October 14, 2019

Our current return expectations for balanced portfolios continue to be in the range of **4.7%,** actual results have done better. With average Carderock stock portfolios up 27% Year-to-Date and 11% since their highs 12 months ago, we find ourselves happy with another third quarter close. Unsurprisingly, we feel a degree of trepidation on opening the fourth quarter given the denouement last year, and post that we will do our best to avoid another "Ground Hog Day" event.

As detailed in the following pages, we believe our worries have merit, but we've kept these leashed for now and allowed the markets to run. With a few small adjustments made during the past three months, we would like to think they'll prove the elixir to keep a sniffle from turning into a cold. Yet we know these "vaccines" aren't expected to eliminate the effects of exposure so much as to build early defenses to assure a quicker recovery.

While in recent weeks we've kept our powder dry, we have begun reviewing portfolios with an eye towards lowering equity exposure (raising cash) as we begin the new quarter. Though market trends will dictate our pace and magnitude of effort, our focus remains on seizing the opportunities presented while keeping the balance required to meet your objectives. Should the fourth quarter follow last year's path, we'll find ourselves at a good place to start and on solid ground for an opportunistic reset in 2020.

As always, we invite you to give us a call to discuss these matters further, review your portfolio and update the specifics of your Investment Plan.

Warmest Regards,

James W. Mersereau, CFA, CIC
President

Daniel A. Kane, CFA, CIC
Managing Director

In compliance with Rule 204-2(a) of the Investment Advisors Act of 1940, we hereby offer our current Form ADV Part II as filed with the Securities and Exchange Commission through notice of its public posting on our website (www.carderockcapital.com). The Securities Exchange Commission's Investment Adviser Public Disclosure database can be accessed at their website (www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx). With reference to Rule 206(4)-2 Carderock urges you to compare the information on your statement with the statements received from your custodian. Please call if you have any questions.

ANGLE:

These days, if there's someone with a skinny on the market, likely the attached caveats run high and confidence low. For most, we only know that when folks buy bonds for capital gains and stocks for income - something's off; and one of the two is bound to give. After the post-2016 (14-month) rise of almost 50% for stocks, February 2018 slammed the door with transfer of Federal Reserve control from Yellen to Powell and a 3,200-point slide (11.3%) in the Dow Jones. Since then, the markets have trended within tight bounds as the consensus shifted like a chameleon between green ("Risk on") and red ("Risk off") through four cyclical rises and falls. Taken together, our aging Bull Market looks to be struggling, yet the falls have settled higher, and that's positive.

ASSESSMENT:

If asked, we'd suggest that we should all take a deep breath and worry less. The leading data remain mixed, ranging from surprising strength in the pulse of profits to spots of real weakness – especially in manufacturing. Services and Business Confidence are also soft, but still at high levels. For now, our activity rests based on an economy that stays strong enough to weather a slowdown without tipping into a recession. That said, the rise in non-economic turbulence (political and trade disputes) risks distraction from the growth agenda and could disrupt a policy response should one be needed. This leaves long-term investors wondering whether the juice is worth the squeeze and sets a trend toward narrowing participation to shorter-term traders.

ACTIVITY and ATTRIBUTION:

Over the course of the quarter, our outlook for **STOCKS** has labored to give the benefit of the doubt to Growth. As it's been a hard slog, we've snugged the **CASH RESERVE** targets in our reviews a touch higher from 10% to 15%. For now, we've used the reset more as guidance applied by exception, and rather than taking broad strokes, we have kept activity to a minimum. This means we've resisted both the urge to make full cut-outs as well as the temptation to fill in small positions and add new plants. Fact is, we've done all three, but within tight bounds. With opportunities scarce and trends long in the tooth, price momentum becomes the lone tool to work with, and we prefer a full toolbox. For now, we see limits, constraints and a possible bumpy fourth quarter ride, but after that, expect solid prospects to emerge in the year ahead.

Meantime, our Equity Cash Reserve targets are running between 10% and 15%. This drives portfolios toward a neutral Equity Exposure close to 87.5% of Investment Plan levels. Good news is that this represents a good stance for responding to conditions as they unfold. Recall that turbulence inevitably creates new openings and should be welcomed as a take-off rather than feared as an uncomfortable landing. Much as we stress over possibly losing an election-year market rally to the mud wrestling free-for-all seen on the nightly news, we know that today's negatives will pass, and count on investors to get back to playing the positives without missing a beat.

With **BONDS**, activity has run equally light. The decline in yields has tended to limit the appeal of new and remarketed issues and curtailed our appetite. While we have seized a few pockets of opportunity here and there in callable bonds, specific sectors and focused exposures, we have been thankful to not feel compelled to buy bonds based on amped up maturities on the one hand. or fear that the U.S. could drift into the abyss of negative interest rates on the other. With maturities low, we've been able to wait this one out and keep to selective purchases.

Finally, as low rates pushed us to monitor the rates of return on **CASH RESERVES**, and complement these with Money Markets where we can, we caution this can limit immediate liquidity and require a day to cover. Thus, we remind you that if your cash needs are changing, please be sure to contact us.

