

Winter 2020

All of us who fly with any frequency have been there. That moment, mid-flight, when the distinctive bell rings and the pilot turns on the fasten-your-seatbelt sign. The voice, both calm and ominous, comes over the speaker warning us not to get up, turbulence ahead. The flight attendants roll the cart back down the aisle, denying us a luke-warm chicken breast, the consuming of which had promised to kill thirty minutes of our flight time. We close our laptop and lift the coffee or scotch from our tray, not knowing just how rocky a ride we're in for, or when exactly it will hit.

There are a lot of parallels between cross-country and international flights and long-term investing. Most often, we reach our destinations without incident, in a timely manner, belongings intact. But occasionally, the bell goes off, the little overhead light comes on, and seatbelts get rebuckled. As pilots of your portfolio, we'd like to begin the year by taking a look at turbulence, reflecting on both the flight that just landed and the one ascending toward its cruising altitude.

Flight 2019 (Landed)

Thanks to low unemployment in the US, Canada, and even Europe, along with globally low interest rates and high consumerism, last year was a pretty smooth trip. There was certainly turbulence, both expected and sudden, along the way, mostly in the form of prolonged, mild bumpiness. China and the US continued to be locked in a trade war, Brexit continued to be unresolved, the USMCA continued to be unratified, and the US impeachment process continued inching forward. Yet, by the time we reached the end of the year, markets around the globe had moved ever higher, as did expectations for a continuing bull market.

The turbulence on the flight would likely be classified as "mild," the least disruptive of the four classifications given by the FAA.

In Readers Digest, mild turbulence is explained by pilot Richard Gonzales, an aviation consultant with Briscoe Group, as "rhythmic bumpiness. You won't have trouble walking around the cabin, and you can expect to see flight attendants out with the service cart." And the other three levels thusly, "*Moderate turbulence* has increased bumpiness and will feel more erratic. You might also feel strain from your seat belt. Anticipating this level of turbulence, pilots will turn on the seat belt sign alerting passengers to return to their seats. *Severe turbulence* is rare and comes with short bursts of weightlessness and more strain on your seatbelt. During *extreme turbulence*, the rarest form of rough air, you will experience violent jolts, and objects in the cabin can get tossed around."

For the sake of example, in contrast to Flight 2019, let's call "Black Tuesday," October 29, 1929, when 16 million shares of stock were sold by panicking investors who'd lost faith in the American economy, extreme turbulence.

Flight 2020 (Take Off)

In many ways, this year began with the same mild turbulence of 2019. Perhaps because many of the same issues (China/Brexit/etc.) have yet to be resolved. But it's nothing that would cause a pilot to ask us to buckle up. That's because the positives of last year also remain largely the same. Unemployment in the US remains extremely low at 3.5%, while Canada checks in with a healthy 5.8%. The European Union is down to 6.3% from over 10% just a few years ago. Interest rates and inflation remain stubbornly low around the globe. Strong sales this holiday season demonstrate a continued consumer confidence.

To everybody's surprise, bumpy air hit last week in the form of a US drone strike on two Iranian military leaders. Followed by Iran's retaliating with missile strikes on US airbases in Iraq. The markets, of course, were temporarily spooked, as they often are by the potential of war. But things quickly calmed, so much so that Thursday saw the Dow Jones hit record highs, moving up over 200 points, with many experts predicting the markets having even more room to run.

While there is a lull in the US-Iran tensions, there are still threats to the global economy if and when they are again heightened. The most obvious of those is a sharp increase in oil prices and the economic slowdown that might cause. While this might be the short-term effect of an escalation, North America has become energy independent over the last decade. No longer does OPEC and the Middle East control oil prices. This is turbulence for which we're well prepared.

But there is the potential for more rough air later this year. Iran is, of course, capable of major cyber-attacks and proxy wars. These things, and their effects on the markets, can't be predicted with any certainty.

Despite all the technical advances in aviation, it's impossible to always avoid turbulence. But pilots have several tools at their disposal to help minimize or evade the bumps.

Before takeoff, dispatchers and meteorologists create a route they deem smoothest for the flight. This is based on atmosphere at the time. Once airborne, the crew has a weather radar display in the cockpit, which provides the latest information on the conditions ahead. If they see a thunderstorm in their path, turbulence is nearly assured. But they can alter the route some, depending on how much fuel the change would use. Precipitation is also a good indicator of turbulence and the pilots have a screen that indicates the strength of the rain in those pockets, allowing them to choose the smoothest of the routes. Mountain wave turbulence can also be predicted by charts and maps, as well as by pilots studying cloud formations. A lens-shaped lenticular cloud at a plane's altitude, for example, is a sign some bouncing could lie ahead.

Flight 2020 (Forecast)

Much of the murkiness remaining from 2019 seems ready to be clarified. Boris Johnson's strong majority in parliament indicates Great Britain and the European Union are finally on the path to a compromise that will lead to a deal by year's end. This should help both the UK and EU in addressing their economies and bolstering investor confidence.

The USMCA is likely to be ratified by the US, Canada, and Mexico in the very near future. This will only help the North American economies in their solid push forward. Central bank policy makers should keep interest rates low throughout the year, keeping the feared recession at bay. (OCM sees little chance of one in the next two years.) Wages, which gained a healthy 3% plus pace last year, should keep growing at a robust clip in 2020. Tight labor pools don't lend themselves to stagnant wages and this year shouldn't be any different. With increased income, consumers will help keep companies' earnings on the plus side of the ledger. With equity markets in the US and Canada fairly valued, there shouldn't be any urgency for a market correction any time soon.

For pilots, turbulence is usually seen not as a safety issue, but one of convenience. When they look for smoother conditions, they do so with passengers' comfort in mind, not because the plane's wings might snap off. Keeping your beverage from spilling, not the plane in the air, is the focus.

Most large passenger planes are designed to take a significant amount of punishment and have been tested to endure extreme amounts of stress. To wit, the FAA reported just 44 injuries due to turbulence in 2016. A drop in the bucket when you consider 932 million passengers flew domestic airline flights that year. (As a side note, USA Today reported that, with the exception of a passenger who suffered a fractured vertebra on one flight, most serious injuries were sustained by flight attendants who were thrown around while standing.) Over the history of modern aviation, the number of airline crashes caused by turbulence can be counted on one hand.

A Message from the Cockpit

By researching and understanding the fundamentals of the companies and markets we invest in, we create what we see as the smoothest route for your returns. And by diversification and close monitoring, we design your portfolio to withstand turbulence.

And there will be some bumps this year. The upcoming 2020 election, like all American presidential elections, promises to cause investor anxiety. Both sides will highlight the negatives of the other and concerns of the unknown (candidates' plans for taxes, regulation, foreign policy, etc.) will add a speculative nature to the markets. Trying to hedge against one candidate or the other always makes investors jumpy. But, as we've said before, presidents generally have very little impact on the economy, and making investment decisions based on who might become, or stay, president is a fool's errand.

We are likely to see a dip in stock prices from time to time this year. More so than on last year's flight. And while we may not see the great returns of 2019, nothing in our forecast calls for seatbelts to be buckled and tightened.