Gore Capital Management

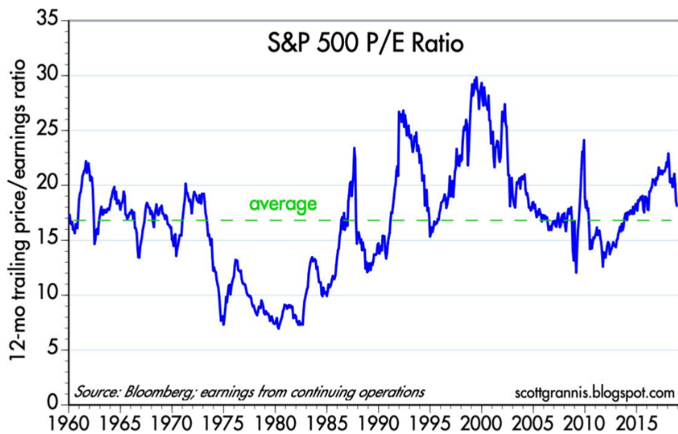
Our only client is you.

Another day, another 1,000 points. Up or down? Why not some of both? Volatility is certainly the story of the year, and the reasons behind the volatility are (as usual) a combination of irrational fear and valid concern about the near future of the economy.

To the fear we think is irrational…

The good news first. Corporate earnings for the third quarter were stellar. According to Factset research, 78% of companies reported a positive earnings surprise with a blended earnings growth rate of 25.9% over the third quarter of 2017, well above the expected growth rate of 19.3%. That figure represents the best earnings growth in eight years, due in part to the Tax Cuts & Jobs Act but also a healthy economic backdrop (Source: Factset).

Speaking of a healthy economy, US GDP is on pace for 3.3% annualized growth this year after a 3.5% read in the third quarter and 4.2% in the second quarter. Even better news, consumer spending (the largest component of GDP by far) was up 4%, the best growth in four years. The Purchasing Managers' Index, a popular measure of manufacturing activity, was 59.3 in November. Any number above 50 indicates expansion. (Sources: CNBC and ISM).



Finally, stock market valuation. The price-to-earnings ratio (P/E) is a simple and popular measurement of the market's general value. Because the ratio is made up of two components, price and earnings, P/E can remain stable while the stock market (the numerator) climbs if corporate earnings (the denominator) are also rising at a similar rate. This is what we've experienced for the past few years; strong corporate earnings fueled most of the market's growth in 2016 and 2017, though P/E ratios did become slightly overvalued as the rise in price exceeded the rise in earnings. Now, thanks to an awful October and November, P/E ratios have declined back near long-term levels (Source: Factset). Why is that important? Bubbles and crashes are usually preceded by astronomical valuations and runaway P/E ratios, and we're just not seeing that in this environment.

In support of the valid concerns…

All of the data referenced above are classified as "lagging" or "coincident" indicators of economic conditions, meaning they tell you what's already happened or what's happening currently. But what about the future? There are two main headlines keeping market participants on their toes: trade and the Federal Reserve.

The trade squabble could turn into a full-blown war. Tariffs have been implemented on both sides with threats of further tariffs in the coming months. Presidents Trump and Xi met at the G20 conference in Argentina a few weeks ago and agreed to a 90-day truce to continue working out their differences. On the surface, this is very good news as it shows both sides are willing to talk. However, markets are concerned that the agreement was merely a "headline handshake" rather than the beginning of

Market Statistics	Q4 2018	YTD (as of 11/30/18)	2017	3-Year Annl.	5-Year Annl.
S&P 500	-5.04%	4.54%	21.10%	16.59%	13.25%
Dow Jones Ind. Avg.	-2.98%	5.59%	28.11%	20.49%	14.57%
Russell 2000 (Small Cap)	-9.50%	0.65%	14.21%	16.65%	10.64%
MSCI EAFE (Foreign)	-8.08%	-9.39%	25.03%	9.23%	4.42%
MSCI ACWI (Global)	-6.14%	-2.55%	23.97%	13.40%	8.67%
MSCI Emerg. Mkts. Equity	-4.95%	-12.24%	37.28%	12.36%	3.61%
Barclay's Aggregate Bond	-0.20%	-1.79%	3.54%	1.31%	2.16%
S&P GSCI Gold (Spot)	2.49%	-6.36%	13.68%	2.36%	-2.05%

