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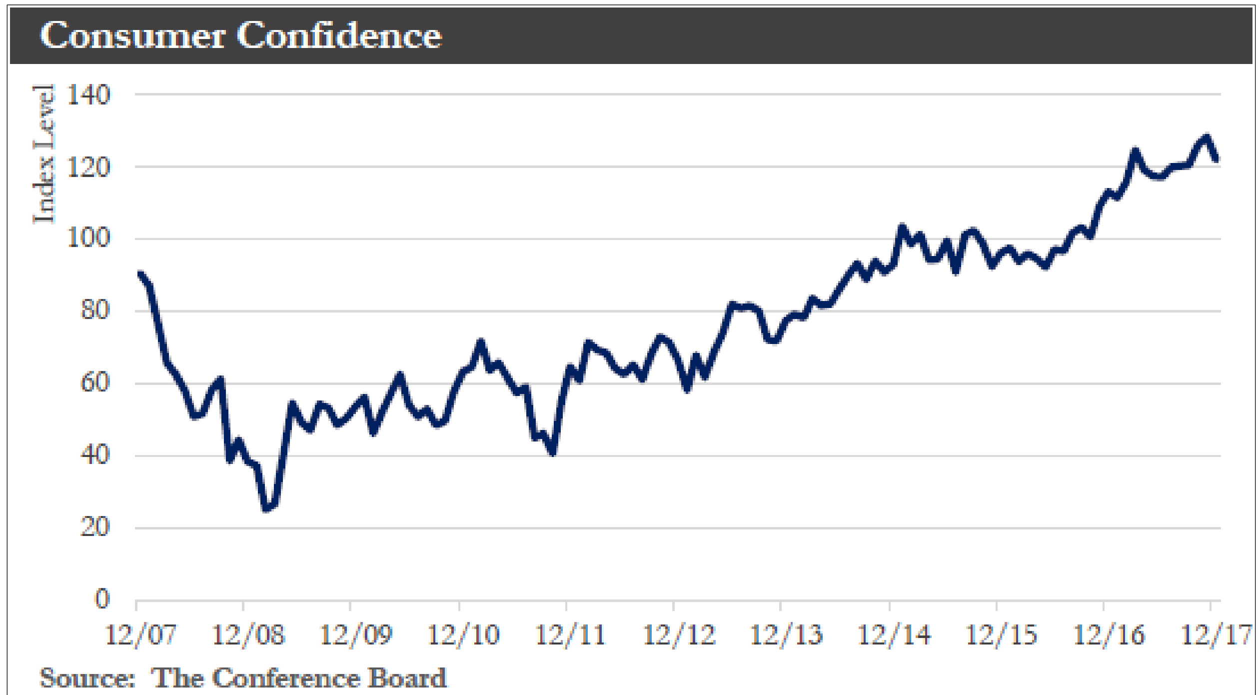
Luxon Global Q4 Newsletter

I. Market Recap and Outlook

Economic indicators going into 2018 are extremely positive and reflect not only a healthy domestic economy but a healthy global economy. Some of our favorite highlights:

- Consumer confidence is at a 17- year high, reflecting very high optimism among average Americans.



- The unemployment rate dropped to 4.1% in November. In the last 30 years it has only reached this level once, reflecting increasingly tight labor markets. While wages have unexpectedly not tightened as much as the labor force, we think this may change in 2018 as the surplus labor pool continues to dwindle.

- Despite tight labor markets, the Federal Reserve Open Market Committee expects inflation to be muted over the coming years, largely due to a similarly muted long-run GDP forecast.

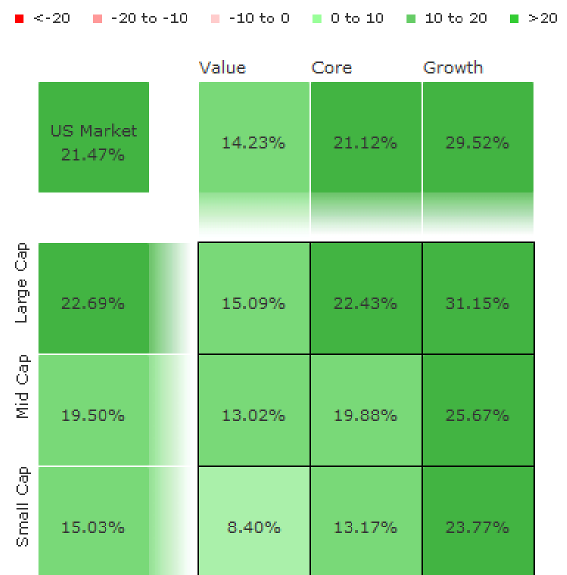
FOMC December 2017 forecasts
Percent

	2017	2018	2019	2020	Long run
Change in real GDP, 4Q to 4Q	2.5	2.5	2.1	2.0	1.8
Unemployment rate, 4Q	4.1	3.9	3.9	4.0	4.6
PCE inflation, 4Q to 4Q	1.7	1.9	2.0	2.0	2.0

