behaving properly.

After initially triggering the October sell-off with some ill-advised hawkish rhetoric, Powell walked back his stance on monetary policy and firmly aligned himself with his overtly dovish predecessors. Both the stock and bond markets applauded.



It certainly didn’t hurt that corporate earnings stayed strong throughout the turmoil and inflation was tame. Q4’s 2.2% GDP growth rate proved not too hot, nor not too cold, but “just right” for dear Goldilocks and investors alike. The technical and computer driven selling of Q4 appears a distant memory as the market welcomed one of the more high profile “unicorns” to the public markets, the IPO of Lyft. (A “unicorn” is the name investors have given to privately held start-ups with market values north of $1 billion.) Lyft came public with a market cap of over $20 billion, despite having lost over $900 million in 2018 on revenues of $2.2 billion. Time will tell

whether there's too much irrational exuberance in today's market; however, many investors appear to be wishing upon a star when it comes to these unicorn IPO's.

Nottingham much prefers companies that make money, and even with those we prefer our exposure come in index form. Our two largest positions across our portfolios, the S&P 500 Growth (SPYG) and Value (SPYV) ETF's combined to return investors 13.5% in Q1, at a cost of only 4 basis points per year. That's what we consider a bargain. And for those of you lamenting not owning enough Apple, Amazon or Microsoft, know that those three companies, along with Facebook and Berkshire Hathaway, represent nearly 14% of the above ETF's.

Diversified portfolios fared well in Q1, after somewhat disjointed returns the past few quarters. Asset classes across the board did well over the past three months with US large (SPX), mid (MID) and small (SML) cap indices all up over 11%, while international developed markets (EAFE) rose 10% and emerging markets (EM) gained 9.9%. Following the steep drawdown in Q4, valuations were right-sized enough so that <u>we no longer deem the US stock market expensive, but rather slightly north of fair value</u>. Steady earnings increases have lent some comfort to the latest run-up being founded upon something other than just multiple expansions.

Bonds prices were broadly higher too in Q1 with US high yield leading the way up 7.25%, followed by EM USD debt up 5.4%, and US investment grade corporates up 5.1%. After seeing no high yield new issuance in the month of December, the BarCap High Yield spread over treasuries fell over 130 basis points during the first quarter. The current spread over the 10yr Treasury of 403 basis points rests firmly near the recent 5yr average, putting US high yield debt right around fair value – assuming one doesn't value investor protections such as bond covenants because by and large there aren't many any longer. Despite the yield advantage one gets from assuming credit risk, we're currently underweight the space.

Our bias over the past few years in favor of shorter duration bonds paid off handsomely in Q4 of '18. Our fixed income portfolios performed admirably against most comparable indices. In the first quarter of '19, this led to some underperformance – which we are more than okay with. We think the rally in bond prices may have run its course and a more logical yield on the US 10yr rests somewhere closer to 3.0% (versus roughly 2.5% as I write). Treasury bills remain a viable hedge as they yield slightly more than inflation and possess superior near-term liquidity.

The Growth versus Value Conundrum

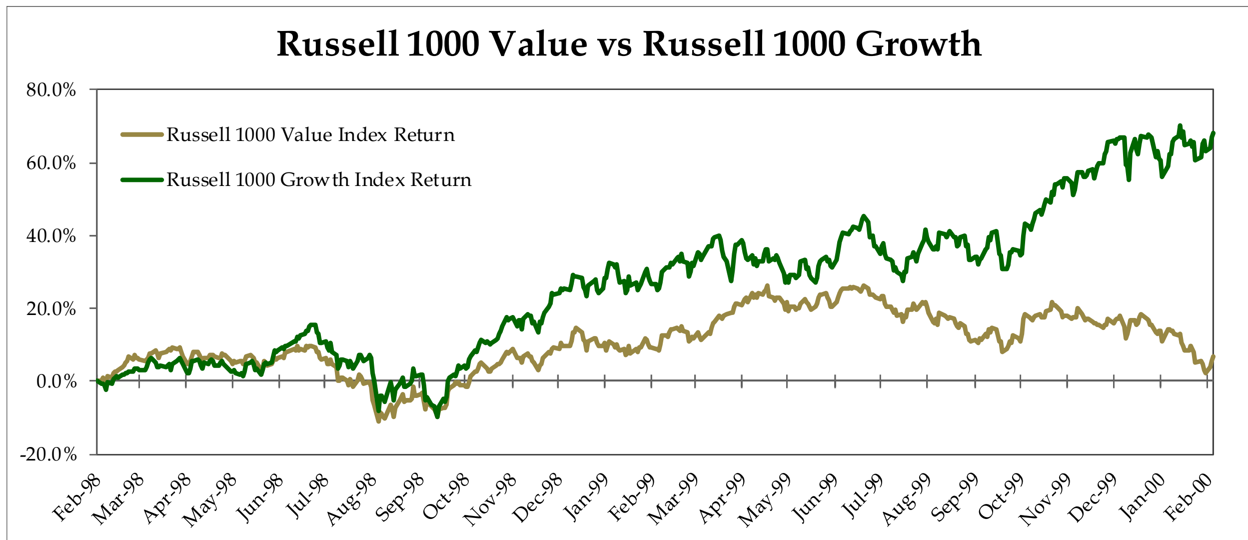
One of the more maddening trades over the past few years has been the underperformance of the Value factor relative to Growth. The relentless rise in the FAANG names (Facebook, Amazon, Apple, Netflix and Google) has pushed Growth indices well above Value, testing the patience of even the hardiest adherents of mean reversion. The most skilled of value-oriented stock pickers have struggled to keep pace with the tech-giants. When will the tide turn?

