

## The Capstone Quarterly

Happy summer! We hope you are having a good year. We continue to monitor the market ups and downs and always welcome your feedback.

### Bryce's Point of View

-By Bryce Pease, CFP®, Chief Investment Officer



Okay, let's all take a deep breath.

If someone were to put you in a room and force you to do *nothing* but read headlines and predictions, you'd probably get whiplash. That's because there's always so much conflicting information and analysis out there about what's happening, or what's going to happen. The result is a lot of uncertainty – and if there's one thing the markets hate, it's uncertainty.

In this letter, I want to briefly recap a few of the stories behind that uncertainty. Then, I want to tell you exactly what my team and I are doing about it.

### Trade War

The long-running Trade War with China blew up in a big way last month – and then expanded into a two-front war with our neighbors to the south.

Early in May, President Trump placed a new 25% tariff on all Chinese imports that had been previously been spared.<sup>1</sup> Soon after, China responded with more tariffs of their own. Then, just as the smoke started to clear from that announcement, the White House announced a *new* set of tariffs – this time on Mexico.

Why does this matter to the markets? In the short term, it all goes back to uncertainty. Remember, a tariff is essentially a tax on imported goods. With over \$50 billion a month moving back and forth across the border every month, higher prices on Mexican products could potentially have a major impact on the economy.<sup>2</sup> After all, American businesses rely heavily on everything from Mexican cars to Mexican cables; from food to appliances. Tariffs could lead to longer and more costly supply chains, which in turn can eat into corporate profits.

When that happens, the markets hurt.

On the other hand, recent history suggests the markets can be remarkably resilient to the Trade War's effects. Often, when new tariffs are announced, the markets will dip and then rise again. Furthermore, the news broke out on Friday, June 7, that the tariffs on Mexico will *not* come to pass – at least for the time being.<sup>3</sup> That's why the only thing we *can* be certain of is, well, uncertainty.

### The Economy

After roughly a decade of growth, signs of a slowing economy continue to stack up.

Economists use various indicators to forecast where the economy will go. One indicator is the job market. While the nation's unemployment rate remains historically low at 3.6%, fewer and fewer new jobs are being added. In May for example, the economy added only 75,000 new jobs, which seems like a lot but was far less than the 180,000 most experts predicted.<sup>4</sup>

Another indicator is the yield on U.S. Treasury bonds. To put it simply, the yield is the return you get on a bond. Bond yields will often fall when bond *prices* – the amount you pay when you purchase a bond – go

up. Bonds are often perceived by investors as being less risky than stocks, so during times of uncertainty, more and more investors will pile into bonds, driving *up* the price and driving *down* the yield.

Got all that? If not, that's okay, because here's what really matters. When the yield on short-term Treasury bonds rises higher than the yield on long-term bonds, economists tend to sit up and push their glasses further up their noses. That's because this "inverted yield curve", as it's often known, is rare, and sometimes signals an impending recession.

An inverted yield curve is happening now.<sup>5</sup>

I could go on for pages and pages on how bonds and the overall economy intersect, but time is precious, and you shouldn't have to spend yours reading about things like inverted yield curves. (That's what you pay me for!) The point is, there are a number of indicators suggesting that the economy is weakening. On the other hand, optimists can point to other, equally compelling data – like the unemployment rate, the country's GDP, and high consumer confidence reports – that says the economy is doing just fine.

### **So, how do we know what's going to happen?**

We don't. Nobody does. Experts can make educated guesses. Analysts can make data-driven predictions. Some of those will undoubtedly come true. Most will be wrong. Nobody has a crystal ball. The greatest financial advisor in the world can't tell you what will happen in the markets tomorrow, let alone next month or next quarter.

In the world of finance, uncertainty rules. Sometimes its influence is greater or lesser, but it's always there.

### **But that doesn't mean we can't do anything about it.**

I said at the beginning of this letter that I would tell you what my team and I are doing. I can sum it up in two words: **Risk Management.**

Risk management is the process of identifying, analyzing, accepting, and then working to *mitigate* the risks that come with uncertainty. It's one of the most important things I do for clients like you!

Standard disclaimer: All investing involves some risk. It's impossible to get rid of it entirely –nor would we want to! (It's a truism that no risk means no reward.) But we *can* take steps to manage your risk, and that's what my team and I do every day.

It's true, I can't tell you exactly what the markets will do. So, here's what I *can* do instead:

### **Use rules-based investing and a sell-side discipline**

These are just fancy terms for something very simple. While many investors practice something called "buy-and-hold", where they pick some investments and then hold onto them no matter what, we put rules in place that determine *when to sell an investment* if it falls below a certain price, or is likely to. While we can't control whether an investment will grow or not, we *can* take steps to protect you from losing your principal. The ancient Greek physician, Hippocrates, had a maxim: "First, do no harm." I take a similar view. While we want to help you *grow* your money, we're dead set on *protecting* your money.

### **Monitor trends by tracking supply and demand**

Risk management is sort of like buying strawberries. When you go to the store, you might ask yourself, "Is it worth it to buy strawberries today?" The answer would depend on lots of things. Are strawberries in season? Are they more or less expensive than usual? Do they look ripe?

That's how you determine whether buying strawberries is worth the risk or not.

We do the same thing with the investments in your portfolio. We look at whether there's more supply or more demand for an investment – more buyers or more sellers – to determine whether that investment is

trending up or down. We look at how strong or weak an investment is relative to other investments that are similar to it. We look at how close it is to the buy/sell price we've already established. (That's rules-based investing.)

That's how we determine whether the investments in your portfolio are worth the risk or not.