Random Gleanings

"In the early 20th century, when there were no negative nominal yields, Irving Fisher imagined them. Now that the Bloomberg screen shows $13.3 trillion's worth (roughly 1/3 overall), there's no need to imagine. 'Did interest rates fall, or were they pushed?' is one question, perhaps the question on the road to understanding. If market forces hammered rates to today's 4,000-year lows, that is one thing. If central banks did the deed, that is quite another.' The evil fruit of artificially low interest rates is an eventual financial crisis." James Grant, **Grant's Interest Rate Observer**, July 26, 2029.

"People have not imagined that the central banks lord it over the business cycle or manipulate the prices of stocks and bonds. It's not a dream but a fact, but the question before the house is whether the central bankers can continue to control events or whether events will turn the tables and start to control the central bankers. Our money's on events. We reason that mighty interventions have unintended consequences. Suppress the rate of interest, and you misdirect capital. Cut short the corrective processes of a business-cycle downturn, and you store up trouble for the next recession. Intervene over and over to save a bull market…" James Grant, **Grant's Interest Rate Observer**, September 30, 2019.

"'The Fed Halted Repo Contagion, But Analysts Want a Long-Term Fix,' is the headline over Exhibit A. The story proceeds from the premise that the pop in money market rates last month was the Fed's doing for somehow overlooking wholly foreseeable events – a tax payment date, a heavy Treasury issuance calendar, etc. – that would produce the scramble for lendable funds. Now the Bank of Powell knows it must act. 'The Federal Reserve's daily interventions appear to have calmed U.S. money markets and prevented a repo contagion from infecting key areas of finance, but to create a lasting peace, the central bank needs to take much grander action in late October sooner according to a growing list of experts." James Grant, **Grant's Interest Rate Observer**, October 4, 2019.

"President Trump managed to trigger a market panic by labelling China a currency manipulator China retaliated by allowing the renminbi to slide below the magic number 7, and before stabilizing the situation by bringing the currency back up. The message is clear – China is drawing a line in the sand and won't back down in the face of trade threats. This may be only the first shot in the currency wars, which could end in a major market correction by the end of the year, if not sooner. It may be less a question of whether we'll see a crash and more why we haven't seen one yet. After all, there are plenty of worried market participants, as best evidenced by the $14 trillion horde of negative-yielding bonds around the world. When this many are willing to pay for the 'security' of losing only a little bit of money as a hedge against losing quite q lot, you know there's something deeply wrong." Rana Foroohar, *Summer of Fear, FT Swamp Notes*, **Financial Times**, August 12, 2019.

"Despite the backdrop, the odds of a U.S. recession are overstated, and the global economy should perk up by early 2020. U.S. Consumers are healthy, the central banks are easing, and global financial conditions support growth. To be sure, consumers are insulated by expanding household disposable income, robust balance sheets with debt service costs the lowest in four decades at under 10% of income, and household debt relative to GDP and household assets at 16- and 34-year lows as well. In addition, with U.S. savings rate at 8% there is a good cushion against shocks, and Housing is showing some positive signs together with a surge in mortgage demand. As to the corporate sector, PMI and capital expenditure growth are still in mid-cycle slowdown territory, debt service costs are far below levels of concern, and the bite of the escalating trade war with China confined to hurting capex intentions. Finally, the Fed will likely cut rates twice more in the coming nine months." *Monthly Forecast and Analysis*, **The Bank Credit Analyst**, September 2019.

CARDEROCK
CAPITAL® MANAGEMENT, INC.

SHORT TAKES
September 30, 2019

RESULTS

The **S&P 500 index** rose **1.7%** for the 3rd Quarter and **20.6%** for Year to Date.

Stocks:

Size: – Large-Cap Stocks outperformed both Mid and Small Stock Indices during the 3rd Quarter.

S&P 500 Large-Cap 1.7%, S&P 400 Mid-Cap -0.1%, S&P 600 Small-Cap -0.2%

U.S. Economic Sectors: – 3rd Qtr. S&P 500 Index Sectors with Ranges from: –

S&P **Utilities** rising **9.3%** to S&P **Energy** stocks losing **-6.3%**

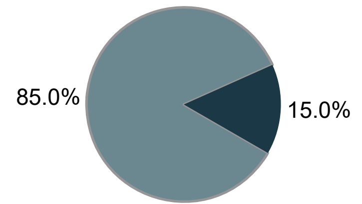
Bonds – Investment Grade Bonds had a strong quarter gaining relative to High Yield as the Interest Rate Yield curve continued to flatten throughout the period.

