SYM FINANCIAL ADVISORS

FALL 2018

UNCOMMON INSIGHTS

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The "Madden Curse" and its Lesson to Investors

Equity Focus: 7-10 Year Horizon

In 2007, NFL phenom LaDainian Tomlinson turned down an offer to appear on Madden 08's box cover. The Madden series is a massive video game franchise and serves as a modern day "Wheaties box" status symbol for professional football's most electrifying players. What could motivate a player to forego the prestige of being the face of a game that has sold over 130 million copies? While endorsement contract negotiations probably played a part, many suspect that Tomlinson grew superstitious and joined his team's worried fans in fearing the "Madden Curse" – a term for players losing their edge after appearing on the game box.

In LaDainian's absence, the immensely talented Vince Young took the Madden honor. Prior to that, he led the Texas Longhorns to one of the most exciting NCAA championships in history, was a first round draft pick, and earned the 2006 NFL Offensive Rookie of the Year Award. During the years after gracing the Madden 08 cover, Vince had a streak of injuries, lost his starting position, and was ultimately released by the Tennessee Titans in 2011.

Vince Young's Madden experience looks more like the rule than an anomaly. Peyton Hillis (Madden 12 box cover pictured above), Adrian Peterson, Marshall Faulk, Michael Vick and many other athletes' careers all seemed to peak just prior their Madden cover year, only to abruptly fall or at least slide downward from their superstar status.

The NFL is an intensely competitive landscape and in order to achieve top status, every detail needs to line up to perfection. A player must play aggressively but avoid concussions, and outwork the competition in the offseason without incurring overtraining injuries. They must earn the trust of their coaches and teammates and stay out of legal trouble. Their teammates must stay healthy to reliably block. A few tough opponents should have some second string players on the field, and a couple of referees' calls should fall in their favor. The team's management must obtain not only their elite talent, but a complementary surrounding cast while remaining within salary cap constraints. Everyone who earned a Madden cover inevitably paired their world-class talent and effort with at least a few factors outside their control.

This phenomenon has an important parallel to investing. To be the NFL's top player for a year, everything has to go right. And as the Madden Curse illustrates, it's very unusual for everything to go right for very long.

In investing and statistics, the tendency of incredible streaks to subsequently collapse is dubbed "mean reversion." Throughout history we've seen examples of investment categories running away from the pack (like Marshall Faulk's five 1,000+ yard rushing seasons pre-Madden) only to subsequently disappoint (after his Madden cover, Faulk missed 5 games to an ankle injury and never again had a 1,000 yard season).

With the stock market, it's easy to be critical in hindsight. In the moment, though, you can typically find some legitimately impressive reasons for a streak. Consider the following examples:

- In the 1980's, Japanese stocks were "obviously" the place to be. The Japanese quality revolution was bearing fruit, the yen was strengthening versus the dollar, and even in 1987, a rough year for U.S. markets, the Nikkei returned a positive 49 percent. Over that decade the Nikkei went up eightfold vs. the Dow's threefold growth. In 1990 the Nikkei plunged 38% and remained considerably down for more than a decade.

- In the 1990's, the computing and internet revolution led many to anticipate a complete commerce overhaul. Optimism poured into United States companies embracing the new economy, with company names ending in ".com" enjoying an added stock price premium. The dollar strengthened, and American stocks appreciated by over 400%. Subsequently, by 2010, the S&P finished lower than where it started ten years earlier and earned the nickname "the lost decade."

- In 2008, high quality bonds provided nearly everything an investor could ask for. In the throes of the worst global financial crisis since the great depression, the "Barcap" bond benchmark outperformed the S&P 500 by over 40%. In fact, bonds had appreciated in value during each of the rough market years since 2000. However, moving to a 100% bond portfolio in 2008 would provide a different sting: it preceded the longest bull market in U.S. history when stocks dramatically outpaced bond returns through 2018.

As the Madden Curse teaches us, there are good reasons for investors to appreciate what it took for a market or investment category to earn its "box cover." Still, we proceed with caution in our expectations for repeat performances.

Today, the most expensive categories of American stocks have earned their Madden box cover for reasons much like those of the 1990s. The dollar has strengthened and stock prices have taken off for tech-savvy businesses seeking to disrupt industry stalwarts. Early and substantial central bank stimulus, tax code revisions, disproportionate investor enthusiasm, and other factors contributed to the rally as well.

We are optimistic that this wave of innovation will improve American lives in the years ahead and we're glad we've allocated a portion of our equity models to this part of the market. However, we recognize that caution is warranted following such an outperformance streak. Like the long list of top NFL stars, repeat performances are very difficult for individual investment categories to achieve.

Yes Virginia, there is a value premium

Numerous academic studies recognize the value premium as a tool to enhance stock portfolio returns; however, value strategies' lower returns year-to-date have alarmed some investors. Considering this investment strategy in light of the recent lagging history, we conclude that value investing has strong merits going forward.

Value investing is the practice of buying cheap stocks, and the value premium describes the extra return accompanying the strategy. "Cheapness" can be defined by comparing a company's low stock prices to its dividends, profits, sales, or net worth per the accountants' financial statements. Some strategists compare the stock price to forward-looking measures like the average research analyst's earnings forecast, or the investor's own evaluation of future profitability. It all comes down to the same in the end: a low purchase price in proportion to the underlying business's economic activity.

It seems self-evident that value investing is a great practice. It bakes a dose of conservativism into a portfolio which can provide comfort ten years into a bull market when the average investment is appearing more and more expensive. Value stocks have outperformed growth stocks over most ten-year periods. During those few eras when they didn't, the anomaly was followed by exceptional outperformance within the cheap stock category.

