First Quarter 2016

Money Movers Were Busy in Q1

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On the surface, the stock market changed little in this year's first quarter, with the S&P 500® providing a total return of 1.4%, the Dow Jones Industrials advancing 2.2%, and the NASDAQ Composite declining 2.8%. But these period-end numbers give little clue of market swings during the quarter. For the first six weeks of 2016, stocks headed decisively down – and by the time they hit bottom on February 11, these three indices had declined by 11% or more. By several measures, it was the worst start to a first quarter in stock market history.

What goes down …

But then, beginning February 12, stocks marched consistently higher, ending with the quarterly returns noted above. During one period spanning 25 trading days, the S&P 500 advanced by 12%! These dramatic moves in stock prices were accompanied by wails of anguish on the way down followed by sighs of relief and cautious disbelief on the way back up. In short, investors were taken on an emotional roller coaster ride in a span of three months.

Motion vs. action

We have money movers to thank for these bouts of extreme market volatility. A "money mover" is anyone who buys or sells securities to try to capture short-term profits or avoid short-term losses. Unfortunately, this group makes up much of today's Wall Street denizens. They are securities traders rather than long-term investors. They move money based on arcane algorithms, recent analyst recommendations, quarterly earnings results, the day's macroeconomic news, their interpretations of stock price charts, political shifts, or myriad other reasons. Those caught up in this frenzied trading affect almost $11 trillion in assets, including many actively managed equity mutual funds ($5.9 trillion in assets), hedge funds ($2.1 trillion), and exchange-traded funds ($2.9 trillion). The regrettable result is that stock prices can swing wildly, as they did in this past quarter.

Market value vs. intrinsic business value

To avoid getting whipsawed in today's stock market, you need to distinguish clearly between changes in market values and changes in intrinsic business values. Market values, determined by stock prices, are inherently volatile over the short term. By contrast, intrinsic business values, determined by corporate earnings and cash flows, are much more stable. In fact, many companies' intrinsic business values changed only slightly over the past three months even while their stock prices may have gyrated by 20% or more. Sadly, these extreme market value fluctuations can spook some investors and impel them to make poor investment decisions. Investors who chose to sell on February 11 because of stock price declines – at the bottom of February's roller coaster ride – were forcefully reminded of this fact.

A chorus of forecasts

Stock prices fluctuate partly in response to the array of forecasts from up and down Wall Street. For instance, during the first six weeks of 2016, we heard predictions of a U.S. or global recession, a collapse of the Chinese economy, systemic credit problems for the banking industry due to falling oil and gas prices, and an impending collapse of many emerging markets. As these and other expectations dart in and out of the headlines, money movers try to capitalize on them, and the markets move erratically. Although many forecasts turn out being incorrect, they do move markets. Noted economist John Kenneth Galbraith had it right years ago when he opined that "there are two kinds of forecasters: those who don't know, and those who don't know they don't know."

Style that creates substance

Against this confusing background of market swings and unreliable forecasting, our distinct approach to equity investing can be reassuring. Our clients can achieve their objectives of wealth accumulation most effectively by owning successful businesses over the long term. We strive to identify companies likely to grow their cash flows and therefore their intrinsic values over the next five to ten years. We pay particular attention to the durability of each prospective company's business model under a variety of economic circumstances, seeking particularly sturdy businesses. A portfolio of such companies is likely to compound wealth over many years. We have based our investment strategy on this disciplined approach.

We hope that you take comfort in our investment style – especially during times of market volatility like those we have already seen in 2016. Our focus on intrinsic business values rather than on erratic stock prices helps us separate the meaningful from the noise and to compound your wealth at attractive rates over extended periods.

We try to combine this common-sense approach to investing with a high level of professionalism and responsiveness to meet your wealth management needs. We thank you for choosing Hilliard Lyons Trust Company, and we pledge our continued best efforts on your behalf.

Past performance does not necessarily predict future results, and historical prices and returns may not be achieved in the future.

Should you have questions about the information contained in this Investment Update or regarding your investments, please contact your Hilliard Lyons Trust Company Portfolio Manager.

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