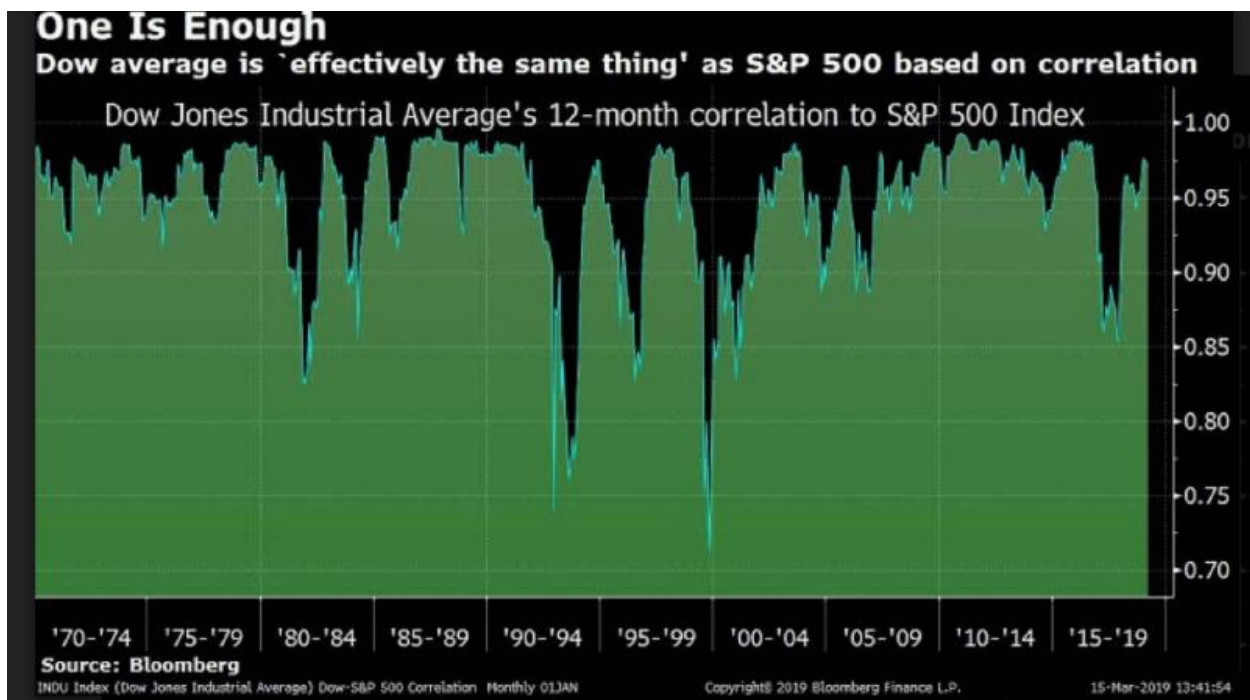


THE POWER OF THE MARKET

Events of the past week have sadly reminded us of the increasingly troubled world in which we live. The horrific murders in New Zealand attest to what hate and ignorance are capable of and what civilized societies must strive to contain. In Europe, the completely bungled Brexit negotiations not only continue to be an embarrassment for Britain but, more importantly, Brexit carries the potential to negatively impact the lives of millions of people and destabilize the fragile construction that is the European Union. Even if the can is kicked down the road and an extension to negotiations is achieved, danger will have been delayed rather than averted. It remains our view that the best outcome both from an economic standpoint and for the population of Britain at large would be for the UK to remain in the European Union.

On a lighter note than the opening paragraph (anything would be), I'd like to draw your attention to the chart below. It maps the correlation between the two indices, the Dow 30 and the S&P 500.



A basic premise of the Global Investment Letter is that all markets are inter-related. The chart above demonstrates that, for the past 50 years, the Dow and the S&P have been so closely correlated that they are practically interchangeable. I was aware that the two indices would have a reasonable degree of correlation given the overlap of large cap stocks, but I was surprised that the correlation was as strong as it has been over such an extended period.

The average correlation between the two indices over the period covered by the chart is well over 90%! The tight correlation did ease at times, most notably during the dot-com boom at the turn of the century. Still, even during that period, the correlation was greater than 70%!

This chart reminds us how difficult it is to escape the influence of the primary trend of the market. The components of the S&P 500 represent about 75% of the total market capitalization of all listed stocks in the United States. There is little refuge in investing in small cap stocks with the long-term correlation between the Russell 2000 index and the S&P 500 being .8 or 80%.

The Global Investment Letter seeks to identify key macro influences and anticipate their effect on markets. We believe the current global economic and geopolitical situation makes a consideration of macro factors especially important. The chart above certainly demonstrates the importance of the secular trend on virtually all stocks. We see our job as recognizing the factors that produce the secular trend, which can then suggest an investment strategy.

By Jonathan Baird CFA

Knowledge is Power..... Just one idea or insight a year can be worth many times the subscription price.

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