American Heritage Financial

December Update **December 5, 2017**

Swimming with the Sharks

Do you recognize this month's title? It's borrowed from a 1994 movie with Kevin Spacey, who plays, ironically, an over-the-top abrasive boss who abuses a young (male) employee. Those of us a bit older may also remember the original iteration of the title, an old fashion ***book*** from 1988, *"Swim with the Sharks Without Being Eaten Alive"* by Harvey Mackay's; written to teach marketing professionals how to "out-sell and out-negotiate" the competition. At any rate, the title sums up the *bewildering, treacherous and even thrilling waters of 2017* with its mushrooming sex scandals, madness in Washington, cryptocurrencies, digital everything, the death of retail as we know it, horrific natural disasters, deadly assaults and escalating geopolitical risks along with more constructive items such as surging economic growth, record-breaking stock markets, growing corporate profits and huge advances in medical therapies, among many others. Some of these topics are not directly tied to financial markets but there are enough indirect connections which make it worth taking a closer look.

The continual revelations about sexual misconduct by powerful men may be the story of the year (yes, even bigger than the chaos in Washington). You know the remarkable list of remarkable names—some of whom haven't been too surprising, while others (Charlie Rose, Garrison Keillor) are real shockers. Powerful men are falling like dominos as once discounted women are being believed. While we may wonder if there are any powerful males that have NOT engaged such misconduct, a bigger question is where this will all end and if it is beginning to smell a bit like McCarthyism. But there is more to it than the social justice issue and there are links to economics and the markets.

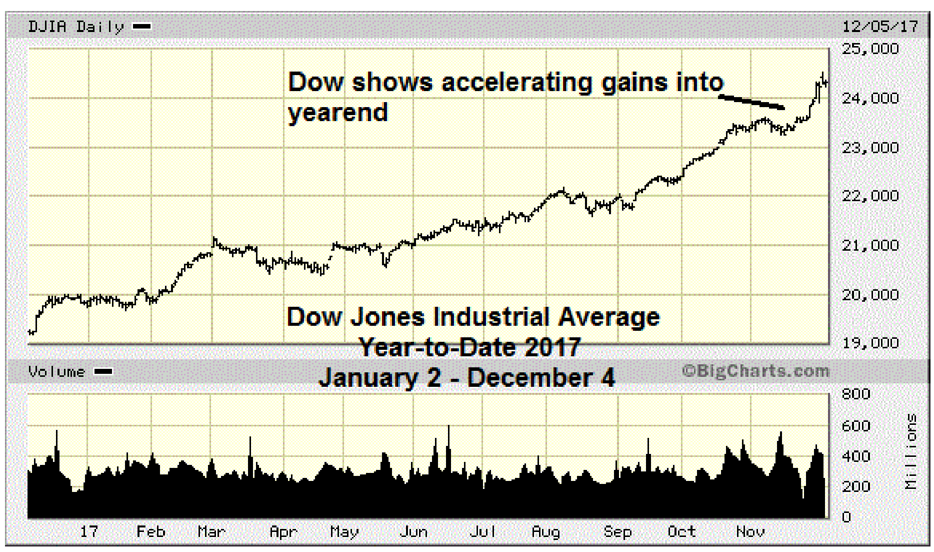
Deeper thinkers will, over time, identify much more profound implications to the misconduct revelations phenomena than we can provide, but we can identify two ways the impact relates to markets and the economy. The first is to understand why these issues are been acknowledged **now,** and are being met with such dramatic responses. **Why now when this problem has existed as long as there have been powerful people?** It is a testament to the ***power of our digital age*** (as are many current big issues). The new, more powerful, influence of consumers—of ALL individuals—resulting from ***ubiquitous social media*** is driving new responses to long-standing issues. In case you forgot: **Twitter** helped elect a President and is now the voice of his administration. Social media from Facebook to WeChat to LinkedIn and many more provide a means to create and share information and ideas in ways never before possible. Ways that corporations, politicians and the broad public understand cannot be ignored. Social media will have an increasing role in our daily lives and its economic impact will continue to grow.

The second broad implication of these revelations of abuse by the powerful is the possible influence these people may have had on our collective thinking and conscious. It is a complex question but could chauvinistic attitudes of some of these powerful men have influenced political decisions, social mores or spending habits? For example, take the complaints that Matt Lauer and other men demeaned Hillary Clinton in last year's election. More credible (in my mind) is the long-term influence Hollywood moguls have had on the smut that passes for entertainment and the major impact that has had on our collective values. Could we hope that a long-term outcome of today's revelations is more balanced, humane and civilized content and conversations in our media, entertainment, social and political interactions?