Source: Morningstar

substantive discussions. In our minds, negotiations are in everybody's best interest – the Chinese need the US and the US needs China – but only time will tell what comes next.

The Federal Reserve has a dual mandate: stable prices and maximum employment. We are enjoying both right now; unemployment is near historic lows and inflation is moderate. There's concern that Fed Chairman Jerome Powell is not paying attention to this data and is convinced that more interest rate increases are necessary to keep the economy from overheating. He has recently made two novice mistakes, first telling the press that "we're a long way from neutral [interest rates]" in October, and then seemingly backtracking that position in late November by saying that rates "remain just below the broad range of estimates of the level that would be neutral for the economy." Of course, neither statement gives a clear indication of what Mr. Powell is actually thinking (because he's also said they may need to overshoot neutral), but in an already jittery market, investors were all too happy to respond with zeal to both statements.

The big rate-related news of the past week has been worry over an inverted yield curve. A normal yield curve shows higher yields for longer-dated bonds and lower yields for shorter-dated bonds (this should make intuitive sense – if you're willing to invest for a longer period, you should earn a higher return). An inverted curve shows the opposite: shorter-dated bonds have higher yields than longer-dated ones. Inversion is primarily a demand-driven phenomenon. Investors who expect a recession sell short-dated instruments and buy long-dated ones to lock in longer-term interest payments now, believing that the Federal Reserve will have to reduce rates in the near-term to spur the economy. Because the Fed is currently raising interest rates on short-dated instruments, the double-whammy of investors' selling bonds and the Fed's raising rates is causing yields on short-dated securities to rise more quickly than usual. Why is this important? Yield curve inversion has preceded every recession since 1976, usually about 18-24 months before the recession occurs (Source: FRED). Although it is a meaningful signal, it does not mean the dreaded "R-word" is looming around the next corner. Instead, we think it confirms what we already know: this economic expansion could persist for a bit longer, but we are likely nearing its end. Quoting Stanford professor John Cochrane, "recessions are unpredictable."

Putting the two together…

There's an old saying that "markets climb a wall of worry," meaning that a healthy dose of skepticism and fear actually fuels the market's long-term growth. Fear shakes the trees, forcing weak hands out of the market and resetting expectations. Absent that fear, a happy bull market can quickly turn into a bubble… and we all know how those turn out.

In short, we believe responding to these headlines may feel good in the short run, but it is a fruitless and often harmful exercise over the long run. Individuals who are invested according to their risk tolerance and time horizon, and are thus able to weather the inevitable storms, will be rewarded for their patience. As always, re-evaluating that risk tolerance is the best way to combat the urge to sell at the wrong moment. If the market's behavior is making you feel queasy, let's talk about it.

We wish you and your families a very happy and heathy holiday season.

Peter, Ben, & Keri

GCM's Top Holdings	Q4 2018	YTD (as of 11/30/18)	2017	3-Year Annl.	5-Year Annl.
PIMCO Income (PONPX)	-0.09%	-0.32%	8.49%	5.72%	5.55%
FPA Crescent (FPACX)	-4.74%	-1.45%	10.39%	8.98%	6.96%
Litman Gregory Masters Alt (MASFX)	-1.38%	-0.64%	4.51%	4.13%	3.44%
Vanguard Mega Cap Value (MGV)	-1.17%	5.50%	16.79%	16.10%	12.55%
First Eagle Overseas (SGOIX)	-5.26%	-7.85%	14.37%	7.17%	4.29%
T Rowe Price Blue Chip Grwth (TRBCX)	-6.32%	11.40%	36.55%	21.68%	17.57%
Dodge & Cox Stock (DODGX)	-3.23%	4.04%	18.33%	17.28%	12.71%
Virtus Seix Floating Rate (SAMBX)	1.06%	2.66%	3.87%	5.30%	3.97%

