Investment Review and Outlook – Summer 2019

Overview:

The current posture of the Federal Reserve, trending patterns in reported economic measures and on-going foreign trade negotiations, will be key areas of focus for Wall Street and investors during the second half of 2019 and will have an important impact on the direction of financial markets for the balance of 2019 and into 2020.

The Federal Reserve's Current Posture:

The case for an interest rate cut has been building as the Federal Reserve prepared to hold its next Federal Open Marketing Committee (FOMC) meeting on July 30th and 31st. In recent weeks, Federal Reserve Chairman Jerome Powell signaled that the central bank would likely cut interest rates over the near-term. The Chairman stated, as a rationale, trade resolution difficulties, slower growth in Europe and Asia, and uneven business trends at home could threaten continued U.S. economic expansion. Recent reports have indicated industrial production, factory utilization, export demand and key retail sectors have shown some weakness and inconsistency that we have not seen over the past few quarters. As a result, today, July 31st, the Fed lowered interest rates ¼ of 1%, putting Fed Funds in a range of 2.00% to 2.25%. Chairman Powell's remarks suggested additional rate cuts could again be implemented during 2019 and into 2020.

U.S. Economic Outlook for 2019-2020:

On Friday, July 26th, the Commerce Department reported that gross domestic product (GDP) had increased by 2.1% in Q2 2019, above the consensus forecast of 1.8%, thanks to solid consumer spending and government investment . Overall, tariffs and the global slowdown accounted for much of the quarter-to-quarter deceleration. The GDP measure was down from the 3.1% rate of expansion during Q1 2019.

A jump in household spending drove the results, as rising incomes and a sense of job security allowed consumers to step up their buying activity. Of concern in the recent April-to-June period was a drop in business spending, particularly among exporters and manufacturers. Areas of the U.S. economy that are linked to trade, manufacturing and new housing construction are no longer faring as well as they have over the past couple of years and face some uncertainty moving forward.

Despite the current choppy trends, the economy still seems poised to advance at a moderate rate of approximately 2% in the third and fourth quarters of 2019, aided by a strong labor market and the expectation of lower interest rates. After the decade-long business expansion, present conditions remain positive for further economic expansion. A key factor will be how the rate of growth breaks down, especially in the area of consumer spending which drives 70% of the economy. In addition, the health of manufacturing will be important to determine how much momentum the expansion carries into 2020.

Second quarter 2019 corporate "earnings season" is underway and is likely to be somewhat challenging as moderating GDP growth put a restraint on profit performance. However, with approximately 50% of the S&P 500 companies reporting results, 75% have met or exceeded forecasts that had been reduced in recent months. In the weeks to come, we'll see how this plays out and impacts the balance of 2019.

The Status of U.S. Trade Negotiations with China:

The world's financial markets are very focused on the on-again, off-again trade negotiations between the U.S. and China, as attempts continue to reach workable accommodations with which both nations can live. The sentiment on Wall Street remains generally positive, reflecting a sense that there will be a positive outcome, as no one wins in a trade war and the overall global economy suffers the consequences of ongoing discord. However, the timing of any agreement could be impacted by delays as we approach the 2020 elections. China may want to have a clearer understanding as to whom they will be dealing with as President of the U.S. in 2020.

This week, negotiators from the U.S. and China are meeting in Beijing to resume talks that have been stalemated since May 10^{th}. The meeting is the result of an agreement reached in early April between President Donald Trump and Chinese President Xi Jinping at the G20 Summit in Osaka, Japan.

Since late June, both countries have also shown a willingness to de-escalate the trade war. On June 28^{th}, the U.S. Department of Agriculture reported a large order from China, over half a million tons of soybeans, the largest sale of agriculture products to China since 800,000 tons of oilseed was purchased in April. Then on July 9^{th}, the U.S. reciprocated by announcing that it would exempt 110 Chinese products from import tariffs. Products ranged from medical equipment to key electronic components.

The reality of the U.S. tariffs is that American soybean farmers, already hit hard by very unfavorable weather, have sustained more damage in the trade war than most industry groups. As of May 30, 2019, accumulated exports and outstanding sales of soybeans to China had declined by over 50% when compared with prior year numbers.

Investment Strategy:

We think that Wall Street's overall outlook is sufficiently bright for investors, even with moderating economic activity in the U.S., uncertainty regarding trade negations with China and with occasional "swings and misses" in reported corporate earnings. With fixed income securities at a historically low level, we anticipate continuing attraction to equities, assuming that expectations are met for a moderate 2% economic expansion, aided by further interest rate easing by the Federal Reserve, as needed.

In our previous "Investment Review and Outlook – Spring 2019", we outlined the following investment strategy that continues to be our backdrop regarding company research and portfolio construction:

> *"While the economy and the stock market remain in their respective comfort zones, we are very focused on securities research and the work of identifying less volatile, more rewarding companies that have above average dividend payouts that add ballast to investment portfolios during times when we experience market price setbacks. Although there is good reason for investor optimism, we are very attuned to monitoring changing trends in economic activity and measuring the health of both corporate and consumer sectors. Our research focus is on capital preservation and achieving a balance between growth vehicles for asset development and safety of portfolio assets. The latter is increasingly important as we move deeper into 2019."*

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