3rd Qtr. 2019 Returns:

- Lipper Short-Int. U.S. Govt. Index: **0.8%**
- Lipper Short-Int. Municipals Index: **0.7%**
- iShares iBoxx **(LQD)** Inv. Grade Corp. Bond Index: **3.4%**
- iShares iBoxx **(HYG)** High Yield Corp. Index: **1.3%**

Source: Lipper, FactSet and Blackrock

Carderock Equity Target Allocation



S&P 500 Sector Performance

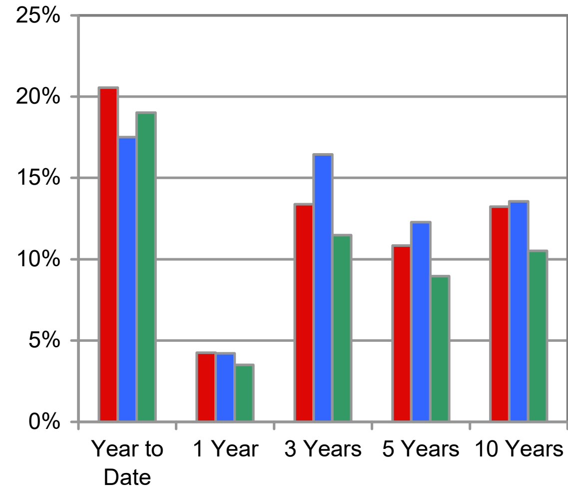
Table of Sorted Standard & Poor's 500 GICS Sectors Returns

GICS Sectors Returns (Total)
For time periods ending September 30, 2019

1 year returns		2 year annualized returns	
Utilities	27.10%	Information Technology	19.49%
Real Estate	24.74%	Consumer Discretionary	16.47%
Consumer Staples	16.85%	Real Estate	14.42%
Information Technology	8.60%	Utilities	14.38%
Communication Services	5.69%	Consumer Staples	9.67%
Financials	3.92%	Health Care	6.83%
Materials	2.70%	Financials	6.30%
Consumer Discretionary	2.36%	Industrials	6.17%
Industrials	1.39%	Communication Services	5.04%
Health Care	-3.57%	Materials	3.35%
Energy	-19.21%	Energy	-4.06%

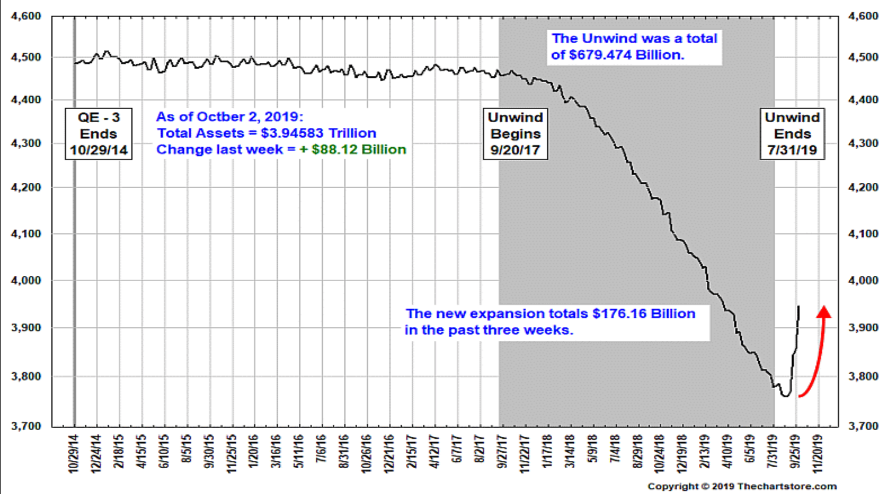
5 year annualized returns		10 year annualized returns	
Information Technology	18.21%	Consumer Discretionary	17.68%
Consumer Discretionary	14.03%	Information Technology	17.11%
Utilities	12.89%	Real Estate	14.72%
Real Estate	11.60%	Health Care	14.21%
Financials	10.51%	Industrials	13.43%
Industrials	9.73%	Utilities	12.51%
Consumer Staples	9.26%	Consumer Staples	12.29%
Health Care	8.95%	Financials	10.77%
Materials	5.37%	Communication Services	9.49%
Communication Services	5.17%	Materials	9.23%
Energy	-5.06%	Energy	3.33%

Global Stock Market Annualized Performance (9/30/2019)

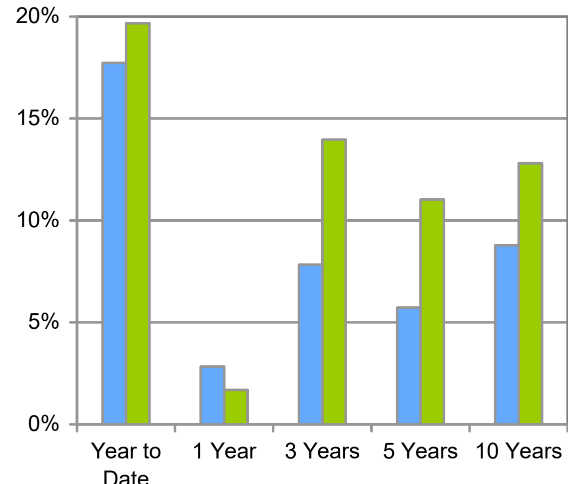


Source: MSCI Inc., IDC

Federal Reserve Balance Sheet



Growth vs. Value Style Annualized Performance (9/30/2019)



Source: IDC