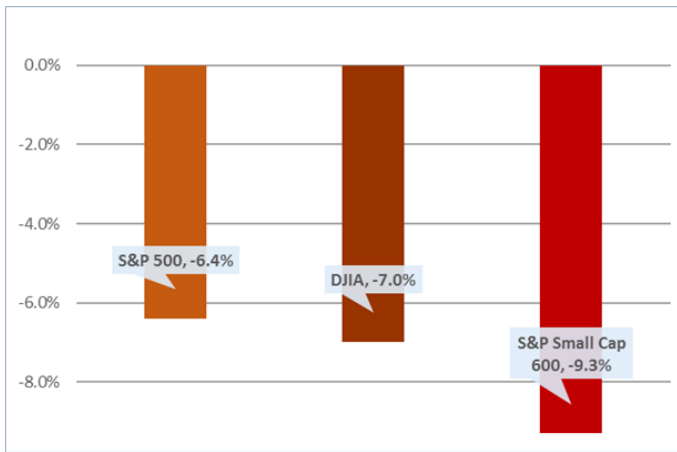




Stock Market Gyration Don't Inform You, But They Can Serve You

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The past quarter produced the first stock market decline exceeding 10% since 2011. During this rocky three-month period, the S&P 500 declined 6.4%, the Dow Jones Industrials fell 7.0%, and the S&P Small Cap 600 lost 9.3%. At its worst point, the S&P 500 pulled back 12% from high to low. This recent decline has left most stock indices with year-to-date losses. Declines like this may leave investors fearful



of further drops, and some will make investment decisions based on that fear. Investors are better served when they make investment decisions based on long-held investment disciplines rather than on the emotions of the day.

Investors who want to survive and excel in today's stock market need to understand the nature of the beast. Stocks are priced rationally much of the time but not all of the time. Furthermore, we don't consider stock market gyrations to be the least bit informative to long-term investors. These market movements are generally the result of massive amounts of money being moved around abruptly in search of short-term profits.

Mechanized market forces at play

Waves of buying and selling sometimes hit the markets with great force. Computerized trading strategies, or algorithms, are a significant factor in stock market price movements today. Up to 70% of daily trades are done by high-frequency trading strategies, which try to make pennies on millions of trades executed in milliseconds. In addition, hedge funds hold over \$3 trillion in assets, and many of them use complicated short-term trading strategies to justify their massive fees. And then approximately \$2 trillion in exchange-traded funds let investors indiscriminately buy or sell all of the stocks comprising different indices with the push of one button. It is absurd to think that all of this rapid-fire trading would result in rational, meaningful price movements.

It is unfortunate that all of these complex trading strategies designed by math wizards dominate short-term price movements in the markets today. It is no wonder that many investors equate investing in stocks to placing bets at a casino. The violent price movements that occasionally result from this market structure serve only to confuse and frighten many investors unnecessarily.

Keeping it simple

Albert Einstein had it right when he stated that "everything should be made as simple as possible, but no simpler." The disparate forces affecting market performance today are anything but simple. But investors can operate quite successfully in this environment by adhering consistently to a certain set of investment disciplines.

Simply stated, *stock market investors can succeed over the long term by thinking and acting like long-term business owners.* Many stock market participants today think of shares of stock as trading chips to be rapidly bought and sold. But the most successful investors think that shares represent an ownership interest in business enterprises full of hard-working people

producing goods or services that their customers need or want. These investors prosper over time by concentrating their efforts on excellent companies run by talented, honest people and investing in those businesses when they are trading at discounted prices. It is often these downward swoons in the market that serve the long-term investor by providing inexpensive entry prices for many different companies. After an initial investment, holding such shares for many years allows investors to compound their investment at attractive rates of return, because successful companies generally grow in value. This long-term business owner approach is the bedrock investment discipline that we follow at Hilliard Lyons Trust Company.

Motion vs. action

As far as stock market movements, we agree with this advice from investment legend Benjamin Graham's classic book, *The Intelligent Investor: The Definitive Book on Value Investing*:

Price fluctuations have only one significant meaning to the true investor. They provide...an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times, [investors] will do better if [they] forget about the stock market and pay attention to...[their companies'] dividend returns and...operating results.

We do not rely on stock market movements to inform us about the companies in our portfolios. Instead, we rely on the business results that those companies produce for

information. We then calculate an intrinsic business value based on those results for each company in our portfolios and compare them to the prices in the stock market. Based on these calculations, stocks today are moderately undervalued. While this observation tells us nothing about the future direction of stock prices, it does give us comfort that stock prices today are not wildly overvalued.

Now what?

Investors naturally wonder where the stock market goes from here. Because we don't believe short-term stock prices can be predicted with any certainty, we'll quote Warren Buffett here: "A prediction about the direction of the stock market tells you nothing about where stocks are headed, but a whole lot about the person doing the predicting."

What we will say during this time of declining stock prices is we believe strongly that a portfolio filled with great companies run by talented people, purchased at sensible prices, will continue to produce attractive returns in future years just as they have in the past. This belief in the productivity of long-term business ownership will continue to drive us as investors. We appreciate your loyalty to Hilliard Lyons Trust Company and we pledge our best efforts as we apply these long-held investment disciplines to your portfolio.

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

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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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