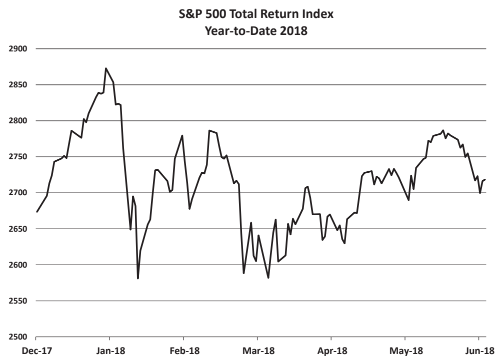
DEIGHAN
WEALTH ADVISORS

Objective, unbiased *advice*

MARKET COMMENTARY

For the past week, much of the U.S. has been blanketed by a massive heat wave, which has resulted in 165 record high temperatures across the country. Fortunately, for those of us who live or vacation in Maine, it's a little easier to cool off thanks to our 2,677 lakes and our proximity to the ocean.

One of the best ways to beat the summer heat is to go boating, a quintessential pastime in Vacationland. But, whether you're boating on a lake or boating on the ocean, there's always a risk that the wind picks up and you encounter a bit of choppy water – small, successive waves that bounce your boat around and make your afternoon decidedly less comfortable. If you were to draw a picture of choppy water, it might look something like this:



Not fun! Especially when all you want is to cool down and feel the wind in your hair. Well, as you might have guessed, the above chart isn't a picture of choppy water. It's actually a price chart showing the performance of the S&P 500 Index since the beginning of the year. The S&P 500 Index tracks the largest 500 companies in the U.S., and it is a good proxy for how the stock market is faring overall.

As the chart indicates, there's been a lot of chop in the market over the past six months. Stock prices have bounced around within a tight, 300-point range. Though the S&P 500 Index managed to return a respectable 3.4% in the second quarter, including dividends, this was just enough to keep the market's head above water. On the year, the S&P is up a meager 2.6%. All this slapping-about has given investors motion sickness, especially after two years of relatively smooth sailing.

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What leads to chop? Well, if you're on tidal water, then chop can arise when the tide and the wind are moving in opposite directions. This interplay of forces tends to result in short, steep waves. In the stock market, opposing forces can also lead to chop. Of course, we're talking about market forces rather than physical forces, but the concept is largely the same.

Over the past several months, two major market forces have been working against each other, resulting in choppy markets and range-bound returns:

- On the one hand, investors have been selling stocks. According to CNBC, June had the highest level of equity outflows since the third quarter of 2016. On the quarter, equity mutual funds saw $52.9 billion of outflows. This has put downward pressure on stock prices.
- At the same time, companies have announced record stock buybacks and have been repurchasing shares. This has helped to prop-up markets, putting upward pressure on prices.

When major inflows collide with major outflows, it's the perfect recipe for chop. What's been particularly interesting, however, has been the timing of these flows. Investors, retail investors especially, have been selling stocks despite historically low unemployment and high consumer and business confidence. Does this mean investors are less enthusiastic about the economy than the numbers would suggest? Or does it simply mean that investors are taking gains after years of double-digit returns? We don't have a definitive answer; it's likely a bit of both.

Even more interesting have been the share buybacks. Corporations are flush with cash,

24 Years
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1994-2018

especially after the 2017 tax cut. But, rather than spend that cash on capital expenditures and growth opportunities, companies have been giving money back to shareholders. In fact, in addition to buybacks, companies issued record dividends in the second quarter. Why is this interesting?

When a company has excess cash, it can spend that cash in any number of ways. Arguably, the most productive use of cash is to reinvest it in the business via capital expenditures or research and development. These types of expenditures help to grow the company over the long term.

Another valid use of cash might be the acquisition of another business. This is another way that companies can grow. Rather than perform research and development in house, for example, a company might choose to buy a competitor for its patents.

