Leigh Baldwin & Co.

Investment Brokerage

"The real danger is not that computers will begin to think like men, but that men will begin to think like computers." - Sydney Harris (Journalist)

As the second quarter of 2017 comes to its rain soaked end, stock investors still had cause to cheer. For the record, large cap stock indexes are up about 8% with the tech heavy NASDAQ issues up just about 14%. While the action continues to center around the now famous FAANG stocks, emerging market issues have also performed extremely well during the first 6 months of this year. Ten year interest rates, which remain planted at less than 2.2%, have underpinned this rally for some time now and with corporate earnings solid if not spectacular, the path of least resistance seems higher.

It is perhaps human nature that as markets rise over a long period of time with little volatility, that investors become a bit complacent and risk averse. Even the idea of trading bitcoin somehow makes sense. But in the foggy distance of future performance, there is a light flashing and it is the light of a computer screen saying "buy more ETF's". Anecdotally, the end of this month will mark the 16th straight month of record inflows into (ETF) exchange traded funds. What does this mean for investors?

ETF's were created by using computer models to establish very low cost mutual funds that will replicate almost all areas of the markets. In a bull market, passive investing will often-times outshine funds actively managed by human beings and this has certainly been the case over the past several years. The funds are managed using sophisticated algorithms and are a useful and viable tool for money management. Their success is also their risk. As passive activities (including indexing) has risen from about 8% of total managed assets to almost 40% today, more and more dollars are being invested in fewer and fewer stocks, and without regard for valuation.

Mathematically, historically, and intellectually we know that all bull markets eventually come to an end, but it is almost impossible to predict when. ETFs and Index funds are now the dominate players in the markets and they carry little if any cash reserves. The risk (and the opportunity) is that when everyone hits the sell button, to whom are we selling? If at that point, as the computers take over, we will be there to guide our clients along the way.

"To err is human, but to really foul things up you need a computer." Paul R. Ehrlich

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