‘Irrational Exuberance’ May Rule the Roost in Stock Markets

Investors are riding a wave of “irrational exuberance” as they extend bullish positions even as they fret over valuations, according to the latest fund-manager survey by Bank of America Merrill Lynch.

While a record net 48 percent of investors say stocks are overvalued, a net 16 percent say they are taking on above-normal levels of risk, another all-time high. Investors are also taking out less downside protection and holding less cash, the survey shows.

“Icarus is flying ever closer to the sun,” said Michael Hartnett, the bank’s chief investment strategist. “And investors’ risk-taking has hit an all-time high.”

The results highlight the dilemma faced by investors in an era where central bank stimulus has flooded the market with liquidity and suppressed returns from less risky assets like bonds. Even after a $5 trillion gain in U.S. stocks over the past year, a net 49 percent said they are overweight, the highest level since April 2015.

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Irrational Exuberance and greed can continue until it doesn’t. —Drew

A bond market crash is a growing worry for investors

One of the top three worries for investors right now is a crash in global bond markets. When asked what poses the biggest "tail risk," or worry for the financial market, 22 percent of global investors considered the biggest risk to be a sharp drop in bonds, according to Bank of America Merrill Lynch's November Global Fund Manager Survey out Tuesday.

That's just below the 27 percent of respondents that fear mistake in monetary policy by the Federal Reserve or European Central Bank the most.

Just 13 percent were most worried about a "market structure"-generated flash crash.

Bond prices fall when yields rise, and some key global bond yields have climbed to multi-year highs in the last few days. The iShares iBoxx $ High Yield Corporate Bond ETF (HYG) was tracking Tuesday for its lowest close since March.

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Rising rates could cause serious problems for the bond market. —Drew

QUOTE OF THE WEEK

“Real riches are the riches possessed inside.”

- B.C. Forbes
Taking a comprehensive look at the overall current stock market

Taking a comprehensive look at the overall current stock market, you can see the chart below representing eight major indices and their returns through the week ending November 17, 2017. In a truly diversified portfolio, the portfolio’s total return is determined by the performance of all of the individual positions in combination—not individually.

So, understanding the combined overall performance of the indices below, simply average the 8 indices (excluding the BofA Merrill Lynch US High Yield Master II Index) to get a better overall picture of the market. The combined average of all 8 indices is 19.21% year to date.

<table>
<thead>
<tr>
<th>Index</th>
<th>Last Week</th>
<th>One Month</th>
<th>Year-to-Date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Close</td>
<td>Net Change</td>
<td>% Change</td>
</tr>
<tr>
<td>MSCI All-Country World Index (ACWI)*</td>
<td>984.39</td>
<td>-1.51</td>
<td>-0.15%</td>
</tr>
<tr>
<td>Dow Jones Industrial Average</td>
<td>23358.24</td>
<td>-63.97</td>
<td>-0.27%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>2578.85</td>
<td>-3.45</td>
<td>-0.13%</td>
</tr>
<tr>
<td>Nasdaq Composite Index</td>
<td>6782.79</td>
<td>31.85</td>
<td>0.47%</td>
</tr>
<tr>
<td>S&amp;P MidCap 400 Index</td>
<td>1840.74</td>
<td>14.99</td>
<td>0.82%</td>
</tr>
<tr>
<td>Russell 2000 Index</td>
<td>1492.82</td>
<td>17.54</td>
<td>1.19%</td>
</tr>
<tr>
<td>MSCI EAFE Index (EFA)</td>
<td>68.91</td>
<td>-0.37</td>
<td>-0.53%</td>
</tr>
<tr>
<td>MSCI Emerging Markets Index (EEM)</td>
<td>46.82</td>
<td>0.53</td>
<td>1.14%</td>
</tr>
<tr>
<td>Markit iBoxx USD Liquid High Yield Index*</td>
<td>267.22</td>
<td>0.09</td>
<td>0.03%</td>
</tr>
</tbody>
</table>

*Above returns include dividends
Data Source: Investors FastTrack

Market Perspectives (through 11/17/2017)

60/40 Allocation: 10.39% YTD
(60% S&P 500/40% Barclays US Aggregate Bond Index)

S&P 500: 15.19% YTD
Barclays Agg: 3.20% YTD

Term of the Week: Cryptocurrency

A cryptocurrency is a digital or virtual currency that uses cryptography for security. A cryptocurrency is difficult to counterfeit because of this security feature. A defining feature of a cryptocurrency, and arguably its most endearing allure, is its organic nature; it is not issued by any central authority, rendering it theoretically immune to government interference or manipulation.
Global Equities: Global equity indices were mixed, with developed international stocks down, US stocks flat, and emerging markets up in weekly trading. Markets were trending down midweek until improved prospects for US tax reform gave equities a shot in the arm. Among domestic equity sectors, Energy fell sharply after enjoying several weeks of gains, as oil price volatility picked up and Chinese industrial demand for copper and other metals fell.