On balance, value investing can sustain stretches of time when it is out of favor. Admittedly, those are the times that can test individuals' mettle. In 2018's first 3 quarters, the S&P Value Index lagged the S&P Growth Index by nearly 14 percent. In such environments it becomes common to hear claims such as "this time it's different," "Warren Buffett (a legendary value investor) has lost his touch," and "cheap stocks are cheap for a reason: they're not as good as expensive stocks." While the future is inherently unknowable, switching to expensive stocks when value lags remains ill-advised. The only other times in history that value has lagged to the current degree were immediately preceding the Great Depression and the lost decade of the 2000's. Value can quickly rally to make up lost ground when expensive stocks falter, and we got a small taste of this as recently as late 2016.

While any single stock pair can move contrary to expectations, they can also provide context on what drives the value premium. In this case consider CenturyLink, a telecommunications company and value stock. We propose to compare that to Tesla, a headline-grabbing futuristic growth stock. For the past few years CenturyLink has paid a $2.16 dividend annually. CenturyLink's stock price is currently $21.72 and if they keep up the payment, roughly ten years of dividends would fully pay an investor back on today's investment (plus they would additionally still own the stock at its future price). In contrast, Tesla is not yet profitable and does not yet pay a dividend. Tesla's $283.00 stock price is entirely based on flashy estimates of future growth.

On average, anticipated earnings growth for growth stocks like Tesla is too high over what's anticipated for value stocks like CenturyLink, and this is a big part of why value stocks typically outperform over long horizons. We believe it is a mistake to equate the most exciting company with the most promising investment opportunity, because price is important. The recent rally for expensive companies is just part of the ebb and flow of the market. We don't expect it to continue forever, and we believe it's bad practice to switch allocations in order to buy the most expensive stocks in the world - even if we expect such businesses to eventually turn a profit, and especially right now when they've already rallied so far.

HAPPY 50TH SYM!

In September, SYM celebrated with legacy events in Midland (shown here), Fort Wayne, Carmel, and Winona Lake! THANK YOU to everyone who came to celebrate with us. We're looking forward to the next 50 years!

WELCOME to SYM James Gallagher and Evan Stark!

James, left, joined SYM as a financial analyst after graduating from University of Pennsylvania's Wharton School of Business. Evan, right, joined the South Bend team as an associate financial advisor. He holds CFP® and AIF designations. Help us welcome these two great additions to the SYM team!

WELCOME to SYM Andrew Kessinger!

Please join us in welcoming Andrew as our new IT administrator! Andrew is a U.S. Air Force veteran and will be working from the Fort Wayne office.

A BIG CONGRATULATIONS to Amanda Legler

upon the completion of her MS in Personal Financial Planning from the College for Financial Planning!

Inflation, Flattening, and (Less) Communication

Bond focus: 1-6 year horizon

Several interesting developments are unfolding in the bond world. As the year progresses, we are observing rising interest rates in conjunction with inflationary pressures, a flattening yield curve, and a change in Federal Reserve communications. While the conservatism baked into our stock portfolios has resulted in a modest lag year-to-date, our defensive measures have boosted the bond model's results.

Front of mind for the bond strategy is the normalization of interest rates from their crisis-lows. Inflation risk is a key consideration when designing a bond portfolio and the current market has several inflationary characteristics. Tariffs can increase the cost of foreign goods and make domestic products more expensive as well. Also, the labor market is very tight with wage pressures spreading throughout the country. While these are both inflationary forces, it's worth mentioning that in recent years inflation has been below the 2% target and is currently at the desired level.

As for the flattening yield curve, SYM's Investment Committee is watching closely and deliberating a variety of "what-if" scenarios. For example, at the end of 2013, a 10-year treasury bond was yielding 2.66% more than a 2-year treasury bond (3.04% and 0.38% respectively). Today, the 10-year treasury bond only yields 0.23% more than the 2-year treasury bond (3.05% and 2.82%). Since the Federal Reserve appears on course to continue raising short-term rates, analysts are debating whether the 10 year yield will rise in light of healthy inflation and strong economic growth, whether the whole thing is distorted by the decade's global stimulus programs, or whether we are facing a frightening inversion. We note that yield inversions are typically more of a stock forecasting tool; however steepness and flatness does inform our search for bond opportunities. While the debate is healthy and the yield curve may not ultimately become inverted, we take inversion prospects seriously and are preparing for the scenario if it occurs.

In a reversal from previous Federal Reserve communication policies, Jerome Powell (the new chair) announced that some of the forward guidance which assured markets in the financial crisis is now unnecessary. In the future, some points of policy communication will be halted. Bond markets generally shrugged off this announcement, likely for three reasons: First, previous communications described the metrics the Federal Reserve considers when enacting rate policy, thus we've been "taught how to fish" and can simply look at the source data. Second, Powell wanted to downplay the precision implied by forward guidance and move the Fed from the economic spotlight. Third, this messaging modification could provide a bit more nimbleness in a generally healthy economy, so it's an opportune time to lower the burden of transparency. While we were a bit surprised that markets took the news so well, the shift is probably not a huge deal in light of those three points.

Based on the sources the Investment Committee considers and discussions with our collaborative teams, we believe that more opportunities currently exist for bonds to lower risk than to generate outsized returns. Rather than reach somewhere we shouldn't, we currently plan to stay the course with the defensive bond lineup that is in place.

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