Here's why I'm telling you all this. While we can't know for certain how the Trade War will affect the markets, or whether the economy will veer into a recession, that doesn't mean we're sitting idle. I want you to know that my team and I are working constantly to analyze how these stories could affect your hard-earned money. We're always working to manage the risk in your portfolio. To keep you on track to your financial goals. Sometimes, we try to speed up the journey. Sometimes, we may slow down, or move off the road entirely. But we *always* try to keep you pointed in the right direction.

If you ever have any questions or concerns, please contact me. In the meantime, I hope you enjoy a wonderful summer!

## Casey's Corner

-By Casey Morris, CFP®



### Happy 4th of July!

Almost two-and-a-half centuries ago, fifty-six great Americans signed the *Declaration of Independence*. It was a document that would change the world, but after the Revolutionary War ended, it languished in relative obscurity for many years. In fact, to many, the Declaration was merely a simple letter that had served its purpose. A historical artifact and nothing more.

It wasn't until Abraham Lincoln that the Declaration took its place as the cornerstone of American ideals. As a young prairie lawyer, Lincoln saw it as more than just a simple announcement of separation. To him, it was a statement of human rights. It was the foundation upon which the United States was built. Lincoln made it the core of his political vision, referencing it often in speeches and letters, most notably in the Gettysburg Address.

But it was five years earlier that Lincoln spoke some of the most powerful words ever uttered about our nation's founding document.

In the summer of 1858, Lincoln gave a speech in Lewiston, Illinois. Concerned that people had forgotten what the Declaration said, he decided to remind them. Not many Americans know about this speech today. I myself had never heard of it until someone shared it with me. But after reading it, and thinking about it, I'm convinced there's no better message I can share this Independence Day.

Here is an excerpt<sup>6</sup> of what Lincoln said:

### Lincoln on the Declaration of Independence

*"My countrymen, if you have been taught doctrines [that] conflict with the great landmarks of the Declaration of Independence; if you have listened to suggestions which would take away from its grandeur and mutilate the fair symmetry of its proportions; if you have been inclined to believe that all men are **not** created equal in those inalienable rights enumerated in our charter of liberty, let me entreat you to come back. Return to the fountain whose waters spring close by the blood of the revolution. Think nothing of me – take no thought for the political fate of any man whomsoever – but come back to the truths that are in the*

*Declaration of Independence. You may do anything with me you choose, if you will but heed these sacred principles.*

*The Declaration...was formed by the representatives of American liberty from thirteen States. These communities, by their representatives in old Independence Hall, said to the whole world of men:*

**We hold these truths to be self-evident: that *all* men are created equal; that they are endowed by their Creator with certain unalienable rights; that among these are life, liberty, and the pursuit of happiness.**

*This was their majestic interpretation of the economy of the Universe. This was their lofty, wise, and noble understanding of the justice of the Creator to His creatures. Yes, gentlemen, to all His creatures, to the whole great family of man. In their enlightened belief, nothing stamped with the Divine image and likeness was sent into the world to be trodden on, and degraded, and imbruted by its fellows. They grasped not only the whole race of man then living, but they reached forward and seized upon the farthest posterity. They erected a beacon to guide their children, and their children's children, and the countless myriads who should inhabit the earth in other ages.*

*Wise statesmen as they were, they knew the tendency of prosperity to breed tyrants, and so they established these great self-evident truths, that when in the distant future some man, some faction, some interest, should set up the doctrine that none but rich men, or none but white men, were entitled to life, liberty, and pursuit of happiness, their posterity might look up again to the Declaration of Independence and take courage to renew the battle which their fathers began – so that truth, justice, mercy, and all the humane and Christian virtues might not be extinguished from the land; so that no man would hereafter dare to limit and circumscribe the great principles on which the temple of liberty was being built.”*

This July 4, I hope we all can take a moment to reflect on the meaning of the Declaration of Independence. It goes beyond politics and partisanship. It's more than a historical artifact. It's the foundation upon which our nation rests.

### **Finally...**

As always, if you have any questions about the markets, or about your portfolio, please let us know. We love to hear from you. Feel free to share this report with others that may be interested.

Sincerely,

The Team at Capstone Pacific

P.S. If you ever run across anyone who could use our services, we always appreciate it when you pass on our name.

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an endorsement of the firm by securities regulators nor does it indicate that the adviser has attained a particular level of skill or ability.

<sup>1</sup> “Trump Renews Trade War as China Talks End Without a Deal,” *The NY Times*, May 10, 2019. <https://www.nytimes.com/2019/05/10/us/politics/trump-china-trade.html?module=inline>

<sup>2</sup> “Tariffs on Mexican imports will ripple across the US economy,” *CNN Business*, June 3, 2019. <https://www.cnn.com/2019/06/03/business/mexican-imports-us-economy/index.html>

<sup>3</sup> “US, Mexico Reach Deal to Avoid Tariffs,” *The Wall Street Journal*, June 8, 2019. <https://www.wsj.com/articles/trump-says-u-s-has-reached-deal-with-mexico-11559954306>

<sup>4</sup> “U.S. Added 75,000 Jobs in May as Hiring Slowed,” *The Wall Street Journal*, June 7, 2019. <https://www.wsj.com/articles/u-s-may-nonfarm-payrolls-increased-by-75-000-11559910687>

<sup>5</sup> “Bond Yields Extend Drop Toward 2%,” *The Wall Street Journal*, June 7, 2019. <https://www.wsj.com/articles/bond-yields-extend-drop-toward-2-11559929639>

<sup>6</sup> “Speech at Lewiston,” *Collected Works of Abraham Lincoln, Volume 2*. <https://quod.lib.umich.edu/l/lincoln/lincoln2/1:567?rgn=div1;view=fulltext>