Fixed Income: The benchmark 10-Year US Treasury Note yield was relatively unchanged at 2.34%. Domestic high yield bonds endured a wild week of trading, with the price of the iShares iBoxx US High Yield Bond ETF (Ticker: HYG) falling all the way to its 200-day moving average before bouncing back sharply to end the week 41 basis points higher. Spreads on high yield bonds reached their widest levels in nearly three months, at 3.97% midweek, before easing back to 3.76%. High yield bond mutual fund and ETF outflows were massive in the weekly period ended November 15th, at $4.44 billion, but buyers returned as the yield on the Bank of America Merrill Lynch US High Yield Index rose to near 6%. A variety of factors may have triggered the panic selling, including a spike in spreads on communications and media bonds, concerns over tax reform, and year-end profit taking.

Commodities: Oil price volatility returned in advance of the month-end OPEC meeting. Concerns over the agreement restricting crude output weighed on crude prices, with doubts growing over whether Russia would sign on for another round of cuts. Industrial metal prices fell after weaker-than-expected economic data out of China, which accounts for nearly half of global copper consumption. Copper prices had risen roughly 25% year-to-date to three-year highs.

Industrial production strengthens: The Federal Reserve's industrial production index reading for October confirmed the recent strength reported by regional data. Manufacturing output surged 1.3% month-over-month, crushing consensus estimates for a 0.3% increase. Motor vehicle production increased 1.0% while technology production was up 1.1%.

Tax reform progress: The US House of Representatives has passed its version of the tax reform bill and the Senate Finance Committee has finalized its version of the bill as well, to be voted on after the Thanksgiving holiday. If successful, GOP leaders would then work to reconcile the two bills, which differ on many key issues. Up for debate are the number of tax brackets (four for the House’s version, seven for the Senate’s), the timing of a corporate tax rate cut (the Senate proposed a one-year delay), a Senate-proposed repeal of the Affordable Care Act’s individual health insurance mandate, and whether to cap or eliminate entirely state and local income tax deductions.

Japanese hot streak continues: Japan is currently enjoying its longest streak of economic expansion in sixteen years after data showed GDP grew at an annualized rate of 1.4% in the third quarter. Aggressive stimulus measures from Prime Minister Shinzo Abe appear to be paying dividends, and increased demand for Japanese exports have offset lower consumer spending.
In utilizing an approach that seeks to limit volatility, it is important to keep perspective of the activity in multiple asset classes. At Horter Investment Management we seek to achieve lower risk with higher returns. More specifically, we seek to achieve superior risk-adjusted returns over a full market cycle to a traditional 60% equities / 40% bonds asset allocation. We do this by implementing global mandates of several tactical managers within different risk buckets.

For those investors who are unwilling to stomach anything more than minimal downside risk, our goal is to provide a satisfying return over a full market cycle compared to the Barclays Aggregate Bond Index. At Horter Investment Management we realize how confusing the financial markets can be. It is important to keep our clients up-to-date on what it all means, especially with how it relates to our private wealth managers and their models.

We are now in year nine of the most recent bull market, one of the longest bull markets in U.S. history. At this late stage of the market cycle, it is extremely common for hedged managers to underperform, as they are seeking to limit risk. While none of us know when a market correction will come, even though the movement and volatility sure are starting to act like a correction, our managers have been hired based on our belief that they can accomplish a satisfying return over a full market cycle, while limiting risk in comparison to a traditional asset allocation approach.

At Horter we continue to monitor all of the markets and how our managers are actively managing their portfolios. We remind you there are opportunities to consider with all of our managers. Hopefully this recent market commentary is helpful and thanks for your continued trust and loyalty.

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**Chart of the Week:**
The Chart of the Week shows the drawdowns of the S&P 500 index since the start of the bull market March 9, 2009. The S&P 500 continues to hit new all-time highs and is only 1.15% (as of 11/15/2017) down from its recent all-time closing high on November 8th.

**Chart created by Hanlon Research, data from Morningstar. Commentary and opinions are those of Hanlon Investment Management.**