YOSEMITE CAPITAL MANAGEMENT

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COMMENTARY

"Life's tragedy is that we get old too soon and wise too late." – Ben Franklin

"*Unless you can watch your stock holding decline by 50% without becoming panic-stricken, you should not be in the stock market.*" - Warren Buffet

We Americans truly live in an amazing time. A smart phone can view live video, send pictures, use apps (many of them free) that can quickly provide many useful services as well as endless information, text, email, and even (gasp) serve as a telephone where you can actually talk to another human being. Self-driving cars are on the road being actively tested today. We have access to medicine and medical care that can cure or at least alleviate the symptoms of many diseases that not that long ago would have been fatal. Healthy food is plentiful and inexpensive, readily available in the local store or shipped to your door.

Until very recently, some of these and many other amazing things existed only in the realm of science fiction. Human ingenuity, dedication, and perseverance turn ideas into reality. The fact that people all over the world wake up every day to make their lives better are ultimately what drives the economy and the financial markets higher over the long term. Progress will continue because advances beget advances, meaning little changes build on each other to eventually form big improvements. This is why ***optimism is better than pessimism over the long term***.

None of this is to minimize the existence of some very real problems. Injustice, poverty, and inadequate access to health care, to name just a few problems out of many that are easy to find, continue to be part of the human condition, including in the United States. The horrors of war, both real and potential, are ever-present in many places around the world. The fact remains that weapons that can kill millions at a time and even annihilate the entire planet are at man's fingertips. Nevertheless, the story of humankind is all about progress, often in response to these very problems.

But progress does not occur smoothly, nor do corporate earnings. Therefore, the stock market cannot grow smoothly either. ***Volatility is the price one must pay to obtain higher returns*** over other

instruments. This is a key reason why ***participants in the stock market MUST have a LONG TERM PERSPECTIVE and the DISCIPLINE to stick with their long term plan*** through thick and thin if they are to make the most of what the American stock market can provide to their portfolio.

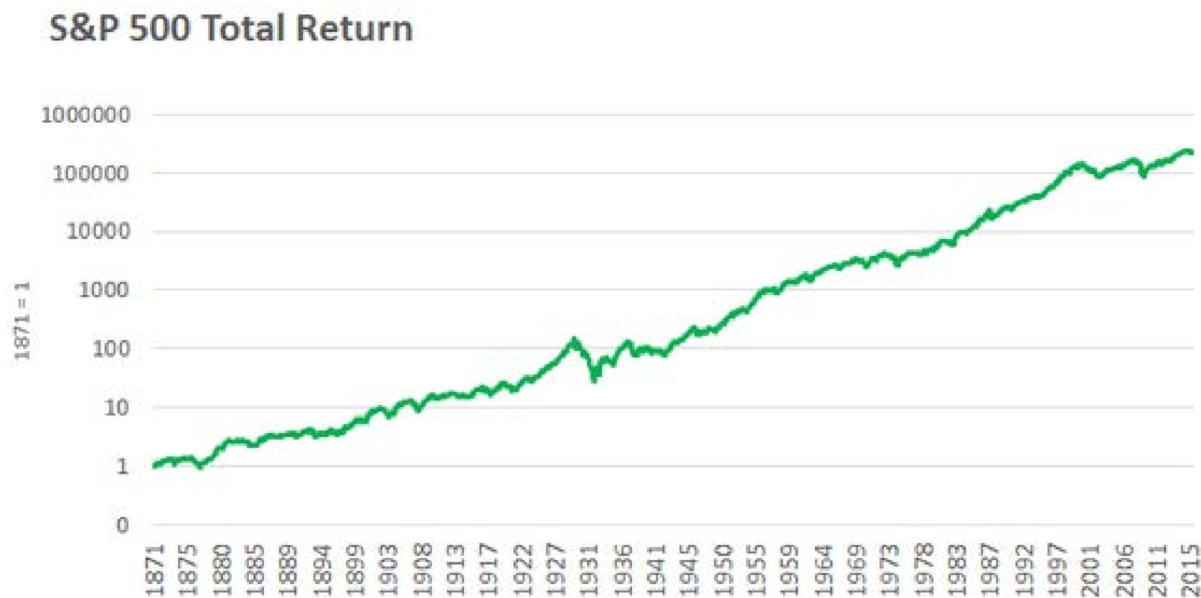
Stock valuations are currently high, though not excessive, in our view. Volatility has been low for the past year or so. The bull market that sprang from the ashes of the credit bust in March 2009 is now the second longest in American history (though bull markets do not die of old age alone). The current rally that began in February 2016 has had quite a run, up about 30% according to Morningstar. The Fed has continued to raise the federal funds rate, with market consensus expecting two or three more hikes by the end of this year.

