IRONWOOD
Investment Counsel, LLC

Ironwood Investment Counsel, LLC constructs and manages customized investment and wealth management programs designed to meet our clients' unique goals and objectives. Our distinctive process maximizes performance through return enhancement, risk reduction, tax efficiency, and cost containment.

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Winter 2019

Cash was King

2018 was a difficult year for investors. Last year, cash was the best performing asset in a balanced portfolio of marketable securities, with a positive return of 1.8%. Over the last 15 years, cash averaged an annualized return of 1.3%, according to statistics provided by JP Morgan research. That return placed cash second to last for the 15-year period! In fact, the returns for most asset classes were turned upside down in 2018 from their 15-year averages. Fixed Income broke even for the year, the second-best performer, (as compared to a 15-year return ranking third from the bottom). With all the market volatility, it is no surprise that commodities and small cap stocks were down 11.2% and 11.0% respectively while foreign stocks were the laggards. Specifically, the Developed International Market indexes were off 13.4% while Emerging Markets declined 14.2% in 2018. Domestically, the Russell 1000 Value declined by 8.3% while the S&P 500 was down 4.4% for the year.

The decline in the S&P 500 was well distributed across all industry sectors. The Energy sector led the way down with a negative 20% return. There were several other sectors down double digits as well. The normally safe Consumer Staples sector was down 11% for the year. Only Healthcare and Utilities were positive for the year (barely).

There is some evidence that economic growth in the U.S. is slowing, but little to suggest a recession will occur in 2019. Third quarter GDP grew 3.5% and economist consensus for the 4th quarter seems to hover around an increase of 2%. Indicators are beginning to give inconsistent signals about which way the economy is headed. For example, just recently, the Purchasing Manager's Index (PMI) declined, while the weekly job growth numbers hit records levels. Interestingly, the unemployment numbers also ticked up as a result of more workers entering the job market.

The short-term economic momentum appears stable at the least, but evidence is accumulating that the U.S. economy is nearing the crest of a 10-year economic cycle. According to J.P. Morgan research, 18.1 million jobs have been created, U.S. Gross Domestic Product increased from $14 to $21 Trillion, and household wealth tripled within a 10-year span.

Most investors think of the experience of our last recession (2008-2009) as representative of a typical recession, when, in reality, that recession was a once-in-a-century event. While it is generally thought that economic cycles don't die from old age, they ***do*** die from growing imbalances. The 2000 recession was the product of Dotcoms' disproportionate valuations, while 2008 was ignited by a systemic imbalance in mortgage lending. Current signs of imbalance are beginning to show up in the market for labor and high levels of non-financial corporate debt. Add rising interest rates, fiscal contraction and an unsustainable balance of payments and we very well could see a recession by the turn of the decade. If a recession were to develop after 2019, it is not likely to be severe. It is also comforting to note that for every one month of economic contraction we have endured over the last 50 years, the U.S has enjoyed over five months of expansion.

So, what do we do now? Ironwood's penchant for quality and consistency works well in this kind of economic environment. As interest rates rise, bonds will become more attractive. It has always been our preference to avoid cyclical stocks, preferring the longer-term secular strengths in areas like technology and healthcare where other factors- like demographics- drive earnings performance.

Market wisdom predicts that as volatility settles down, prices settle up. There are currently a number of existing conditions which are keeping investors slightly off-balance. The market does not respond well to uncertainty, and in such circumstances, quality and consistency are an investor's greatest assets.