Two more thoughts can be added as a post script to this conversation. One, it is interesting that the default reaction to accused media or entertainment people is immediate firing, banning and disgrace while the worst result for accused politicians (that I am aware of) is that Congress is setting up "sensitivity training" (paid for by taxpayers, of course). Second, going further down the road of political madness is the incomprehensible possibility that a man with the history of sick abuse which Roy Moore is accused of may be elected to the U.S. Senate on December 12. The only reason that election could go in Moore's favor is similar to the reason Donald Trump was elected. It is the *negative reaction to his opponent*. It may be the opponent's character or it could be what his/her election could mean from a political perspective. But, in my opinion, it is the same reaction which drove the electorates' response in November 2016; and another example of the divisiveness of our politics.

Although sex and politics may be welcome diversions from our normal economic fare, what about other issues that make us feel we are swimming with sharks? Affecting us both positively and negatively—but definitely making us feel vulnerable—is our growing digital world. We mentioned above the pervasive and growing impact of social media. A more recent phenomenon is the explosion in "value" of **Bitcoin**. Bitcoin is the most widely accepted of new "cryptocurrencies," or digital currencies which, supposedly, will someday replace currencies issued by governments. If you question the future viability of digital currency, consider that incoming Fed Chair Jerome Powell stated just last week that he is watching developments closely (he also warned of risks such as cyber-attacks, criminal use and privacy issues). Or, consider that ***Yahoo*** is now providing quotes on over 100 cryptocurrencies. Recently, I heard an amazing first-hand story of a local businessman paying a hacker in Bitcoin in order to get his hacked files back.

More significant than cryptocurrency is the new technology these currencies are based on: **blockchain**. The easiest definition of blockchain I can provide is that it is a continuously growing list of ***digital records*** which are linked, secured and resistant to modification. It is widely accepted that blockchain technology will revolutionize record keeping, transaction processing and document storage. It is one more new marvel of technology to watch. Cognizant and IBM are two stocks in many client portfolios which are expected to lead the commercialization of this exciting new revolution.



If you have read this far, you may be looking for the answer to the question many clients have begun to ask; **"What is going on with this stock market?"** The easy answer is that it is just more of the same, but a whole lot more. Stocks have been moving steadily higher all year. They have (pleasantly) surprised optimistic investors and astounded the cynics. The leading stocks have been the dominant "big growth" beneficiaries of our digital age (i.e. FAANG stocks—Facebook, Amazon, Apple, Netflix, Google, among others). The market has risen due to growing earnings and positive economic news, including a broad global economic rebound. All of this has occurred in a controlled, subdue environment—until recently!

A recent change in the tone of the market is being heralded as the beginning of the end of the long bull market by pessimists, or simply normal rotation of a maturing bull market by the optimists. The first change is an acceleration of market gains, volume and volatility over recent weeks. For example, the Dow Jones Industrial Average had gained a strong 13.4% for the first nine months of the year as of September 30. The index added more than 4% in both October and November and is now up 22.9% year-to-date through December 4. Volatility also increased with the illusive "1%" day that has been missing all year appearing in November (both up and down days of +1% for the NASDAQ). November also was the heaviest volume month so far in 2017.

Rotation is a more profound change in market character. While the overall market continues its steady ascent, there has been a dramatic shift in leadership. The long-invincible tech leaders such as FAANG stocks, semiconductors and other technology darlings have experienced big sell-offs while 2017's lagging sectors such as small caps, banks and "value" stocks have surged. The tech leaders suffered moderate declines in the second and last week of November but the rotation is accelerating into December. On Monday, the S&P 500 Info Tech sector dropped by 1.6%, including a 4% drop for Microsoft, a 5.1% loss for chip-maker Nvidia Corp., and a 1.5% dip in Netflix. At the other end of the spectrum, the KBW Nasdaq Bank Index rose 2.1% for its fifth consecutive session of gains. Analysts speculate that possible tax reform measures will have an outsized benefit for bank shares and small-cap stocks, while the tech sector's 18.5% effective tax rate in 2016 is already lower than the 20% proposed corporate tax rate. "Rotation" often occurs when markets age as the leading stocks become over-valued and over-owned and lagging stocks appear cheaper and potentially more rewarding. It is a sign that the long bull market is aging—but that does not mean the bull market is yet done. (And that comes from an aging—but not yet done—investment advisor!)

We hope you will take a break from the bewildering, treacherous and even thrilling waters of 2017 to relax and enjoy the Holidays with family and friends. We would like to express our gratitude for the confidence you express in our continuing relationship. All of us at American Heritage Financial extend our Best Wishes for a healthy and prosperous 2018!

Best regards,

Ted Ingraham

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Questions or comments?
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