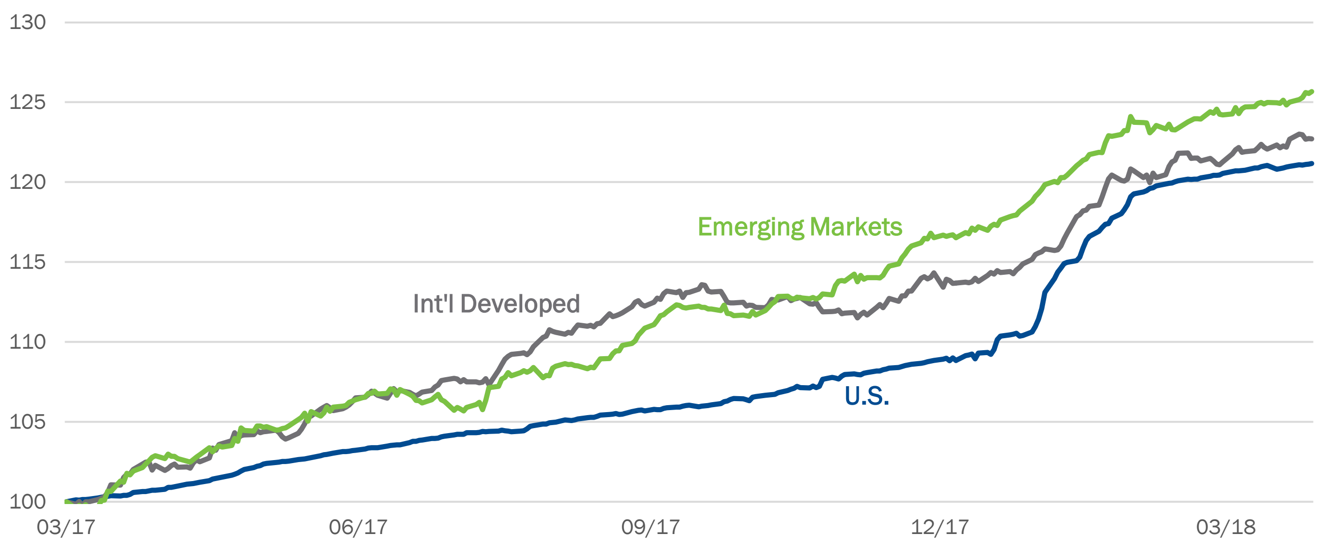
INVESTMENT PERSPECTIVE Q1 2018

IN DEFENSE OF THE OXYMORON

Forward Earnings Estimates as of 3/31/2018



Source: Bloomberg, Hirtle Callaghan. As of 3/31/2018. Normalized at 100 on 3/1/2017. Earnings per share estimates are time weighted Bloomberg consensus analyst estimates. U.S. is represented by S&P 500 Index. Int'l Developed and EM are represented by MSCI EAFE Index and MSCI EM Index respectively.

"Healthy correction" sounds like one of those expressions that deserves a special place in linguistic hell. Like "Congressional Ethics" and "Chocolate 'Nilla Wafers", it draws a nail down the chalkboard of our logical consciousness. If wealth accumulation is the critical mission, how can its rapid reversal be remotely healthy? For most investors, financial markets come in just two flavors – the upwards (good) kind and the downwards (bad) kind. However, for investors with a sufficiently long horizon, bull markets can be unhealthy and bear markets can be healthy. We examine why that awful oxymoron might actually make sense.

Markets respond to two impulses – cash flow news and discount rate news. The cash flows are the future income stream, and the discount rate is the interest rate (adjusted for risk) that is used to determine the present value, or what that income stream is worth today. When that interest rate goes up, it means that the future payments are worth less today, so today's asset prices fall. So far, so bad. But here's the twist. If the future cash flows materialize just as they were forecast, the income in those future periods to investors has not changed. What has changed is that the compounded return will be higher going forward, since the lower current price combined with the same future payments has simply changed the returns earned, not the income. Imagine that you win this week's Powerball lottery jackpot. The income stream will be about $4 million per year for the next thirty years. You might wonder what you're worth today since you won the $122 million jackpot.