THE DANA VIEWPOINT

September 28, 2018
Dow: 26,459

Red Sky

Red sky at night, sailors delight; red sky at morning, sailors take warning. This is a common phrase that actually has its roots in the Book of Matthew in the New Testament. Shakespeare also used it in one of his plays. This saying seems to indicate that the exact same observed condition could have different meanings depending on the timing of the observation or one's point of view. In the markets, there are always different camps of people with different interpretations of the current situation, sometimes leading to vastly different views of the future. Both sides are usually most vocal at market highs and lows, and we are at a market high right now.

The S&P 500 surpassed its January high in late August, the Dow Industrials reached a new high in late September, and small caps and the NASDAQ have been on a steady rise for most of the year. Virtually everyone feels good when their market holdings are appreciating, and the market has roughly tripled over the last ten years. The S&P 500 Index has gone from 1900 to 2900 in just the last three years, and it is natural to question whether gains can continue. Even with a 1,000 point gain in the S&P 500 Index, earnings have grown roughly in line with stock prices, so the P/E ratio is near its trailing three-year average, a good thing for those looking for room for prices to move higher. On the other hand, some look at the same facts, the same 'red sky', and see a market propped up by debt with a market correction coming soon. Some worry (including us) that the market leadership, which so far has been a handful of the largest tech companies, must broaden for the market to continue to rise. The fact that the Russell 1000 Growth Index has outperformed the Russell 1000 Value Index for seven consecutive quarters and by more than 29% since the beginning of 2017 really highlights the momentum of the technology and health care sectors. This strong divergence in performance will normalize over time,

(CONTINUED ON REVERSE SIDE)

but occasionally, like the early 2000's, it's created a violent "red sky." So, while we see more positives than negatives for the stock market in the near term, we encourage investors to remain disciplined and not ignore security valuations.

After the latest FOMC meeting and press conference by Fed chair Jerome Powell, the markets had little reaction. We see this as a good thing, as the Fed has telegraphed their expected rate path for the future. If all goes well, expect another rate increase in December and more to come next year. Their current plan is that Fed funds will end up around 3%. So far, the rate increases have not upset the market run. Because the rate increases have been well telegraphed, and long rates have not moved significantly higher on inflation concerns, bond market returns have only been slightly negative this year. The housing market has continued on a healthy path, and economic news has continued to be positive. Powell has said that he has a fear of inverting the curve (short rates higher than long rates) so the two- and ten-year Treasury yields will probably have to continue moving up to continue to allow the Fed to raise short rates. This may not be a pressing issue until the middle of 2019.

We continue to operate with a measure of conservatism in the fixed income market and maintain a preference for high-quality holdings with shorter durations. While we appreciate the opportunities higher bond yields provide, we should all continue to enjoy the stock price increases driven by higher earnings while they last. It's a virtuous circle, and we don't see the end yet.

Random Thought for September 2018: "I think the first duty of society is justice"

- Alexander Hamilton

20700 SWENSON DRIVE • SUITE 400 • 53186 • P.O. BOX 1067 • BROOKFIELD, WI • 53008-1067 • 262.782.3631 • FAX 262-782-0581
365 ERICKSEN AVENUE.N.E. • SUITE 312 • SEATTLE, WA • 98110-1888 • 206.855.8781 • FAX 800.560.6227

E-Mail: dia@danainvestment.com
Web Site: www.danainvestment.com