NEWSLETTER

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Strongbox
tailored wealth management

What should you be doing?

For years it seems various pundits – including us - have been writing about the surging US stock market and wondering when the bull run in equities that started after the GFC was going to have run its course. The most recent sharp sell-off in the market already appears to be abating, but this must surely be the beginning of the end of this bull run – maybe!

With the US economy booming – unemployment has reached it lowest level in almost fifty years – all the signs are that – finally – inflationary pressures will rear their ugly head and the Fed will start to tighten monetary policy even more than it has already done. Donald Trump's rantings are unlikely to make any difference to that, it has always been inevitable. Recent comments by the new Fed Chairman Jay Powell implying that interest rates may rise even faster than previously expected led to the rally in Treasuries (in anticipation of higher returns from them) at the expense of equities. But this is all to be expected. Equity valuations are high (the S&P 500 forward PE multiple is now almost 18x) and a correction is inevitable. Increasing costs of wages and borrowing money will put pressure on corporate balance sheets and earnings prospects, especially in the tech sector which has been a huge part of the upward run in markets. And there are still many geo-political risk factors at play – the problematic relationship between the US and China, the risk of rising trade barriers to Europe, and increasing threats to many over-indebted Emerging Market economies. At an IMF meeting in Bali last week, Christine Lagarde warned world leaders against the dangers of protectionism and trade barriers, but the rising forces of populism and nationalism may outweight other considerations.

So the chances are that the major run in equities may be over, but with the underlying strength of the US economy and expectations of good earnings in the short term at least, our money would be on a correction rather than a rout.

Equities comment

The top performing stock in the model portfolio year to date is Noble Offshore which is up 55%. Unfortunately, we bought this stock when oil was close to its high, only to see the share price collapse along with the oil price. Fortunately, the oil price has now started ticking up and this has started to breathe new life into the offshore drilling market.

Noble recently purchased a newly built jack-up rig from another company at less than the cost of construction, and have already secured a three year contract for this rig in the Middle East.

Noble is the most robust and least debt-burdened company in the offshore drilling sector. We look forward to making our money back in this stock as the price of oil continues to increase – which seems likely given the present state of tension and uncertainty in the global geo-political arena.

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Model Portfolio

The model portfolio has reached another all time high, and we have taken the opportunity to make some sales and add to a holding.
We have sold Oracle (realising a gain of 56% excluding dividends) and Aetna (realising a gain of 75% excluding dividends).
We sold Oracle because we were not impressed with the lack of transparency in the latest quarterly report, and we sold Aetna because with the take-over by CVS seeming to be going ahead, there is likely to be little upside left in the price.
We increased our holding in Micron as we feel the market is overlooking the value in this stock over the mid to longer term.

Model Portfolio
Initial value $1m **Current Value** $2.528m
Cash 25% **Shares** 75%

Performance		**Bottom Performer Shares (ytd)**		**Top Performer Shares (ytd)**	
6 months	+4%	Indivior	-55%	Noble	+55%
12 months	+11%	Micron	-14%	CNOOc	+38%
since start	+107%	Alaska Air	-6%	CF Indus	+28%

Investment basics - So what exactly is risk?

Risk is generally defined as “The uncertainty that an investment will earn its expected rate of return”, or, to put it another way, risk is the possibility that the returns on a asset will vary more widely – or be jless than - expected. There are many sources of risk, but the following are the most common:

(i) Business risk – the risk that a business you invest in, either directly or through it’s shares or bonds, does not achieve its expected results and returns are then lower than expected.

(ii) Financial risk – the risk that, because of the way a business is financed, it may not be able to meet its obligations leading to lower than expected returns to stock or bondholders. This is a particular risk in an environment of rising interest rates.

(iii) Liquidity risk – the risk that the asset may not be readily convertible to cash. This risk applies more to hard assets, such as real estate, artworks etc. than to financial assets, although certain kinds of financial assets, such as shares in small companies, can also carry high liquidity risk. Some smaller company shares are sold only in what is known as the OTC (over-the-counter) market, and it can take days if not weeks to find a buyer.

(iv) Exchange rate risk – the uncertainty of the return earned by an investor holding assets in a currency other than his home currency. This is particularly relevant to investors from a small country such as New Zealand who need to invest overseas in order to gain exposure to a wider range of quality assets.

(v) Country risk – the uncertainty caused by the possibility of adverse political events in a country. Developed countries such as the US have lower political risk than emerging or unstable ones.