Timing changes in investor sentiment over the years has proven difficult. The difference between being "early" and being "wrong" is often determined by capricious investors lacking long-term time horizons. This can introduce a fair amount of career risk into the lives of portfolio managers and business risk into investment management firms, large and small alike.

It has often been said that diversification is the only free lunch left in investing. One could argue that time horizon (also known as "patience") is another. Markets often present patient investors with money-making opportunities while the rash and short-sighted typically end up chasing after yesterday's hot performing fund.

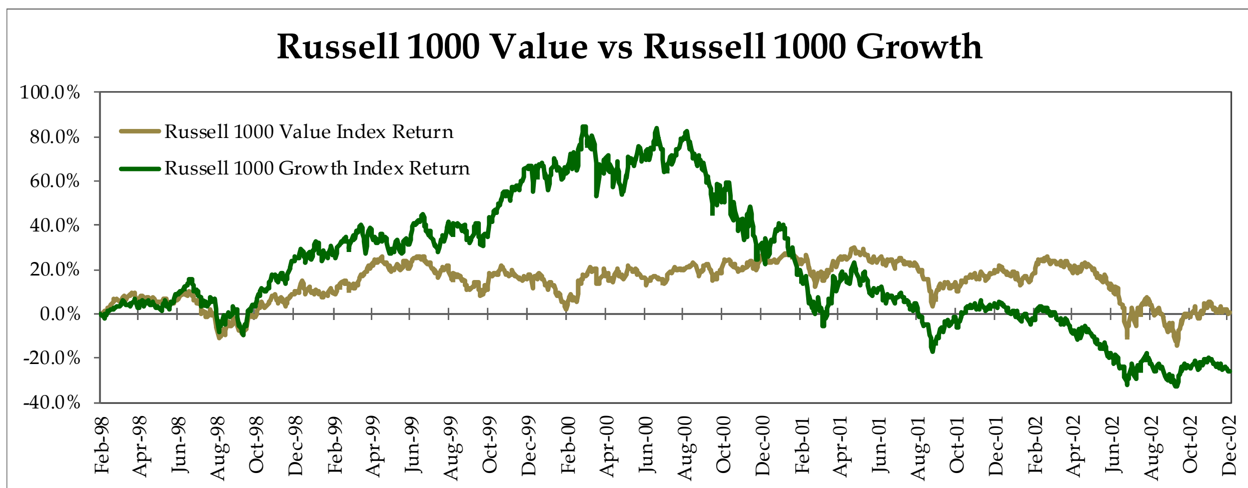
The current growth/value dichotomy hearkens back to the chasm that developed during the late '90's, the last great tech boom period. As the following charts illustrate, from Q1 of 1998 into Q1 of 2000, the Russell 1000 Growth Index gained an astounding 63%! Its Value counterpart, the Russell 1000 Value Index, managed only a paltry 2.75% gain. In December of 1999, the Wall Street Journal published an article titled "What's Wrong, Warren?", and it began with the now-ludicrous sentence, "After more than 30 years of investment success, Warren Buffett may be losing his magic touch." From the time of that article until now, Berkshire Hathaway

stock has returned 437% versus 180% for the S&P 500. Apparently nothing was wrong with Warren; he just chose to be patient.



Source: Bloomberg

During the 1990's, many a value manager was cast aside in favor of the likes of the Munder Net Net Fund and other fast growing tech funds, only for those intrepid investors to witness a spectacular peak to trough decline of -57% following the bursting of the tech/media/telecom bubble. During this same time period the Value Index "only" declined -14%. Value managers went from laggards to leaders in short order and investors once again got burned chasing after recent performance. Mean reversion is a very powerful tendency in investing.



Source: Bloomberg

At Nottingham Advisors, we continue to advocate for long time horizons, sufficient diversification, and low expense ratios. Great performance is not measured quarter to quarter or year to year even. Certainly a 10-year U.S. bull market is not a very appropriate environment to assess an all-asset portfolio that is diversified across regions and asset classes. Typically a full cycle is needed for that. International equities will have their day, and US stocks will fall. It's always worked this way. And despite the meager yields available in fixed income, investors will come to appreciate these "stores of value" during the next stock market pullback.

Summary

We're not ready to call an end to either the current economic cycle or the bull market, and we can thank the Fed for that. With a real Fed Funds rate of just .30% (Nominal Fed Funds of 2.4% minus inflation of 2.1%), short-term interest rates are hardly restrictive. Economic growth will certainly slow from the 3.0% pace in 2018, but 2.0% growth is okay by us. Certainly risks abound, many of them politically driven – China trade war, border closing threats and alternative tax regimes to name a few. But unemployment remains historically low, wages are gradually rising, the consumer is in decent shape and the full impact of the 2017 tax reform act have yet to be fully realized. Despite the brief inversion of the yield curve in Q1, we don't think a recession is nigh.

We're grateful for a lot of things here at Nottingham. At the top of our list though is our diverse and loyal client base. It's always our pleasure to interact with clients and advisors and to try and help find solutions to challenging problems. Helping our clients chart their financial future and then seeing it become reality is one of the most rewarding elements of our job. Uncertainty is part of life and a big part of investing. Developing a plan to mitigate uncertainties is what we do at Nottingham. We always like hearing what's on your minds so please don't hesitate to reach out to us with questions or concerns. Thank you for your continued business.

Larry Whistler, CFA
President/Chief Investment Officer
April 2019

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