NAPLES GLOBAL ADVISORS

"Globalization really is a concrete, fundamental fact in everybody's lives,
and you really see that come to life in soccer stadiums."
- Franklin Foer, Author of *How Soccer Explains the World*

June 30th marked the end of the second quarter for capital markets, but a greater portion of the globe will probably recognize that date as marking the end of the group stage and beginning of the "knock-out games" for the World Cup. (After all, domestic stock market trading volumes dropped a whopping 55%, on average, when a country's team was playing during the 2010 World Cup.) While the World Cup is not the main sporting event in the U.S. (especially this year since the national team did not qualify), it certainly is for most everywhere else on the planet. One simply needs to watch the national anthems at the start of the games to witness the passion that each fan base exhibits for its country and the "beautiful game." The line-up of national flags, from *Senegal* to *Iceland* to *Iran*, is also quite impressive and highlights the truly global nature of the game.

Investing has also become a global "game," which is why NGA places no geographic boundaries when looking for profitable companies that meet our investment criteria. While investing globally has not worked for investors thus far in 2018 (most international markets are down 0-5% year-to-date), one only has to go back to 2017 to remember the benefits in the form of +20% returns.

When Good is Not Good Enough

Soccer can be a cruel game where the best teams with the best game plans can lose (e.g. *Germany*). The same can be said of investing. Having a sound investment thesis about a company does not always equate to positive returns on the stock.

"The ball is round, the game lasts ninety minutes, and everything else is just theory."
– Sepp Herberger, Coach in Miracle of Bern

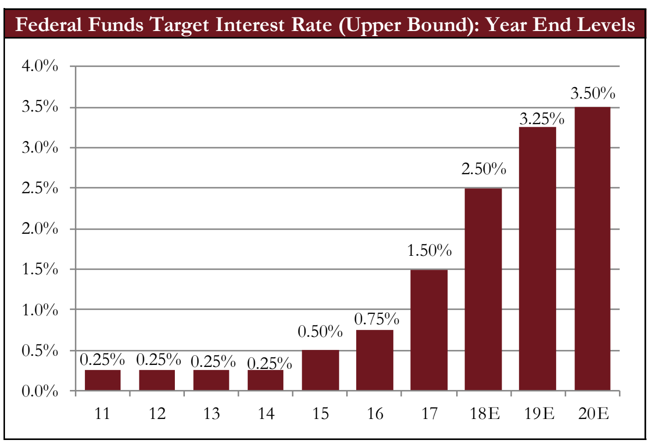
There have been a few times this year where our theory on a company's prospects has been correct, yet the stock hasn't performed well. This can frequently be noted around quarterly earnings reports. An overwhelming majority of companies have indeed reported higher sales and income in the first quarter of this year, yet sometimes that is not good enough. Sometimes a company also needs to beat Wall Street analysts' expectations for the stock to react positively to good quarterly results. A company can be punished if they don't. For example, a U.S.-based payroll services provider (whose founder now calls Naples home) grew its earnings by 15% in the first quarter, but results were slightly lower than expectations. The stock fell roughly ~8.5% in the trading period around its quarterly earnings release. However, the difference between soccer and investing is that the latter isn't a 90 minute game.

Markets can react irrationally in the short-term, and we often view these situations as potential buying opportunities. Over the long-term, rationality typically prevails. For the company mentioned above, the market did finally come to its senses with the stock rallying back ~16%.

When Good is Bad

Winning is generally a good thing. In the World Cup, teams want to finish 1st in their group, but sometimes that can backfire. *England* and *Belgium* realized that. *Belgium*, reluctantly, beat England to finish 1st, placing them in the same half of the bracket with powerhouses such as *Brazil* and *France*. Time will tell if that will come back to haunt them. The bond markets are in a similar type of conundrum, where what is good for the economy is typically bad for bond returns.

The U.S. economy has been strong enough for the Federal Reserve to have raised its benchmark interest rate seven times from 0% to a corridor of 1.75-2.00% as it looks to "normalize" monetary policy. The Federal Reserve expects favorable economic conditions to continue in the near-term, and as such have foreshadowed further interest rate hikes each year through at least 2020.



Source: Standard & Poors, Bloomberg

Note: 2018-2020 data is the Federal Reserve Median Estimate

Rising rates are bad for fixed income total returns, because bond prices are inversely correlated to yields, evidenced by the -1.6% total return on the ICE U.S. Aggregate Bond Index for the first half of 2018.

We have been cognizant of the risks of rising rates for some time now. However, in our preparation, we have not completely abandoned fixed income as an investment. (After all, when bonds are purchased, we are locking in a positive total return for the life of the bond as long as there is no default.) Instead, we have adjusted the risks – specifically the interest rate risk, which is measured via duration.

The output of a duration calculation is a number that simply tells you how much the price of a bond should fall (rise) if yields rise (fall) 1%. As an example, the duration of the U.S. Aggregate Bond Index is 7, which infers that if interest rates were to rise by 1%, the price would fall 7%. To reduce the risk of price declines, we have mindfully targeted much lower durations for client portfolios by purchasing shorter maturity bonds. While not always obvious, our clients have definitely benefited from this deliberate maneuver as their portfolio bond prices have fallen only modestly year-to-date.

While short-term negative returns are not appetizing, we honestly welcome the rising rate environment and a return to more normalized yields that savers can benefit from in retirement. As rates creep higher and maturities come about, NGA will be able to reinvest at much more attractive yields than we have been able to over the last several years.

When Good Is Great

Turning away from the markets… Our team members continue to hone their skills. Sara Perkins and Ryan Gavin recently passed their FINRA Series 65 exams. Ryan will now embark on the CFA charter while Sara will look towards the CFP. That is simply great news for them individually and for the firm as a whole. Evidenced in the World Cup, a connected, deep squad will almost always beat a one-man team, even if that one man is the best player in the world (e.g. Lionel Messi and *Argentina*). As our clientele continues to grow, we are working to ensure our team is "deep" enough to deliver the same excellent service that we have always strived to deliver.