PEAK CAPITAL
MANAGEMENT

D. MICHAEL BURLEIGH
Registered Investment Advisor

953 NE Jensen Beach Blvd.
Jensen Beach, FL 34957

772-334-9592 • 772-334-3856 fax
Mike@peakcapitalmanagement.net
www.peakcapitalmanagement.net

THE ADVISOR

FEBRUARY 2019

Markets May Shake Off Bad News for Quite a While…Or Not

Things stabilized a bit in the financial markets in January, and both the Dow Jones Industrial Average and S&P 500 enjoyed increases of just over 7% (although all the major indexes are still down from their peak highs).[1] Overall, the month was certainly a welcome change from all the volatility of 2018, which ended as Wall Street's worst year since 2008. In January, big investors seemed to make an effort to shift their focus mainly to positive and hopeful financial news. But why, and how long will they be able to keep it up?

Granted, there was some hopeful economic data for investors to focus on in the first month of the New Year, including strong early fourth quarter earnings reports and the more dovish language coming from the Federal Reserve about interest rates. In its January meeting, the Fed said it would be "patient" with further interest rate hikes, and removed language about "further gradual increases" from its policy statement.[2] In addition, the U.S. added 304,000 jobs in January (more than anticipated) and the Labor Department reported that average hourly earnings over the last 12 months rose 3.2%.[3]

However, before you jump on the optimism bandwagon, keep two things in mind. Number one, there was also a lot of positive economic news throughout 2018, yet despite that, the year saw extreme

Continued on page 2

Asset Allocation and Diversification

So, it's time to start selecting investments for your retirement account. You sit down at your desk, start looking over the list of investment options, and are quickly overwhelmed. How do you build your retirement portfolio (or any other investment portfolio)? What's right for you? The answer to those questions lies in two essential investing concepts: asset allocation and diversification.

Asset Allocation

Asset allocation sounds complicated, but it's actually a fairly simple concept. It involves selecting a variety of different types or categories of investments — called asset classes — for your portfolio as a way to hedge against risk. Asset classes the average investor is most likely to encounter include cash equivalents, stocks, and bonds. Other asset classes include commodities, real estate, and other investment alternatives.

Why invest in different asset classes? Because they are affected differently by economic events and market factors, investing in a variety of asset classes is a way to reduce risk in your portfolio. For example, if stocks fall dramatically, other asset classes in your portfolio will likely help mitigate your losses.

Diversification

Choosing your asset allocation is just the beginning. In order to minimize risk, you'll also need to think about diversification. But if you just build a portfolio out of several different asset classes (say, stocks, cash, and bonds), aren't you already diversified? Not necessarily. In addition to diversifying among asset classes, you also need to diversify *within* asset classes.

Diversification is simply another way of saying, "Don't put all your eggs in one basket." If 60% of your portfolio is in stocks, 30% in bonds, and 10% in cash equivalents,

Continued on page 3

Markets

Continued from page 1

volatility and some of the largest single-day point declines in market history; and number two, in order to focus on the positive headlines in January, investors had to also ignore a lot of negative news, including concerns about the economic impact of the longest government shutdown in U.S. history.

Typical Trend

In truth, what we're seeing with the markets now is not uncommon from a historical perspective. Investors typically fall into a trend of shaking off bad news toward the end of a cyclical bull market period, and—as we discussed in the 2019 market forecast last month—we believe we're at such a period. We are forecasting a second straight year of losses for the stock market, and an economic slowdown that could lead to a new recession by 2020. Whether we're in the early stages of the third major sustained market correction of this secular bear market remains to be seen, but it's certainly possible.

It's also forecasted that the Fed is not going to be able to achieve its original goal of approving three additional short-term interest rate hikes this year, and may not even end up approving one. The Fed amending its statement in January to remove the "further gradual increases" language suggests our forecast is accurate. We believe our forecast is also supported by the fact that long-term interest rates continued to exhibit a strong resistance level throughout January, with the yield on the 10-Year Treasury rate ending the month almost exactly where it started, at around 2.7%.

As we've previously discussed, the bond market is often said to be "smarter" than the stock market when it comes to forecasting economic growth, and this resistance level is an example of that. When the Fed instituted its last rate hike in December, that's when the bond market said, "enough is enough," and this time bond yields didn't rise to make room for the Fed's increase.

As a result, the yield curve remains perilously close to being flat, with the Fed funds rate now at 2.5% and the 10-Year holding fast at around 2.7%. In fact, the yield curve almost did completely flatten on January 3, when the 10-Year sunk to 2.56%—which could easily happen again. Remember, too, that the yield curve is already partially flat and has been since December 3, when yields on the 2-Year Treasury rate rose higher than yields on 5-Year Treasuries. As we discussed recently, a flat yield curve preceded both of the last two market crashes and is widely regarded as a huge red flag of a coming recession.