Perhaps the least useful way to spend excess cash is via stock buyback. Now, some investors will disagree (some vehemently), because buybacks have their benefits. For example, if a company purchases its own shares, then this is a strong signal to investors that management thinks the shares are cheap. Hence, buybacks can encourage further buying. Also, buybacks result in fewer shares outstanding, which improves any "per share" metrics like earnings per share, cash flow per share, or the price-to-earnings ratio.

But when a company gives money back to investors, whether it's in the form of a buyback or a dividend payment, it also tells investors that the company has no better use for the cash. It's basically like saying, "Here, take your money elsewhere. We don't have profitable growth opportunities." This is a pretty damning statement, and it's a statement that many companies are making right now.

The good news is that merger and acquisition activity is strong. But capital expenditures are expected to rise just 6.6% in 2018 and 5% in 2019, according to estimates from the Conference Board. This means that, by and large, companies don't have much use for their excess cash. This is somewhat concerning, given that the economy is firing on all cylinders. Shouldn't companies be awash in opportunity?

Part of this is due to the political climate. While we often try to refrain from political statements in our commentary, it's hard to deny the impact that political uncertainty is having on boardroom decisions. It might be that companies DO have investment opportunities, but some managers are likely erring on the side of caution. With all of the rhetoric around tariffs and trade wars, the safer course of action right now is to issue buybacks rather than start up new business lines.

The big question is what this means for the future direction of the stock market. Currently, buybacks are helping to keep the market afloat. In the absence of buybacks, the S&P 500 would likely be down on the year. But a market cannot continue to rise on buybacks alone, because buybacks are not sustainable and they do not promote growth. Therefore, if businesses are truly unable or unwilling to invest in themselves, then it's hard to see much impetus for value creation and share price appreciation.

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Any immediate benefits from the tax cut have largely played out, and it's clear that corporations are using the tax savings for buybacks rather than more profitable ventures – at least in the near term. As interest rates continue to rise, capital investment will become more expensive (and less attractive) for businesses, and customers will spend less on large ticket items like homes, cars, and large appliances. All of this will eventually start to drag on profits and, ultimately, stock prices.

This doesn't mean we're expecting a recession. Like we said earlier, the economy is firing on all cylinders. While a recession will naturally come in due course, a recession is not imminent. However, we could see a stock market correction, defined as a decline of 10% or more. It's important to keep in mind that the stock market and the economy, while related, are not the same thing.

A market correction would be unpleasant, but it would not be unexpected. In fact, one could argue that it would even be healthy, as the market needs to clear out the deadwood every now and then. In earlier commentaries, we stressed that investors should prepare themselves for increased market volatility, and we've seen that warning play out with the choppiness this year. Continued caution is warranted. Choppy, range-bound markets are markets looking for direction. Eventually, the market will breakout either to the upside or to the downside.

The best defense against a market correction is a properly diversified portfolio, which is why we take care to spread your investments across many different asset classes and geographies. We've been keeping bond maturities short to minimize interest rate risk in a rising rate environment, and we continue to like emerging market stocks for their growth prospects, lower correlations with other global equities, and better relative valuations. In our U.S. equity portfolios, we have limited exposure to companies that are interest rate sensitive, and we've kept a focus on companies that have good long-term growth opportunities.

As always, we're happy to discuss your portfolio, especially if the water gets choppier from here. Choppy markets, like choppy seas, make for rough riding. But, with a little planning and prudent navigation, a good portfolio, like a good boat, can weather the storm. Please call or email if you have any questions or concerns.

To close, remember that, though it's hot, the days are fleeting. There will be time enough for cooler temperatures come November and December. Until then, enjoy the summer! Best wishes for happy investing.

