

# KWAG April Update

Good Afternoon! I hope this update finds everyone doing well, as we enter the spring and the seventh year of the current bull market. It's hard to believe, but on March 9<sup>th</sup>, 2015 we celebrated the six-year anniversary of the current bull market. Over that six year period, small cap stocks have increased over 200% and have significantly outperformed large caps brethren by more than 40%. That said, it has been one heck of a run regardless of where you've been invested. Of course, every once in a while large cap stocks will outperform small cap stocks, much like they did for a good part of 2014. However, since mid-October (2014), the natural pecking order has been restored and small caps are leading the charge once again. This should not come as much of a surprise to our loyal long-term readers who recognize the benefits of being well diversified across the entire stock market.

## **The Numbers**

Since October 12th, 2014 small cap stocks (as measured by the Russell 2000 price Index) are up 19% (through the end of March, 2015), while large caps (as measured by the S&P500 price index) are up 10%. Since the beginning of the 2015 calendar year, large cap stocks (S&P500) are barely breaking even at 0.4%, while small cap stocks (Russell 2000) are up 4.0%. There are a number of logical economic reasons behind the divergence in large and small cap performance, which we believe will continue for quite some time.

## **The Economy**

Remember, large global companies growth prospects are significantly driven by the global economy, while smaller companies are primarily driven by our domestic economy. Over the last year, the global economy has significantly slowed down, while the US economy has accelerated. This gives small cap stocks an advantage. In addition to the global slowdown, the Federal Reserve has stopped quantitative easing (QE), which has significantly strengthened the US

Dollar. As the US Dollar gains strength, global companies have less of an exporting advantage versus their global peers. This adversely affects their bottom line. Again, this points to a small cap advantage. Of course, we are aware of the fact that large caps have now gone more than three (plus) years without a normal 10% dip. Given that fact, many analysts argue large caps (as a whole) are now a bit overpriced, and in some sectors moving into bubble territory. Small caps on the other hand have experienced a normal 10% dip every single year since 2008. So, it should come as no surprise that we have been rebalancing away from large caps into small cap stocks for quite a while now.

### **The Big Picture**

Overall, we don't see much (from an economic perspective) that gets us worried long term. Our economy is incredibly stable. Corporate America remains lean and highly profitable. And, the U.S. is growing at a very nice clip. In addition, jobs are being created at a high rate, and when you omit the energy field, almost every industry in America is expanding. As long-term investors, we remain optimistic, as long as investors stay well-diversified, use excellent managers, and pro-actively rebalance. Even if there is a short term selloff (in large or small caps), we believe it will be short lived and healthy for the market. After all, look at how small caps have performed after their sell-off at the end of September.

### **Issues Still Remain**

Even though we remain optimistic over long term, there are still a number of short-term risks that remain. For example, the U.S. holds the current distinction of being the only major global economy whose growth rate is poised to outpace that of last year. Europe is currently experiencing a recession and will be struggling to recover for some time. China is slowing down over the short term, given their goal to be driven less by exports and more by their own consumers. We believe this is an excellent long-term strategy being embraced by China, but it could have a near-term negative impact on large cap U.S. companies who rely on exports.

Other short-term issues include Iran/Israel, Northern Africa, Terrorism, and the unyielding political gridlock. Of course, there is also the bond “conundrum” and the issue of rising interest rates. We don’t believe any of these issues will have a lasting impact on stocks prices, but any of them could affect short term pricing. Of course, we’ve been dealing with these same issues for several years now, and it has had relatively little impact on stock prices over the long term.

Keep in mind, we purchase companies for their profits and cash flows. As long as profits and cash flows continue to rise, there is no reason why price of stocks should not follow.

### **The Upcoming Newsletter**

We plan on sending out the newsletter and quarterly reports on or around Friday, April 17th. The newsletter will cover our thoughts on the stock market, the bond market, the economy, and our portfolio’s. We will place special emphasis on “investor psychology” by examining the three most import core concepts that drive long term portfolio returns. We hope you enjoy the upcoming newsletter and find it informative and educational. As always, we look forward to your valued feedback.

### **In Closing**

We know April 15<sup>th</sup> is fast approaching. If you need to make an IRA deposit/contribution, please have your checks sent to Katie’s office in Oak Ridge, NC by tomorrow Wednesday, the 8<sup>th</sup>. That way, she can have them postmarked and in an envelope up to TDA before the 15<sup>th</sup>. As usual, if you have any questions or concerns regarding our updates, your portfolio, or any of our investment strategies, please feel free to contact us immediately. We always look forward to hearing from you and appreciate all of your continued referrals.

### **One Final Note**

For those of you who are wondering about Piper Elizabeth and Kaitlyn Blake, they are doing great! (We use two names in the south!) They were born on February 10th and spent their first five and a half weeks in the hospital. They came home on Friday, March 20th and have been a pleasant handful ever since! They feed, poop, pee, and make all sorts of great noises all day long. They are developing great little personalities and they bring us so much joy. It's only tough when they have too much gas and they can't get it out. It seems quite painful. Even though they are gaining weight and doing great, the doctors have them on a mini-lockdown until the flu season is over. Soon, we will introduce them to our neighbors and friends. In the meantime, I have no clue where my days go between work and family...but I'm having the time of my life!

Kellie and I sincerely appreciate all of the notes, e-mails, texts, and cards. Every one of them means a lot. Enjoy your spring...and text me if you want to see any recent pictures!! I've been pretty good at keeping up with requests.

- **Joe & The Gang at KWAG**

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