Emotional Attachment

So, with at least as much bad or potentially bad news underlying the good, how and why is it that big investors typically shrug off all the bad news near the end of a bull rally? Psychology is one answer. Many investors remain "mentally stuck in the 90s" because they first started investing in the 80s and 90s, during the best long-term bull market in U.S. history, and enjoyed great success. Nearly 30 years and two major market crashes later, it's still the paradigm they're still used to. They remain committed to it either because it seems logical (even in the face of mounting evidence to the contrary) or because they have an emotional attachment; it's simply what they're comfortable with.

Keep in mind, too, that many big investors tend to be competitive by nature. They have an athlete's perspective and treat investing as a competitive sport. The trouble is, many get so focused on offense and trying to ring every last dime out of a bull market that they ignore or forget the importance of financial defense…until it's too late.

But how long can these investors continue shaking off bad news and ignoring warning signs near the end of a cyclical bull rally? The answer is: sometimes for quite a while. Remember in 2007, it was widely known in February and March that the subprime mortgage crisis was coming, but it wasn't until November that the markets started to drop.

The good news about this lag time is that it allows informed investors to make changes and decrease their risk in time to avoid getting caught in the next downdraft. Keep in mind that even after last year's turmoil and losses, the market overall is still only down about 10% from its peak highs since the financial crisis. So, ask yourself: if you were going to make a change, doesn't it make sense to do it at 10%, rather than risk getting caught in a drop that history says could range between 40 and 70%? That, of course, is a rhetorical question.

[1] "Stocks Wrap Up Best January in 30 Years," *CNN Business,* Jan. 31, 2019.

[2] "Treasury Yields Fall Further After Fed Vows Patience," *CNBC,* Jan. 31, 2019.

[3] "Why the Fed's Shift into 'Superdoveland' Looks Shaky After the Jobs Report," *MarketWatch.com,* Feb. 1, 2019.

Asset Allocation

Continued from page 1

you are diversified among asset classes. But if you only own two or three different stocks, you're not diversified within that asset class. If one of those stocks plummets in value, your portfolio could take a big hit.

Diversification may sound fairly simple, but it can be more complicated than many realize. For example, you may think you're well diversified by investing in eight or nine different stocks. But if each of those stocks is in the same industry, they'll each have roughly the same performance. To better diversify, you might want to select nine stocks in nine different industries. Another big diversification that people make is investing too much in their employer's stock. No matter how confident you feel about the future of your company, it's rarely smart to place too much of your assets there — if the business goes under, you could be out of a job and much of your savings.

Asset Allocation and Diversification in Practice

How do you determine the right asset allocation or diversification for your portfolio? It depends on your investment goals and time frame. If you are young and investing for retirement, you can afford to have a significant portion of assets in equities, with the goal of maximizing your investment return. As your retirement date nears, you'll likely want to shift to a more conservative portfolio with a smaller allocation to stocks, so you can better protect your wealth.

In the intervening years, you will periodically tweak your asset allocation so it changes with your situation. You should also monitor your specific holdings in each portfolio, making occasional adjustments so you are properly diversified. The ultimate result is a portfolio that evolves with you and the current market situation. Please call if you'd like to discuss this in more detail.

Why Teach Your Children about Investments?

It's never too early to begin teaching your children about money. Children as young as three can begin grasping basic financial concepts, while older kids can handle more advanced concepts than adults may give them credit for. Yet too many parents neglect to educate their children about how money works, which does them a serious disservice.

When you teach lessons about money, you give your children a valuable gift that will serve them well throughout their lives and help put them on the path to financial independence.

Not convinced your children need to know how investing works? Here are four good reasons to teach your children about investing.

Because Someday They'll Need to Do It on Their Own

You teach your children to ride a bike, swim, or safely cross the street because you want to be confident they'll eventually be able to do those things without you holding their hand. The same goes for investing. Once your children are on their own and have jobs, they'll have to make decisions about investing for retirement and other goals. If they are armed with good lessons from childhood, they're more likely to make smart decisions.

Because Good Money Habits Start Early

Children's core money habits may be ingrained as early as seven years old. While it may not be reasonable to expect a second grader to understand the intricacies of derivatives and hedge funds (especially when most adults aren't familiar with those concepts), you can start to teach children about concepts related to investing, like the idea that wealth builds over time. One way to do this is by having children open a savings account that earns interest, or you could reward their saving on your own, perhaps by matching a certain percentage of their savings, just like your employer matches 401(k) contributions.

So They Can Make Mistakes

Making mistakes is a part of the learning process. Most people have to make their investing mistakes as adults, when losing money often hurts a bit more. But by exposing your children to investing at a young age — and by letting them make their own decisions when it's appropriate — they'll learn valuable lessons now, when losing money hurts less. So let your children invest a small amount in that questionable stock. When it tanks as you expect it will, junior will have learned a valuable investing truth.