Given these developments, we provide a gentle reminder that ***a decline in the stock market is overdue***. When this occurs or how far this will go is not knowable in advance, which is why we do not advocate guessing when to move in or out of the market. Such an event could stem from any number of reasons, and it is quite possible that markets could pull back with no apparent trigger. This is simply what stock markets do and even ***a decline of 15% to 20% would be considered normal***. Declines greater than 20%, the general definition of a bear market, usually only occur in the context of a recession (which we do not foresee in the near future), although there are exceptions such as the 1987 market crash.

Regardless of the extent, a decline in the stock market is NOT a reason to be concerned, or panic, or especially change a long term plan because, in the United States, the odds are extremely high that such declines are TEMPORARY and not permanent. We know this because ***the American stock market has had a 100% recovery rate from every single decline it has ever experienced*** no matter the cause – without exception. See Exhibit 1.

Exhibit 1, The S&P 500 and Proxies Since 1871

The American stock market has had a 100% recovery rate from every single decline it has ever experienced – without exception



Source: The Motley Fool

If market declines are temporary, then by definition declines in the value of a portfolio are also temporary. ***Temporary declines are not losses*** – unless one panics and makes a bad behavioral decision.

Some might respond "Okay, but that was the past and things are different today. What about [insert your favorite scary economic scenario]? Or what about [insert your favorite scary financial market scenario]? Or what about [insert your favorite scary political scenario]? Or what about [insert your favorite scary foreign scenario]? Or what about [insert your favorite scary other kind of scenario]?" Any or all may sound plausible and even come true to some extent. But ***there always have been and always will be scary possibilities***. Their constant presence is reflected in the bull market adage that "stocks climb a wall of worry". ***The time to be concerned about the financial markets is when people perceive there are no worries and everything is going great!*** See 2007 at the height of the credit bubble or 1999 at the peak of the dot-com boom for examples. Otherwise, darting in and out of a portfolio based on fear of what could happen simply hasn't worked out. See Exhibit 2.

Exhibit 2, There Are Always Scary Possibilities
Darting in and out of a portfolio based on fear of what could happen hasn't worked out

Source: The Irrelevant Investor

So regardless of the cause, ***market declines will happen***. Therefore it's best to ***have the right ATTITUDE about market declines***.

For market participants who are still making contributions to their portfolios:

Stock market declines provide the opportunity to buy securities at lower prices

For retirees who are living off their portfolios and making withdrawals:

They already have a significant portion of their portfolio (usually at least 40%) not exposed to the stock market (this is true for YCM clients; if not true for other readers, let's talk)

That portion not in the stock market is in bonds instead, which often increase in value when stocks go down, thus mitigating portfolio fluctuations

With the right attitude, market participants can at least tolerate and maybe even embrace a temporary market decline.

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Morgan Housel, one of the best financial writers of our day, penned two articles a few years ago that highlight how good we have it. They may be worth reading any time one needs a bit of perspective.

> "50 Reasons We're Living Through the Greatest Period in World History"
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> https://www.fool.com/investing/general/2014/01/29/50-reasons-were-living-through-the-greatest-period.aspx
>
> "Everything Is Amazing and Nobody Is Happy"
>
> https://www.fool.com/investing/general/2013/11/29/everything-is-great-and-nobody-is-happy.aspx

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We remind clients and friends that all of our Commentaries are on our web site. As always, please contact us if you have any questions.

http://www.YosemiteCapital.com/News-Commentary

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The S&P500 Index is designed and maintained by Standard & Poor's (a division of The McGraw-Hill Companies), is a free-float market capitalization weighted index that includes 500 leading companies in leading industries of the U.S. economy, and is intended to be an ideal proxy for the total market. This index is calculated on a total return basis with dividends reinvested and is not available for direct investment.

The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency). This index is calculated on a total return basis with interest reinvested and is not available for direct investment.