– Deighan Wealth Advisors

PORTFOLIO CHANGES

REMOVED: Nicholas Fund (NICSX)

Nicholas Fund (NICSX) was sold from client portfolios due to significant changes that occurred at the fund since our initial purchase. When we first bought NISCX in October of 2015, its management style complemented our other mid-cap investments. We liked its long track record of solid performance, and philosophy of buying attractive companies at good prices and holding them for the long term or until fundamentals changed. The lead Portfolio Manager of the fund since its inception in 1969 continued to manage it until his passing in August of 2016. His son had been the Associate Portfolio Manager since 2011, and he moved into the lead spot upon his father's passing. The fund added a new analyst last year, and the focus seemed to turn, adding a number of large-cap tech names that we already hold elsewhere in client portfolios. Instead of complementing our other mid-cap manager, NICSX started to look more like a large-cap fund. With performance stagnating, and the fund not playing the role we originally purchased it for, we made the decision to exit.

ADDED: Schwab U.S. Mid-Cap ETF (SCHM)

We added Schwab Mid-Cap ETF (SCHM) to replace Nicholas Fund. SCHM's mandate is to closely track the total return of the Dow Jones U.S. Mid-Cap Total Stock Market Index. We reviewed a number of index fund choices, both mutual funds and exchange traded funds (ETFs) and this ETF has the best combination of low expenses, long-term return for the amount of risk taken, and pure exposure to medium-sized companies. Because it tracks an index, the composition of the fund will not change due to the fund managers' decisions, but rather due to changes in the composition of the actual index. We think that it is important for client portfolios to have exposure to medium-sized U.S. companies that are more established than smaller companies, but still have more room to grow than larger ones. With an attractive risk-return profile, a low expense ratio, and no transaction charge at Schwab, we think that SCHM is a good addition to the equity side of client portfolios.

DEIGHAN WEALTH ADVISORS INTERN PROGRAM

In September of 2016, members of the Deighan Wealth Advisors management team met with Dr. Marie Hansen, Dean of Husson University College of Business, to talk about our vision of a curricular offering at Husson for students interested in the financial planning profession. We proposed a bachelor's degree program that would be registered with the CFP Board to satisfy the required coursework for students to sit for the Certified Financial Planner™ Certification Examination. Dr. Hansen agreed that Husson University's current business offerings and student interest in financial planning made Husson an ideal candidate for becoming a CFP Board registered institution. Her colleagues at Husson were enthused about such an offering as well, and before long the CFP Board approved Husson as a registered institution offering courses that cover the core knowledge needed to practice personal financial planning. We couldn't be happier that Husson University shared our vision.

We love what we do here at Deighan and want to share our experience with a new generation of financial planners, which is why we established an intern program a few years ago. So, how does a company build a strong team of professionals to support its vision, mission and goals, as well support the professional and personal goals of those that it employs? We think that a strong paid internship program is a great start. Our goal is to provide college students with an opportunity to learn and gain invaluable experience in the wealth management industry. We are fortunate this year to have two interns from Husson University!

Of course, we have high expectations for our interns. If you imagine a college student spending the day in front of a shredding machine or scanner, you're partially right. Anyone who has worked in a small business knows that there are many hats to wear. We try to expose our interns to a variety of tasks so they understand what it's like to actually work in our environment. While menial tasks can't be completely avoided in any business, we do try to provide challenging assignments as well. Interns become an integral part of our team for twelve weeks beginning in June. They are responsible for learning our processes and systems, as well as becoming proficient in the software we utilize to serve clients. We encourage and expect their input on improving our systems and processes, and we include them in most of our internal and external meetings to give them exposure to professional presentation skills, client communication, and community service and networking opportunities.

Our paid internship program is competitive, and this year's candidates did not disappoint. We were fortunate to receive several applicants from both the University of Maine and Husson University. It was encouraging to interview so many potential financial professionals, and

SOUNDBYTES

Tyler Hoxie sat for Level III of the Chartered Financial Analyst examination on June 23rd in Boston. The Chartered Financial Analyst program, administered by the global CFA Institute is considered the most rigorous in our industry. We wish him the best of luck as he awaits his exam results in late July.

