WILSON CAPITAL
INVESTMENT ADVISORY

We feel investors should have an information outlet for the financial markets that is thorough, but does not require a prerequisite degree in economics. We hope this makes our commentary informative and educational for all levels of investors. We have also included a glossary at the end of this commentary that defines terms marked with an asterisk (*).

Quarter in Review

Asset Class†	3rd Quarter 2017 Return	Past 12 Months
International Stocks	6.2%	19.6%
U.S. Small Cap Stocks	5.7%	20.7%
U.S. Large Cap Stocks	4.5%	18.6%
Commodities	2.5%	-0.3%
U.S. Bonds	0.9%	0.1%

In terms of market performance, this quarter was almost an exact repeat of the previous quarter; steady positive gains in the stock markets along with record low volatility. The only slight difference is that the 3rd quarter had higher returns and lower volatility. Not since 1972 have there been fewer trading days (8) where the S&P 500 moved + or – 1% since the start of the year; an indicator that investors remain confident with current economic conditions.

The market environment continues to show positive signs, as corporate profits for companies in the S&P 500 grew for a 5th straight quarter to the highest levels on record. This comes despite little progress from Congress or the White House on delivering on the tax reform promised during the 2016 campaigns. On the economic front, the Federal Reserve has made a series of increases to their target interest rate since the end of 2015 in response to record low unemployment and rising inflation. While unemployment has continued to decline in 2017, inflation has been more tempered. In turn, current forecasts predict fewer rate changes through the end of 2018.

Richard Thaler and Behavioral Economics

In the first week of October, the Nobel Prize in Economics was awarded to Richard Thaler. Readers may remember Thaler for his cameo role in the movie "The Big Short" as the economist who explains the mortgage crisis using a blackjack game with Selena Gomez. While that role likely garnered him more visibility than winning the Nobel Prize, The Academy officially awarded the Prize for:

> Incorporat[ing] psychologically realistic assumptions into analyses of economic decision-making. By exploring the consequences of *limited rationality*, *social preferences*, and *lack of self-control*, he has shown how these human traits systematically affect individual decisions as well as market outcomes.

This, in short, is the description of Thaler's field of Behavioral Economics, which looks beyond the hard numbers typically associated with economics and adds a human decision-making element more often associated with the social sciences. Traditional economic thought relies on the rational choice theory where individuals always act in their best economic interest. Anyone that has ever made a frivolous purchase in the past knows this isn't always the case, but it is only recently that Thaler's human decision driven Behavioral Economic perspective has become more accepted in relation to the larger economy.

In many ways the current market conditions break the mold of history and academic research. In the period around the financial crisis, central banks (like the U.S. Federal Reserve) relied on monetary policy* to be the prescription to heal a significantly weakened economy where unemployment soared and consumer spending shrank. While unemployment rates have dropped dramatically, the expected rise in inflation has not followed as rapidly as textbook economics would predict. This is the monetary economists' version of 1 + 1 = 3. A variety of explanations have been proposed, but ultimately this era has stretched the bounds of traditional economic reason.

With some areas of the economy displaying abnormalities that contradict traditional economic thought, it is even more reason to reflect on Thaler's research and how human behaviors may be impacting recent trends. This is especially true considering that we are currently living through one of the most prolific bull markets on record. With few data-driven market indicators flashing warning signs and companies around the world reporting improving earnings, there is little reason to believe the bull market is nearing an end. However, if history is any indicator, bull markets often do not merely fizzle, and all data originates with personal decisions that can eventually drive a change in economic results without an explained reason. As the market strolls down the current euphoric path, watching for behavioral changes may be the first sign of a significant change of course.

Glossary

Monetary Policy: Economic theory mainly associated with economist Milton Friedman, that centers around central banks, like the U.S. Federal Reserve, using their power to manipulate interest rates in order to achieve a desired set of results such as full employment or low inflation.

Bulls Market– Centuries old term (along with Bear Market) used to describe positive (Bull) or negative (Bear) market sentiments. The origins are disputed, but the term may be due to bulls lifting their horns upward to attack, while a bear swats its paws downward.

† Indices used to represent asset classes:
U.S. Large Cap Stocks – S&P 500
U.S. Small Cap Stocks – Russell 2000
International Stocks – MSCI ACWI ex-U.S.
U.S. Bonds – Barclays Aggregate
Commodities – Bloomberg Commodity

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