CAIRN INVESTMENT GROUP

Newsletter and Quarterly Update March 2019

ADV Firm Brochure Available Online or By Request

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Important Reminders:

- **April 15—IRA Deadline**

NYSE Closed—No Checks, Deposits or Settlement on:

- **April 19—Good Friday**
- **May 27—Memorial Day**
- **July 4—Independence Day**

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Greetings from the Northwest.

My golly, what a crazy twelve weeks of news it has been. The first quarter of 2019 showed that the economy still had strength as investors bid prices up again after the 2018 fourth quarter deflate.

How to absorb all of this noise, and move on? I like a bit of quiet time with the Wall Street Journal and a cup of coffee on the weekends. This particular end-of-the-first-quarter newspaper even had a few pink cherry blossoms stuck to it as I pulled it out of our paper box. How beautiful, the scents of spring blossoms, fresh pressed coffee, and printer's ink not quite dry on the sunrise edition.

And then the crazy stuff begins. Parliament rejected . . . The FBI has embarked . . .Trump again threatened . . .The Justice Department . . . Emails in a lawsuit . . . U.S. and Chinese trade . . .The Red Cross said . . . The Vatican issued . . . Lyft shares jumped. . . and then the clincher . . . U.S. stocks notched their biggest quarterly gains in nearly a decade, lifted by bets that central banks would hold interest rates at low levels as global growth slows.

Patrick, what does it all mean?

Patrick's Part

With the markets regularly acting like a kid bouncing on a pogo stick, you are forgiven if you are wondering what will happen next. In the third quarter of 2018, U.S. stocks (measured by the S&P 500) rose 7.71%, followed by the fourth quarter decline of -13.52%. And just when pundits were calling for continued declines, the S&P 500 rebounded 13.65% during the first quarter. Predicting short-term market

Marieta Island *Photo by Steve C.*

movements is usually an exercise in futility, which is why we spend our time looking at long-term valuations on which we base our expectations. While the decline that happened during the fourth quarter made the broad market "cheaper," it did not move the needle very much, from a long-term perspective. So while we were able to invest in some new companies, at cheaper prices, we still view the broad market as rather expensive.

The topic du jour over the last few weeks has been the Treasury yield curve and the inversion of the 3-month/10-year U.S. Treasury yield. On March 22 the shorter yield was higher than the longer yield, thus inverted. Inversion of the yield curve has predicted the previous nine U.S. recessions with few false signals, so you can see why this news has become so prevalent. News articles and TV pundits will confidently make predictions about the timing

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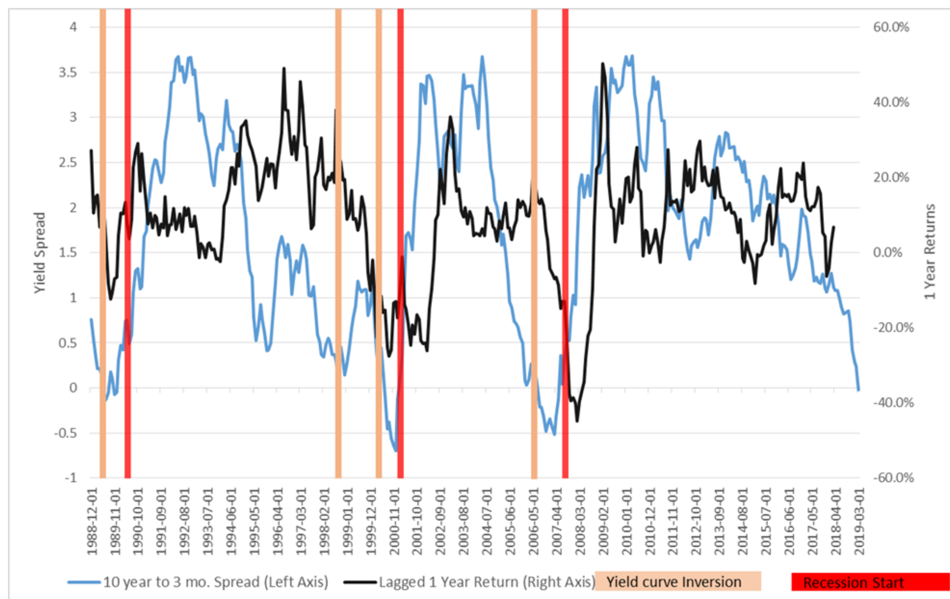
of the next downturn, but, like many events in both finance and economics, inversion of the yield curve is not always a direct cause and effect relationship regarding stock market returns, or an accurate predictor of when a recession will emerge. The chart below graphs the yield spread versus the one-year future return of the S&P 500 Index.



When we examine the data, a few things become clear. First, taking a look at the previous three recessions, the average time from yield curve inversion to recession was twelve months, with the longest being twenty-two months in 2007. Second, future one-year market returns were inconsistent with no discernable pattern. When the yield curve inverted in 1989, rolling one-year returns post-inversion were positive and continued that trend through the recession that followed. In 1998, there was a false signal during the Asian Currency Crisis. No recession followed and market returns were positive as the tech bubble took hold. After the inversion in 2000, market returns were negative approximately 16-20% and would continue that trend through the recession. Most recently, in 2006, rolling one-year returns were positive for almost a year before turning decidedly negative as the housing bubble burst. A hard look at the data is always needed to see what historical outcomes have unfolded. Does it signal that caution should be warranted? Yes, especially when combined with other market data points. We have been in that camp for some time now as market valuations remain elevated. Does it signal that the twelve-year economic expansion is getting long in the tooth? Yes, but that is what should be expected after a twelve-year economic recovery. To quote famed value investor Howard Marks when discussing cycles, "We may never know where we're going, but we'd better have a good idea where we are . . . and act accordingly."

We will not try to guess when the next recession or bear market will start, but we do have a good idea of where we are in this cycle and our research has us acting conservatively.

Please feel free to email or call with any questions regarding these topics and how we are managing through them. Thank you!

—*Patrick Mason*

Thank you, Patrick.

These are exciting times, made more comfortable by having a plan and sticking to it. Maybe we will change Patrick's name to "Col. John Hannibal Smith" the leader of the renegade commando squad "A-Team" . . . or not?

Please take me up on my standing offer of swinging in for coffee. The pot is always on.

Happy Trails,

Jim

Jim Parr, Principal
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