QV UPDATE

Weekly Commentary | August 11, 2017

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Comfortably Invested

Stock market volatility has been exceptionally low, and by some measures, at record levels. Maybe the dog days of summer have resulted in a lethargic investor base focused on holiday time, rather than worrying about the markets? Who can blame them? There's always something to concern ourselves with when it comes to investing, it can get pretty exhausting.

Our guess, however, is there is more to it than investors being distracted at the moment. There seems to be a growing comfort with being invested. It has taken many individuals a long time since the great recession and bear market of 2008/2009, but they seem to be making their way back to the markets. This is not just a feeling we have, but rather a reflection from a recent update on a Charles Schwab quarterly conference call. (Schwab is a large U.S. financial services company).

"*New accounts are at levels we have not seen since the Internet boom of the late 1990s, up 34% over the first half of last year… [I]t's clear that clients are highly engaged in the markets. We have cash being aggressively invested into the equity market as the market has climbed. By the end of the second quarter, cash levels for our clients had fallen to about 11.5% of assets overall. Now that's a level that we've only seen one time since the market began its recovery in the spring of 2009.*"

In addition, according to U.S. data, the level of borrowing to invest has reached yet another record high.

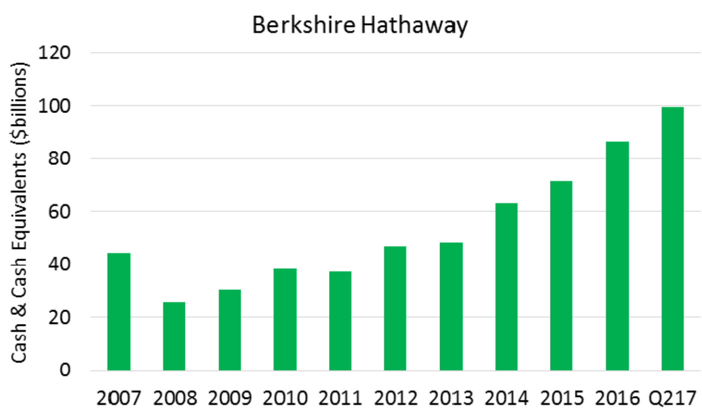
Why are investors either more comfortable or less concerned in the current environment than say 5, 6, or 7 years ago when the markets were half their current level?

That question typically prompts us investing types to unload a plethora of economic and financial ratios to justify a certain viewpoint about the state of the economy and markets into the future. But in reality, the answer lies in basic human nature. The cycle of fear and greed. The more the markets go up and the further away we get from the last major correction, the emotion of greed displaces that of fear. That has been a constant for all stock market cycles in history.

We're guessing many investors with a new-found confidence are looking into their proverbial investing rear view mirror. What they see are global stock markets broadly appreciating over the past five years, with the U.S. S&P 500 index generating a 15% annualized return. These returns are excellent on their own, but look fabulous when compared to the measly yield one gets in alternatives such as savings accounts. The old habit of extrapolating past returns into the future is just as risky now as it has been in past cycles.

With the U.S. market up nearly 275% from the last bear market and valuation risk high, we'd argue the best risk/reward opportunity for this cycle is far behind us. We're not suggesting that just because volatility is low and there is a greater enthusiasm in the markets they have to tumble. In fact, they can stay this way for a long time. We firmly believe though that the return opportunity today carries with it substantially greater risk than that same return when markets were well valued and investors scared.

We'll leave you with one last thought before you get back to your dog days of summer. As the chart below illustrates, Warren Buffett's Berkshire Hathaway reported recently that it held a record $100 billion (U.S.) in cash at the end of the quarter. Ironically, while the general public's confidence and exposure to the market has been increasing, Mr. Buffett has been building a stockpile of cash potentially waiting for a better risk reward opportunity.



Source: Capital IQ & QV Investors