Starboard Advisors

October 29, 2018

MARKET COMMENTARY: OCTOBER TURBULENCE

Market Update

Tom Burnett, CFA, Starboard Investment Committee

October has proved to be a difficult month for stock market investors. The Dow Jones Industrial Average is down some 7% for the month and is now off 8% from its 26,951 high level. While the tech-heavy NASDAQ Composite Index is down 10% for the month, it remains in positive territory for the 2018 year to date.

We do expect short-term volatility to continue, but we do not see this 'correction' as the onset of a full-blown bear market. The US economy is growing at an annual rate of 3%, corporate earnings are holding up and expected to grow next year, and interest rates continue to hold at historically low levels. We encourage investors to take a long-term view and avoid reducing equity exposure during market sell offs. Those investors with material cash holdings should consider adding to their portfolios with quality names, many of whose stock prices have declined 20% or more from their yearly highs.

Client Perspective

Bart Weisenfluh, CFP ®, Founder & President

"It's not as important to figure out what is going to start the next forest fire as is to focus on what tools it will take to put it out or control it."

-Hank Paulson, Former U.S. Treasury Secretary

Unless you are a Red Sox fan, there has not been a lot of good news in October, especially in the stock market as summarized above. For the most part, equities are back where we began the year and we have two months, mid-term elections and the holidays in front of us. Although every family at Starboard is different, much of the strategic planning and cash flow assumptions are the same. Generally, the biggest differences between various families' investment portfolios is the portion of "risk on" assets (those assets that are most likely to have price swings in the short term). These

assets are most often comprised of equities in the form of individual stocks or stock orientated mutual funds and ETFs. After a month like October, I always think it's prudent to review three questions with clients:

1. **Do you have enough cash and bond holdings to fund your required cash flows for the next 3 to 5+ years?**
   a. Example: If your annual cash flow needs (from investments) are $150k then having between $450k ($150k x 3 years) and $750k ($150k x 5years) in cash and bonds would be prudent. Of course, as is with most of financial planning, this process of allocation is far from perfect and has to allow for the most human of emotions such as risk tolerance or the ability to sleep at night. In addition, many families prefer an extra cash cushion for the flexibility of investing *during* sell offs and or taking advantage of higher bond yields by purchasing them *after* rates have increased. Regardless, we equate 3 to 5+ years of cash/bond holdings as an asset that allows families to endure through turbulent times and NOT have to sell stocks at depressed values for cash flow needs (i.e. selling stocks in 2008 and early 2009). Conversely, often when equities have risen or exceeded allocation targets, we seek to "trim" them for cash flow needs.
   b. With money market rates now over 1% we're recommending most clients to hold at least 5% cash (or near cash alternatives) of their overall accounts – many have 10% for increased flexibility. The downside of cash is that when markets "run" it becomes a drag on overall return. For this reason, we always separate our equity/stock performance in our reporting so clients understand exactly where returns are or are not coming from.

2. **Can you endure another 10% of stock market sell off?**
   a. Even though this is a frequent situation we discuss with families, it remains a possibility and would put us -20% from recent highs (currently YTD stocks are about flat). We often try to equate a correction in "dollar terms" to families so they have a tighter grasp of how their net worth may be impacted. It is our opinion that this type of further correction is a possibility but would more likely be brief in its tenure if it were to occur. Regardless, it's important to note that we

believe that despite the market turbulence, over the longer haul (the next 5 to 10 years) equities will come out on top.

3. **Are you a long-term optimist with the stock market?**
   a. If the answer is no (or partially no) with any of the above it's time to recheck your allocations and drill down into a deeper discussion on your overall holdings. The vast majority of families we work with that are living off of their investment portfolio are targeting 4-5% annual withdraw rates. To attain these rates (over time) families are required to seek out at least some level of risk assets (most often equities) to fulfill a portion of the returns. The bell weather 10 Year U.S. Treasury Bond is still only about 3% pushing asset allocation to levels where families must depend on a combined return of bonds and stocks to provided sustained cashflow over time.
   b. The key with families is finding the right mix and being as transparent as possible with potential outcomes. One positive from the recent sell off is that in conjunction with a year of overall robust corporate earnings, U.S. stock market valuations have come back down to earth and opportunities to enter in (or back in) to the market are presenting themselves.

We continue to be on station at Starboard and look forward to speaking with many of you as we enter yearend and the holiday season. If you should have any immediate questions or concerns, please do not hesitate in contacting us.

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