CENTURION COUNSEL
MARKET COMMENTARY
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In his book *Predicting the Future*, Nicholas Rescher writes that "we are inclined to view the future through a telescope, as it were, thereby magnifying and bringing nearer what we can manage to see." So too do we view the past through the other end of the telescope, making things look farther away than they actually were, or losing sight of some things altogether.

These observations apply neatly to technology. We don't have the personal flying cars we predicted we would. Coal, notes the historian David Edgerton in his book *The Shock of the Old*, was a bigger source of power at the dawn of the 21st century than in sooty 1900; steam was more significant in 1900 than 1800.

In one experimental example, people were asked how much they would pay to see their favorite band now perform in 10 years; others were asked how much they would pay now to see their favorite band from 10 years ago. "Participants," the authors reported, "substantially overpaid for a future opportunity to indulge a current preference." They called it the "end of history illusion"; people believed they had reached some "watershed moment" in which they had become their authentic self.[2] Francis Fukuyama's 1989 essay, "The End of History?" made a similar argument for Western liberal democracy as a kind of endpoint of societal evolution.

This over- and under-predicting is embedded into how we conceive of the future. "Futurology is almost always wrong," the historian Judith Flanders says, "because it rarely takes into account behavioral changes."

Forecasters have a tendency to take something that is (in the language of behavioral economics) salient today, and assume that it will play an outsized role in the future. And what is most salient today? It is that which is novel, "disruptive," and easily fathomed: new technology. You may wonder why we bring this up, as everyone must realize the 4th quarter was one of the worst in years, wiping out gains made over the first 3 quarters. But the market provides great backup for the writing above. In the first three quarters most assumed the market would go up nearly forever with little or no volatility.

We readily acknowledge that your returns for the 4th quarter were below expectations as a perfect storm hit Wall Street. The good news is the S&P 500 has now gained 13% since Christmas Eve, while the Nasdaq is up 16%. After the recent plunge, it would be normal for the indices to give up most of their gains and retest the lows again. That's been a consistent pattern over the past 40 years. But when a plunge is followed by exceptional breadth like we have witnessed in the past month, a low retest has been unlikely.

Rapid plunges when the economy is still expanding, like now, are typically followed by strong forward returns. Moreover, it is encouraging that emerging markets, which have been the hardest hit by the threat of a trade war, reached a 4 month high this week. Those markets originally bottomed in October and retested those lows in December (a possible basing pattern).
It’s certainly possible that some of the rapid gains since Christmas will be given back before the markets moves materially higher. A period of consolidation and retrenchment in the weeks ahead would not be surprising. The trade war isn’t the only thing driving the market, but it has clearly been important and further reduction of trade tensions on will likely drive the market back to its prior range. SPX to the top of its October-December range, just as re-escalation could plunge it back towards its Christmas low.

Robust Domestic Economy:

There is nothing wrong with the domestic economy. Second quarter GDP hit 4.2%. Initial third quarter GDP was reported at 3.5% above the consensus of 3.3%. It would have been even higher but a weakening housing sector subtracted approximately .2% off GDP growth this quarter. Housing investment was down four percent year-over-year in the quarter while investment in commercial buildings fell 7.9%.

For the year, GDP should come in at three percent or better for this first time since 2005. GDP growth should slow down some in 2019 with most forecasters penciling in 2.5% to 3.0% growth. Still, this is significantly above the ‘trend’ and bodes well for job and profit growth next year.

In addition, the amount of recent job openings is more than the official unemployed. That is the first time this has ever been recorded.

Strong Profit Growth:

This strong domestic economy along with the recent corporate tax cut are the two main drivers behind the big profit growth we have seen this year. The third quarter will be the third one this year where year-over-year earnings growth comes in at the low to high 20s for firms within the S&P 500. Usually this only happens coming off recessions after earnings have bottomed. This is a rare occurrence where earnings are spiking this late into a bull market. June of next year will mark the 10-year anniversary of when the Great Recession officially ended. Profit growth will slow down in 2019. However, five to ten percent growth seems reasonable outside a major geopolitical event. We also think the threat of tariffs are overblown in regards to next year's bottom lines.

Interest Rates Are Moderating:

The decline in the market early this month was triggered by interest rates spiking. The 10-Year Treasury yield hit a seven-year high of 3.26% on October 5th. However, that yield has pulled back to 2.80% as of this Friday. Something equities seem to be overlooking at the moment. If interest rates stay at current levels, we think investors will start to notice and this could help the market rally.