Source: JPMorgan Asset Management, Federal Reserve

Equities: Growth vs. Value

Growth had another extraordinary year relative to Value equities in all market capitalization ranges. We have maintained a slight overweight to growth funds over the last several years relative to our benchmarks, which has proven to be a successful asset allocation decision. This chart shows the dispersion in US markets in 2017 – a trend that was largely mirrored in international markets.



We have also maintained an overweight to mid-cap and small cap equities relative to our benchmarks. While these have not proven as profitable as large cap stocks in recent years, history and our asset allocation model suggest they remain a wise counterbalance to the concentration of mega-cap firms that dominate market weighted indices.

We will be carefully monitoring our growth vs. value allocations in 2018. As growth continues to rally, we may consider a tact back to core and value to help balance out the portfolio.

II. Portfolio Performance

For 2017, although the traditional Luxon Global Portfolios outperformed most US indices, they underperformed their global benchmarks. The Luxon Global Alternative Portfolio substantially outperformed since its inception date at the end of April through the end of the year.

Fortunately, our manager selection for 2017 was favorable and all but one of our individual managers outpaced their respective benchmarks and added significant performance to the portfolios. Unfortunately, our asset allocation detracted from performance. Specifically, our underweight to international hurt relative performance versus our global benchmarks as the dollar fell 10% for the year (note: when the US dollar is weak, international returns receive a substantial boost when

translated back into the dollar for US based investors). An additional drag on performance came from our exposure to small and midcap equity which both underperformed relative to large cap equities.

The lone underperforming fund for the year came within our equity exposure and was a large cap growth index fund. Our belief in using active managers benefited portfolios as all of our active managers outperformed.

All fixed Income managers outperformed their respective benchmarks for the year. Despite a drag of more than 4% due to a weak dollar, the fixed income portfolio underperformed by less than a quarter of one percent. One of the best performance returns came from our international bond manager. Additional out performance came from managers with the flexibility to own credit and high yielding bonds.

While we would have preferred to outperform our global benchmarks across all portfolios, we were pleased with our manager line-up as they performed well against their respective indices giving us confidence that once the dollar stabilizes or reverses our portfolios are well positioned to provide our clients continued favorable long- term results.

PORTFOLIO POSITIONING:

No changes for the quarter.

III. Thought Topic – Market Timing

It has been exactly 10 years since the start of 2008 – a year that has become synonymous with investment pain and self-examination in capital markets. The S&P 500 peaked in October 2007, began its downward trend in Jan 2008, accelerated into a full-scale crash in August 2008, and bottomed in March 2009.

Despite this, from 12/31/2007 through 12/31/2017, the S&P 500 Total Return index (i.e. with dividends reinvested) returned 126%, or 8.50% annualized over that period. If you had chosen to invest at one of the worst points in market history, you still would have more than doubled your money. This would have required enduring the volatility in 2008 and early 2009.

It is an oft-cited statistic that the business cycle in the United States typically runs for 5-8 years[i], and this has produced many predictions that we must certainly now be approaching another recession. However, the market rarely behaves in the manner you think it might. For example, another developed westernized country with a similar economic profile to the US – Australia – has gone 25 years without a recession.[ii] This defies conventional wisdom of the business cycle, particularly given the commodities bust of recent several years in a commodity heavy economy such as Australia.

It is always tempting to be “right” about the direction of the markets, and far more exciting than being in a balanced, diversified and global portfolio. However, most comprehensive market studies[iii] have roundly rejected market timing. We say, don’t be tempted.

Volatility was at record lows in 2017. Don’t expect that to continue. There will be days, weeks and months where it is uncomfortable to own securities. That said, the past decade has demonstrated that staying true to your risk-tolerance and process, investing for the long term, and leave market timing alone can lead to impressive investment results even in the most challenging of markets.

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Sources:

https://fred.stlouisfed.org/

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[i] http://www.nber.org/cycles/cyclesmain.html

[ii] http://www.bbc.com/news/business-39124272

[iii] Cliff Asness, Antti Ilmanen and Thomas Maloney, MARKET TIMING: SIN A LITTLE RESOLVING THE VALUATION TIMING PUZZLE, Journal Of Investment Management, Vol. 15, No. 3, (2017), pp. 23–40

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