Jenifer Butler and **Lucie Estabrook** attended the annual Envestnet|Tamarac Conference in New Orleans in May. This three day conference attracts more than 2,000 financial professionals from 525 unique firms to hear insights on the latest trends shaping the wealth management industry. Envestnet|Tamarac provides leading rebalancing, reporting and practice management software for advisors.

we were impressed with the professionalism, maturity, and poise of all of the candidates. Congratulations to our two new interns, Michael Parent and Shanna Porter. We hope that you'll enjoy getting to know them, and we look forward to introducing them to you in person when you visit our office.

MICHAEL PARENT

Michael Parent is a senior at Husson University with graduation anticipated for this coming December when he will receive a Bachelor of Science degree in Finance. Michael currently holds an Associate's Degree in Business Management from Eastern Maine Community College. Regarding his move to Husson to continue his education, Michael says, "At Husson, as I began to take more finance-oriented classes, I enjoyed the hurdles they presented and analytical thought processes they required. From personal wealth management to the management of an actual investment portfolio, the Carlisle Fund, I have overcome and enjoyed the challenges they have put forth."

When we asked what attracted Michael to our field he said, "What drew me to finance and investment planning was that I had a knack for thinking in an abstract manner, which can be very handy when analyzing a security or portfolio. I like connecting various pieces of information to form the "big picture" and that is exactly what you do at times in this field. It's like piecing together a puzzle. You can have all these bits that alone don't mean anything but as soon as you begin to put them together you find patterns, and you develop a sense of what is going on."

When he isn't in class or working, Michael enjoys taking trips to the coast with his fiancée, and hiking trails to take in what our beautiful state has to offer. He is an admitted "foodie" who likes to make a point of visiting a new restaurant when he is on an adventure and thinks that "Maine has some of the best spots to grab a bite and a pint in all of New England." Later this summer, Michael and his best friend, "a spitfire of a nurse", will marry. They will honeymoon in Ireland, France, Germany and Greece. Michael and his fiancée have caught the travel bug and hope to visit many more destinations.

We are impressed with Michael's readiness to take on any project or task. His professionalism, maturity, sense of humor, and willingness to work through anything from the most menial task to professional level analysis make him a great intern. We wish Michael and his fiancée many, many years of fun and adventure.

SHANNA PORTER

Shanna Porter is currently finishing her fourth year at Husson University in a five-year program to obtain a Master's degree in Business Administration and a Bachelor's degree in Accounting. During her time at Husson, Shanna has acquired both analytical and research skills through research papers and case studies required by her courses. During her previous work experience with the law office of Patrick E. Hunt, P.A., she developed valuable skills for communicating with clients on legal matters. Her more recent experience as an intern with Baker Newman and Noyes in Portland, Maine, provided her the opportunity to work with time sensitive tax-related matters in a fast-paced environment as she prepared income tax returns.

Shanna has been a hard worker for many years. She hails from Island Falls, in Aroostook County, Maine, where her family owned the local mechanics garage and gas station. Shanna began working at the age of 13. "My parents always told me that they would provide me with everything I need but would not spend money on things that I simply wanted. With this in mind I began setting up budgets for myself, sparking my interest in finance and financial planning. My interest has grown tremendously throughout my high school and college careers as I have found that knowing how to invest and being financially prepared for whatever life may put in your path provides an enormous sense of security and relief."

A fun fact about Shanna is that she studied and taught dance for thirteen years from age four through seventeen. She performed many recitals dancing ballet, tap, and jazz/hip-hop routines. Shanna enjoys walking "not hiking" trail adventures as well as babysitting and dog-sitting for friends and family. We found out during her interview exactly how much she likes dogs. She almost ran right out the door when we told her that the Bangor Humane Society encourages volunteers to stop by to walk the dogs. Her eyes widened as she said, "Really?!" We nearly had to collar her to complete the interview!

We appreciate Shanna's solid work ethic, confidence, inquisitiveness, and her bright, cheerful attitude. She shares our philosophy for top-notch client service, and we appreciate her willingness to enthusiastically tackle any project that we give her.

Please join us in welcoming *Michael* and *Shanna*!

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