KWAG October Update

Good Afternoon! For over a year and a half, we have been writing about the lack of any real market volatility and the lack of a normal (much overdue) 10% correction in the S&P 500. After the significant run-up in prices, during 2013 and the first part of 2014, it was clear the stock market more than fairly valued. For obvious reasons, we don't have to write about those two items anymore. After peaking on June 23, 2015, the S&P 500 finally experienced the much anticipated (and much needed) 10%+ decrease in its value. In addition, the VIX (which measures overall stock market volatility) spiked and has remained higher than normal for almost three months now.

We believe both are extremely healthy for the stock market over the long term. But, as loyal readers, you already knew that. We view this dip as nothing out of the ordinary. In fact, it was the lack of volatility over the last few years that has been surprising and had us concerned.

The Numbers

Entering the third quarter, the S&P 500 stock index (a bellwether index of large cap stocks) was up 0.20% on the year, while the Russell 2000 stock index (a bellwether index of small cap stocks) was up 4.09%. During July, stock market volatility began to escalate as the month came to a close. However, it was not until the middle of August that volatility peaked and the stock market finally experienced a normal (and much needed) 10% dip! Between the relative peak of the market on June 23, 2015 and the first market valley on August 25, 2015, the S&P 500 index fell more than 12%, while the Russell 2000 index lost more than 14%. Over the next month, through the end of the quarter on September 30, 2015, the stock market gyrated up and down before finally finishing the quarter on a down note.

During the third quarter, the S&P 500 index lost more than 7% of its value, while the Russell 2000 index lost over 12%. So in essence, the overall stock market (large and small stocks combined) lost roughly 10% during the quarter. When we examine the year-to-date numbers through September 30, 2015 the S&P 500 stock index is off -6.74% on the year, while the Russell 2000 stock index is down -8.63%. In other words, stock portfolios should be off (or down) between 6% and 8% YTD, depending on the level/type of stock market exposure.

The Silver Linings

There are a number of silver linings associated with normal stock short-term stock market dips. First, as we have mentioned many times before, stock dips provide excellent opportunities for our managers to buy any number of stocks at attractive valuations. At the end of the third quarter, over half of all stocks trading on the NYSE were down more than 20% from their all-time highs and many were down more than 30%. Buying opportunities like these are invaluable to our money managers and investors over the long run. It's the reason we love ordinary stock market volatility - it provides great buying opportunities on a yearly/regular basis.

Second, if you are regularly contributing to your portfolio on a monthly or semi-monthly basis, these dips allow you to "dollar cost average" or buy into the stock market at lower than normal prices. In essence, you are indirectly behaving like a seasoned professional money manager by embracing (and buying into) normal market dips. The net effect is two-fold. First, you get to buy stocks at below average prices. In the long run these purchases enhance your portfolio's value. Second, your year-to-date portfolio return is typically much better than the overall market return, since it includes these timely low priced buys. In essence, by investing an equal amount regularly into the stock market - through thick and thin - you buy more shares on sale when the markets are down, and fewer shares

when the markets are up (or overpriced). The net effect of dollar cost averaging into your investment portfolio is incredibly significant over time. Why more people don't embrace normal short-term market dips is beyond me, since they only help a long-term investors portfolio earn more over time.

Finally, ordinary dips generally pave the way to new all-time stock market highs. The last time we experienced a significant 10%+ market dip was in the third quarter of 2011. During that quarter, the S&P 500 fell by more than 13%, while the Russell 2000 lost over 21%!! At that time, the credit crisis of 2008 was still etched in peoples' minds, even though it was three years removed. As a result, we provided a nice market chart that showed how markets typically pause in year three after a significant crisis. So what happened? Over the next quarter, stocks increased more than 10%. Over the next year (2012), stocks increase another 14%! And, in 2013, the stock market exploded and gained more than 30%!

We have no idea what will happen over the next quarter or year. However, if history repeats itself, this market dip will provide the foundation for a nice run-up over the next three, five and ten years. Based on the vast majority of feedback we get from our clients and friends, almost all of you seem to understand both the short-term nature of dips and long term trends of the stock market over time. Thanks for keeping your perspective…it will serve you well over time.

The Upcoming Newsletter

The upcoming quarterly newsletter will be sent out next Thursday, October 15th. As usual, we will provide our thoughts on the stock market, the bond market, and the global economy. We will include a few tables that examine typical stock market dips and we will cover our process of portfolio monitoring. This quarter, we will also include a Q&A session with the doctors, which will cover a number of news events grabbing current headlines. Specifically, we will answer questions on China's devalued currency, the Fed's plans on U.S. interest rates, declining oil

prices, ongoing uncertainty in Greece, and so on. If we can share our insights on any of these topics with you or answer any other questions you may have about what makes the markets act the way they do, we are happy to hold those conversations with you at any time. Please feel free to call or e-mail us and we'll get back with you in a timely manner.

In Closing

As always, please be in touch whenever we can be of service to you and your family. If you have any questions about this update, our views, your accounts, or our managers, please feel free to call or e-mail any time. The recent referrals are much appreciated and we thank you for your continued confidence in our firm and our services. If you need anything or your goals or time horizons have changed, please do not hesitate to call or drop an e-mail to set up an appointment. We are here to serve your financial needs, whatever they may be.

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