October 2, 2018

Investment performance in the third quarter continued the upward trend of the previous period, only with a stronger advance. All asset classes in New West portfolios provided a positive total return for the quarter and year-to-date. That said it was the equity portion of accounts that did the heavy lifting with a total return of over 8% in Q3. Equity mutual funds also helped out while cash equivalents and bonds had fractional gains.

Deeper analysis showed that of the twelve industry groups only the technology, consumer and healthcare sectors were major contributors to account value increases. Therefore client portfolio performance in the quarter was defined by the amount invested in each of these categories as well as the amount allocated between stocks and bonds.

While bond investments have added minimally to returns for the quarter and year-to-date, this asset class will have an impact on all investments going forward. New purchases of U.S. Treasury bonds due in 2 years are currently guaranteed to return 2.8% per year. While from a long-term historical perspective this is hardly a reason to celebrate, the current rate is 10 times greater than what was available five years ago. Back then one received just 0.28% annually for investing in the 2 year Treasury bond. Interestingly, German investors are currently losing 0.5% yearly to park money in their government's bonds of this maturity.

The Federal Reserve continues to move the Fed funds rate higher by 0.25% each quarter and gives every indication that this will endure for another four or five increases at least; more if inflation creeps further upwards. It is not hard to imagine the yawns that the idea of a 4% annual return on bonds elicits. However 4% guaranteed will be rewarding in the next economic or stock market swoon. And more importantly, this change in interest rates has already begun to alter the valuation metrics for other types of investments and effect economic activity, creating opportunities.

For instance there has been a healthy slowdown in the increase in prices and sales volume of homes while inventories have increased even as they remain below normal levels. Also auto sales have slowed by a small amount year over year. These are large industries that rely heavily on financing in closing transactions. It appears that the pent up demand for cars and houses has faded and increased prices and financing costs have had some impact on economic activity.

The above should not create concern about the strength of the economy or the near term likelihood of a recession. The unemployment rate hit a 39 year low of 3.7% this morning and corporate earnings continue to be robust, as is consumer confidence. With strength in income from wages, and now interest for investors, the economy may well be in the process of transitioning to a more rational and sustainable level of activity. That would be a welcome environment after a decade of Federal Reserve crisis management policy.

Enclosed please find your most recent investment portfolio report for accounts managed by New West Investment. I appreciate the opportunity to work together with you to achieve your financial goals.

Best regards,

Peter V. Hedberg
President