We hope all's well with you and your family, and that you're enjoying this summer so far!

We are sending you this email simply because nothing is wrong. All seems to be good, quiet, calm, even-keeled in the markets; one example of this is illustrated by the VIX, a volatility index, which hit a recent low price this past week.

Why is low volatility bad?

When volatility is high, there's plenty of worry in the market, and prices typically calm down shortly afterwards; conversely, when volatility is low, the amount of worry is low, complacency sets in, and herein lies the complexity. As you've undoubtedly heard us say over the years, we worry more when investors do not and worry less when investors do. We, as wealth managers, need to recognize that the only constant is change, and to quote Charles Darwin, “It is not the strongest of the species that survives, nor the most intelligent. It is the one that is the most adaptable to change.”

A chart we have used over the years illustrating the psyche and potential reaction of investors, as well as its repetitive cycle:

Source: *EquityCompass Strategies*

The stock market typically has 5% price drops a few times a year and 10% declines at least once a year, going back through many years of historical data. The most recent 5% drop had occurred last fall (9/19/14 – 10/15/14), over eight months ago; more importantly, a 10% drop has not occurred in almost four years (early August – early October, 2011). It appears to be overdue for a stock market correction.

Why are we due?

Trees don't grow to the sky. It's a breathing process, and the market needs to take a deep breath.

Is it something to worry about?

No. Not if we've been planning well enough for your ongoing income distributions (if necessary), and income is sustainable for your foreseeable future. So, if you need money from your portfolio over the next six to 12 months, let's assume we've already planned for this. If not, please talk to us about any short-term cash needs we might not know about.

Why shouldn't we be too concerned about lower equity prices?

Although we would love to believe that we are smart enough to buy at the bottom, sell at the top, AND then buy again at the next bottom, it is a fool's game to think so. We recognize that portfolio returns relative to asset allocation risk, i.e., the mix of stocks and bonds in your portfolio, may have been greater than expected over these last few years. The stock market's strong returns from the bottom, following the 2008-2009 financial crisis and last recession/depression, had been warranted - think of a rubber band that doesn't break but snaps back, and now the economy is on a better economic growth cycle.

How does the Fed's statements or actions affect our portfolios?

It seems as if Janet Yellen and the Governors of the Federal Reserve Board are in balance reading the economic signs accurately for now. The economy is improving, albeit in a jagged and uneven fashion. When interest rates rise, due either to market forces (the yield on the 10-year treasury bond had increased from 1.85% on April 17th to 2.28% on May 13th), or by monetary policy (the Fed raising rates), the result could dampen economic growth. We strongly believe that an initial interest rate increase, what we might be seeing today, tempers economic growth, which is a good thing. If the Fed starts raising rates to prevent or control inflationary prices, that also is a good thing. Our concern will be at an inflection point wherein much higher interest rates impede the current economic growth cycle.

What should we be doing?

We were asking clients over six years ago, when portfolio values were low, to mentally inflate those values; in other words, it may not have been as bad as it felt. We are now asking clients to mentally deflate current portfolio values; in other words, things may not be as good as they seem. It is our belief that any impending 5-10% price correction burns off any excesses and allows a longer term growth trajectory to continue.

Besides mentally resetting investor expectation levels, we stay focused on maintaining current asset allocation blends for our clients and balancing equity portfolios with a decent mix of high-growth and dividend-paying, quality companies, which, we think, should continue to grow their respective businesses through this current economic cycle.

An interesting tidbit: this day in history, in 1896, the Dow Jones Industrial Average was first published and the average price of 12 initial stocks was $40.94

We hope you had a great Memorial Day, and that you have a wonderful summer season. Please call us or e-mail us to discuss any thoughts, questions or comments.

Thank you very much, for your continued trust and confidence in allowing us to help care for your financial life!

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