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QtrNotes

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FIRESTONE CAPITAL MANAGEMENT

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Quotes

It does not matter how slowly you go, as long as you do not stop.
Confucius

Price is what you pay.
Value is what you get.
Warren Buffett

If you want your children to turn out well, spend twice as much time with them and half as much money.
Abigail Van Buren

Build your own dreams, or someone else will hire you to build theirs.
Farrah Gray

Reminder
April 17th is the deadline to file your taxes or apply for an extension, and to make contributions to your IRA accounts.

Form ADV Annual Offer

Each year, the SEC requires that we notify clients when we have updated our disclosure brochure, known as the Form ADV Part II. You can download the updated document from our website by entering the following URL into a browser: firestonecapital.com/docs/FCM Form ADV Part II.pdf

If you would like a copy sent to you directly, please call our office. We will be happy to mail or email you one.

Volatility Returns to Wall Street; Main Street Stays Calm

It should have been obvious that the story wouldn't last forever, but no one knew exactly when or why the trend would end. The story of ultra-low volatility and sanguine markets came swiftly to an end early this February. Stock prices dropped, volatility spiked, speculators suffered major losses, and questions are still swirling whether this is the start of a new bear market. Although stocks rebounded quickly, they fell off again at the end of the quarter and are now down slightly to close the first quarter of 2018.

The good news is that this is all perfectly reasonable and normal in the grand scheme of investing – especially when coming off such strong returns from 2017. Here is some perspective:

Since 2009, the typical correction in stock prices has been a 14% drop, lasting about 200 days. Should this current correction end today, it will have been smaller and shorter than the recent average. When this correction will end is unknown, but it will be well within the norm if stocks continue to fluctuate and even take an extended pause before rising again in the years ahead.

Our portfolios aren't immune to these swings in the market, but our positioning isn't driven by these short-term moves. We don't claim any ability to time market cycles and we don't know how long this current correction will last, but we know that patient investors will be rewarded for enduring these periodic spells.

VIX: How Wall Street Measures Volatility

We measure the market's gauge of risk by monitoring an index known as the "VIX," which tracks the stock market's volatility, both actual and anticipated. The VIX rises like the temperature of a patient with flu when investors are spooked. When investors feel no pain, the VIX declines.

Index	3/31/2018	YTD
Dow Industrials	24,103.11	-2.5%
S&P 500	2,640.87	-1.2%
Russell 2000	1,529.43	-0.4%
MSCI EAFE	2,005.67	-2.2%
Bloomberg US Bond	2,016.5	-1.5%
US Treas 10-yr yld	2.8%	

It's a condition of human nature that things always seem worst while we are experiencing them. The VIX's gauge of investor fear always spikes highest after the damage is dealt, when stock prices have already dropped and misery is highest. Such was the case in 2008, when the VIX hit its highest level ever. It took nine years and one of the calmest, steadiest, bull markets in history for the VIX to make history again, this time reaching a new all-time low in late 2017.

There was reason for this calmness. Global economies were growing in unison, markets around the world were cheering, and business optimism was nearing a 17-year high. The perception of risk had left the building and seemed never to return. Wall Street even proceeded to invent new trading strategies betting on the permanence of the market's new paradigm – which was probably the biggest sign of all that a correction was imminent.

Economic Growth and Trade

Economic growth continued through the first three months of the year. Jobs remained plentiful; by one measure, there were 12 unfilled jobs for every 10 job seekers. The unemployment rate remained at 4.1% and the workforce continued to grow steadily each month. As growth accelerates, inflation, measured by the Consumer Price Index, has picked up slightly; it remains around a modest 2% and may rise to 2.6% by the end of 2018.

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Safety in Numbers: Social Security Insecure

Identify theft could be called the "gift" that keeps on taking. Over the last 20 years since identity thieves adopted the internet as their hunting ground, millions of identities have been compromised. Some of that stolen data can continue to harm the victim for years after the original loss.

