There was no slowing down for the investment markets last quarter. Following a relatively strong first quarter the overall market continued to deny the naysayers as both equity and bond markets posted meaningful gains. Currently, most major U.S. equity indexes sit at or near all-time highs, international and emerging market stocks are rallying, and bonds provided a more than reasonable total return between April and June. With performance like this what is there to talk about…? Actually, quite a bit.

We have recently received a steady stream of questions about the state of the investment markets. Are equity valuations too high? Can earnings growth continue? Is the economy improving? Will the Fed raise rates again this year? Is inflation beginning to creep higher? Which policy changes will/won't President Trump get done by year-end? And are we in another "bubble?" Our overly simplified answer to all of the above, it depends on how you evaluate the situation, the assumptions one makes, and the timeframe over which the analysis is conducted. We remind investors that there are always reasons to be concerned about the investment markets. If there weren't risks than economic theory predicts there wouldn't be any reward. Maybe contrary to what many would suggest, in our experience it is at the times when investors perceive the least risk (think Tech stocks in 1999 or Housing in 2006) that in fact the risks may be the greatest.

When asked about our investment related concerns we highlight the risk of investor complacency. We believe investors are slowly recovering from the trauma of the Great Financial Crisis and are increasingly taking more risk in their portfolios whether knowingly or not. Each quarter the average investor looks at his or her statement and realizes that the global markets continue to move higher as if in a straight line. This has the effect of encouraging increased ownership of risk-assets or at the very least prevents investors from rebalancing and taking some of their chips off the table. Over time this has shifted investors from portfolios that were too conservative when the markets were the most attractive to allocations that are potentially more aggressive than they will be comfortable with during the next market pullback. It is our contention that once the hypothetical "last holdout" gets back into stocks or shifts their portfolio to increase their expected return, the markets will incur a typical correction along the lines of 10%+. However, since investors are finally beginning to take an interest in the stock market again, when that correction occurs they may quickly be unnerved by the decline. This could in turn trigger them to sell their risk-assets when the markets have already fallen.

Why do we highlight this as a risk? Around mid-April both U.S. and Non-U.S. equity markets saw a significant increase in fund flows from individual investors. Why mid-April, we believe this was when investors opened their quarterly statements to see that the stock market was up yet again. At which point they finally decided to get back in the market or increase the risk in their portfolios.

At RiverGlades we have been closely monitoring our clients' overall asset allocations with a focus on keeping the risk exposure in-line with our clients' risk tolerance. We look forward to discussing your individual situation and have technology to assist us in confirming whether or not your portfolio is in-line with your expectations. While we continue to believe the intermediate trend is positive for equities and slightly less so for fixed income, we are well aware that complacency in the markets could end at a moments notice. We prefer to be pro-active and discuss the what-if's in advance of any declines rather than reacting after the fact.