So They Can Start Building Wealth Early

Consistent, focused investing is one of the best ways for most people to build wealth. If your children start young, you'll be giving them an important leg up for their financial future. Even if you aren't prepared to give children the reins yet when it comes to managing their money, you can show them how you're giving them a solid foundation by putting their birthday cash and other gifts in an investment account like a Roth IRA. As long as children have earned income from a job, they can put money in a traditional or Roth IRA. Even if it's just a few hundred dollars, by starting early, their money will have decades to grow. If they continue those good habits as adults, by the time they reach retirement, your children could accumulate significant sums.

If you're ready to teach your children about investing but aren't sure where to start, please call.

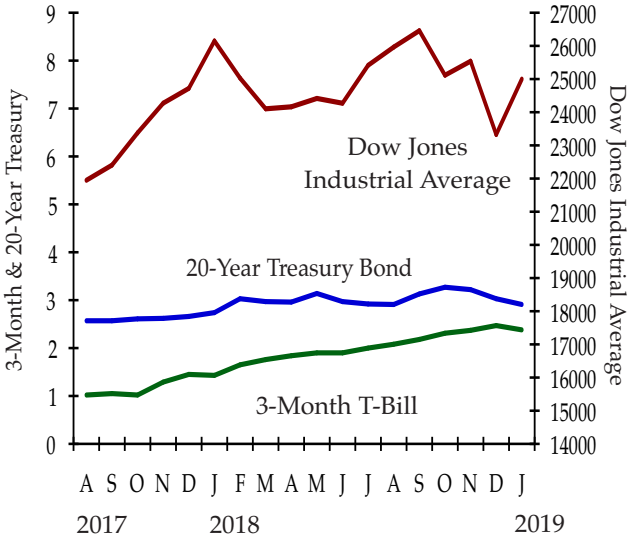
Business Data

Indicator	Month-end Nov-18	Dec-18	Jan-19	Dec-17	Jan-18
Prime rate	5.25	5.50	5.50	4.50	4.50
3-month T-bill yield	2.37	2.47	2.38	1.45	1.43
10-year T-note yield	3.06	2.89	2.75	2.46	2.59
20-year T-bond yield	3.22	3.03	2.91	2.66	2.74
Dow Jones Corp.	4.50	4.40	4.16	3.13	3.29
GDP (adj. annual rate)#	+2.20	+4.20	+3.50	+2.90	+3.20

Indicator	Month-end Nov-18	Dec-18	Jan-19	% Change YTD	12-Mon.
Dow Jones Industrials	25538.46	23327.46	24999.67	7.2%	-4.4%
Standard & Poor's 500	2760.17	2506.85	2704.10	7.9%	-4.2%
Nasdaq Composite	7330.54	6635.28	7281.74	9.7%	-1.8%
Gold	1217.55	1281.65	1323.25	3.2%	-1.6%
Unemployment rate@	3.70	3.70	3.90	5.4%	-4.9%
Consumer price index@	252.89	252.04	251.23	-0.3%	1.9%

— 1st, 2nd, 3rd quarter @ — Oct, Nov, Dec Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield
August 2017 to January 2019



Segregating Your Risk

Your willingness to assume risk with your investments is not necessarily a static concept. You may be less willing to take risk with investments designated for an essential financial goal, while you may be more willing to take risk for nonessential goals. However, those varying risk levels may be difficult to assess if all your investments are commingled in one account.

For instance, assume you have three goals — to ensure you have enough funds to support yourself through retirement, to send your children to Ivy-league colleges, and to purchase a vacation home. The most crucial goal is to ensure you don't run out of money during retirement. Thus, you want a high level of assurance you'll reach that goal, devoting a substantial portion of your resources to the pursuit of it. Your investments for that goal are likely to be somewhat conservative, especially as you approach retirement age. The next important goal is sending your children to Ivy-league colleges. You have more limited resources to devote to that goal, plus your children can still attend a less-expensive college or pay part of the costs themselves. For that goal, you may be willing to assume more risk with your investments to increase the likelihood of reaching it. Your goal for a vacation home is clearly last, so you may have few resources to devote to it. For that goal, you may be willing to use very aggressive investments, since that may be the only way to achieve it.

The point is that your willingness to assume risk is not static. It will vary depending on how important the goal is to you and how much you can designate to it. Commingling every investment for all goals in one account may make it difficult to analyze your investments in this manner. Thus, you might want to set up separate accounts for each goal, so you can more closely match investments to your willingness to assume risk.

FR2018-1017-0009

PEAK CAPITAL
MANAGEMENT
953 NE Jensen Beach Blvd.
Jensen Beach, FL 34957