Social Security benefits theft once meant some-one stealing the checks (remember checks?) out of your mailbox (remember mail?) Now, it can mean a criminal hacking into your online account at ssa.gov (or even setting one up in your name, using your personal data), then filing for and collecting your benefits, even claiming lump-sum payouts.

Because of the risk of benefits theft, the Social Security Administration now encourages people to open their ssa.gov accounts as soon as possible, and to check them regularly for unauthorized behavior. It should go without saying to make sure that your password is robust!

If you are still working, you'll receive an annual reminder to review your statement. If you've reached retirement age but have not yet started to collect benefits, be particularly alert: this is the most vulnerable time.

If you do find evidence of suspicious activity, contact the SSA immediately.

Economy and Trade

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Additional good news came late in February when the new IRS tax tables kicked in to reflect the new tax code, raising hopes for higher paychecks. Strong job growth and modest wage gains are supporting healthy consumer spending. Since personal consumption is nearly 70% of the US economy, this bodes well for continued economic growth.

For the past two decades, free international trade has been a driver of real growth and progress, especially for the developing economies. The current administration has adopted a harder line, protectionist view on trade, at least for their initial posturing.

There are no winners in all-out trade wars, but early signs suggest trade negotiations will take the place of actual battles. Recent developments have shown hard-line policies bending to allow tariff exceptions for our closest allies, and negotiations with South Korea have yielded positive results. Expect protectionist bluster to lead discussions, but more moderate conclusions to end each negotiation.

The global economic expansion won't be discouraged by small changes in trade policy. US and international markets are on track to expand in the years ahead; and since equity markets (over the long term) reflect the real economy, this should be a positive for long-term investors.

Interest Rates and Bond Prices

Jerome Powell became the new Chairman of the Federal Reserve on February 5th, just as market volatility was spiking. Under Powell's leadership, Fed policy has maintained its course so far. As anticipated, interest rates rose in March, the sixth hike since 2015, when interest rates were a full 1.5% lower. Strong employment data and a healthy economy will support additional rate hikes. Tepid inflation readings will allow the Fed to move slowly as they keep hiking. A slow and steady approach comes as good news for savers and investors alike.

Investors are starting to notice interest on their savings accounts. Some money market accounts are yielding over 1%, and short-term corporate bonds more than 3%. Bond investors have profited during the current interest rate cycle, but not every single period is positive. In the last twelve months alone, bond investors have enjoyed positive total returns despite four interest rate hikes, as interest income has compensated for price fluctuations.

Bonds aren't without risk, adjusting from time to time to reflect the current reality of the bond market. At the end of the first quarter, many bond investments are showing small losses as prices have retreated. Losses are never welcome, but bond holders should not be discouraged. Yields have improved over the past year, and bond investors are positioned to earn more interest from bonds than from cash. Bonds will continue to serve as a moderating influence in portfolios, tempering the swings of the stock market.

Not Buying Into Bitcoin

Speaking of the hot investment of the month, some of our clients have begun asking us about investing in Bitcoin or one of the other myriad of cryptocurrencies. Should we be "diversifying" into Bitcoin? The short and unequivocal answer is "No". This is a most speculative investment, and at present there are absolutely no controls or even regulations.

Bitcoin and its cousins are not yet useful for buying goods or services; their fluctuations in value are extreme and unpredictable; and even trying to explain how they work in a single column would be a challenge. Until these new currencies become more mature and predictable, we're certainly not ready to include them in our strategic portfolio construction.

That being said, the technology behind cryptocurrency, called "blockchain", has the potential to allow <u>any</u> digital transaction to be internally validated and verified. The result is a "smart contract" – one in which both buyer and seller are guaranteed complete security.

In a world where the convenience of online transactions is constantly undermined by the threat of fraud, the implications are tremendous; but any changes that blockchain might bring will be gradual. As a gold mine, Bitcoin and its cousins are just as likely to be fool's gold.