Source: Morningstar

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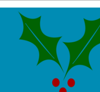
Ben's Corner



What a quarter. What a year, for that matter. This is probably the worst market action I've seen in my (admittedly short) career. Every time some good news emerges, the market tries to stage a halfhearted rally before resuming its drop. It's hard not to feel a bit downtrodden, resigned to living in "the house of pain" (a phrase I'm stealing from Jim Cramer) for awhile longer. All the charts, graphs, ratios, and data in the world can't prevent a market from behaving irrationally, nor can they predict that behavior.

"Boy, there's a bleak picture," you say. "If that's how you feel, why don't we just sell everything until the markets start to look better?" you ask. And you're not alone; we're asked this question all the time, and there are a lot of answers we can give to explain why we believe that such a strategy is ineffective. Here are some of my favorite statistics and comments on the subject:

1. Since 1946, the S&P 500 has experienced a pullback of 5-10% nearly every year. On average, pullbacks require about 2 months to recover. *(we're past this point now)*
2. Corrections of 10-20% happen every few years, with an average peak-to-trough loss of 15%. They usually last about 5 months and require about 4 months to return to breakeven. *(we might be here)*
3. Bear markets with losses of 20-40% have occurred 9 times since 1946, requiring about 14 months on average to recover. *(we're not here yet)*
4. The market doesn't have as many good days as you'd think, and missing them has a significant detrimental impact on your portfolio. Nejat Seyhun, a professor at University of Michigan, analyzed market returns from 1963 to 1993 and determined that, "just 90 days generated 95% of all the years' market gains — an average of just three days per year."
5. Josh Brown, CEO of Ritholtz Wealth Management and a prolific blogger known as The Reformed Broker, reminds us that, "there's never been a stock market crash that the Dow hasn't recovered from."

This is why we feel risk tolerance and financial planning are such vital components of the investment process. If we can make investment decisions according to each client's unique timeline, goals, and ability to stomach the roller-coaster, we can minimize the probability that market declines hamper that individual's financial future. The market has always been volatile and it will likely always be volatile. The causes of the volatility are constantly changing, but like a bad action movie, the plot follows the same formula. Despite what the media may say, there's no reason to believe this time is any different.

Source: https://thereformedbroker.com/2013/11/12/everything-you-need-to-know-about-stock-market-crashes/

Source: https://www.aaii.com/journal/article/stock-market-retreats-and-recoveries.touch

Source: https://www.ifa.com/12steps/step4/missing_the_best_and_worst_days/

Market Movers	Q4 2018	YTD (as of 11/30/18)	2017	3-Year Annl.	5-Year Annl.
Alphabet (GOOGL)	-8.07%	5.34%	32.93%	23.66%	15.12%
Amazon (AMZN)	-15.62%	44.52%	55.96%	57.58%	44.99%
Apple (AAPL)	-20.57%	7.19%	48.24%	28.32%	28.31%
Chevron (CVX)	-1.82%	-1.41%	10.03%	19.71%	3.42%
General Electric (GE)	-33.57%	-54.96%	-42.12%	-18.51%	-8.35%
JP Morgan Chase	-0.75%	6.29%	26.30%	24.92%	18.74%
Microsoft (MSFT)	-3.04%	31.11%	40.22%	39.07%	29.54%
Verizon (VZ)	14.07%	18.41%	3.51%	11.50%	6.73%

Source: Morningstar

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Peter H. Gore, CFA, CFP®, MBA
Benjamin Sadtler, CFA
Gore Capital Management
500 Strawberry Plains Rd., Suite 100
Williamsburg, VA 23188

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