Schroeder | Capital Management, LLC

Global Investment

Investment Review and Outlook - 2020 Begins

The Current U.S Economic Landscape:

The economy was in a good place as 2019 concluded with consumer confidence remaining high and brisk retail sales, especially in record-setting e-commerce transactions, recorded during the holiday season. As January is unfolding, the economy is continuing to show improvement. In recent weeks there has been a decline in jobless claims and the unemployment rate has held steady at a 50-year low with wage growth continuing to rise. In addition, a two-year high in existing homes sales was recorded for December along with a sharp acceleration in housing starts, advancing to a 13-year high. These readings easily surpassed analyst expectations and validated that the housing market remains very strong.

Meanwhile, U.S. manufacturing showed mixed results with a 5% decline in motor vehicle and parts production while higher output of other durable goods and food and beverage production more than offset the motor vehicle decline. The manufacturing sector comprises about 11% of the U.S. economy, compared with consumer spending that represents nearly 70% of gross domestic product (GDP).

The overall economy continues to move ahead at a modest pace, despite having been impacted by the 18 month-long trade war with China. Following GDP gains of 2.0% and 2.1% in the second and third quarters, respectively, the final three months of 2019 continued to advance and will likely record an expansion rate of approximately 2.0%, enabling the long economic expansion to continue. After a very positive corporate profit showing for the first nine months of 2019, 70% of the companies in the S&P 500 have now reported positive earnings surprises for the final quarter of 2019, validating a continuing solid economic environment. We also think this could be the consensus expectation over the next few quarters.

Possible Challenges in Early 2020: There are also potential risks that could negatively impact growth.

The Boeing 737 MAX 8 Aircraft – Economic expansion during the first half of 2020 is expected to be negatively impacted by the suspension of production and the ongoing grounding of Boeing's 737 MAX 8 aircraft. While the Federal Aviation Administration just this past Friday suggested that the grounded fleets of 737 Max 8 may be returned to service faster than a Boeing statement three days earlier, production of the aircraft remains suspended. Estimates are for a reduction of at least 0.50% in GDP expansion to a range of 1.5%-2.0% for Q1 2020. Boeing is the largest exporter in the U.S. and the important 737 Max 8 production suspension is having a significant, costly impact on the company's suppliers, resulting in order cancellations, and cash flow problems that will continue until the 737 Max 8 is recertified by the Federal Aviation Administration and production resumes.

The New China Trade Deal - There has been notable progress on trade between China and the United States, culminating in a phase one trade agreement signed on January 15th. China has agreed to materially boost its purchases of U.S. agriculture and other products in exchange for cancelling additional tariffs that were scheduled to go into effect for a large array of Chinese imports. Although this limited deal will not cancel existing tariffs on goods shipped from China, it is a critical first step in lessening trade tensions with the world's second largest economy and offering an opportunity for a very positive boost to the U.S. economy.

The next challenge will be to fashion a longer-term trade agreement as the second phase of the trade deal that will be a more complicated process and take many months of hard bargaining, given the formidable economic and political divide between the two nations. There are also risks going forward as a cancellation by either party is available if certain terms are not honored. Future negotiations will be closely watched.

Wuhan Coronavirus: Rapidly Spreading Chinese Virus - According to news and research sources, the virus causing the illness in Wuhan, China, a city of 11 million, is a novel member of the “coronavirus family” that has never been seen before. Like other coronaviruses, it originates in animal hosts with examples like Ebola and flu. This strain is thought to have spread from bats to snakes to humans. It is airborne and transmitted in a similar way as colds and influenza, attacking the respiratory system. Many individuals infected in Wuhan, China either worked or shopped in the Huanan Seafood wholesale market in the center of Wuhan. The market also sells live and newly slaughtered animals.

The latest statistics relating to the Wuhan Coronavirus outbreak are that at least 56 million people are in lockdown in 18 Chinese cities. Approximately 4,000 cases have been reported in China and at least 100 deaths. With each reporting, the numbers are rising. Globally, the numbers are also rising. Officials have banned public transportation in many cities, curtailed Lunar New Year’s celebrations and closed entertainment complexes.

In recent days, investors have become increasingly worried that Wuhan Coronavirus in China might be difficult to contain as it has gradually made its way to a number of other countries, including the U.S., and are speculating how this flu-like virus would impact global growth during 2020. As the virus spreads, there are obvious economic implications for China as well as the world at large. China will now need to turn its full attention to this health crisis to the exclusion of other matters impacting its economy.

Previous slowdowns in China, most notably in 2008/09 and 2016, saw the country unleash huge lending programs to spur construction to revive their economy while giving the global economy a nice lift with huge imports to which the global economy had become accustomed. With current growth in China at the lowest level in nearly three decades, the healthcare crises they are facing will require a refocus of economic priorities that most likely will delay an economic stimulus program on which the world has relying.

Outlook for 2020:

Despite the risks that are discussed above that could potentially threaten the rate of global economic expansion in 2020, there are important positives in the investment landscape that are in place: stellar year-end 2019 corporate earnings are being reported, positive economic data is being announced, the recent signing of a phase one trade pact with China has been well-received, and positive investor sentiment is evident on Wall Street. Furthermore, the steady rise in personal income, a healthy level of consumer confidence and spending, and an accommodative Federal Reserve suggest that GDP expansion is likely to be sustained at an annual rate of approximately 2% for 2020.

Investment Strategy:

For now, we see little ahead to cause us to alter our positive market outlook, despite the previous comments regarding “potential challenges in early 2020.” The backdrop for U.S. equities remains favorable. Assuming no significant problems occur in global relations or adverse economic conditions develop at home, stocks should show moderate strength in the months to come. However, we anticipate increased market volatility as efforts to forge a long-term trade agreement with China while also maintaining calm in international waters, especially in the Middle East, may have investors on edge from time to time. However, as we consistently maintain, such volatility offers investment opportunities in the overall global arena.

We are maintaining a conservative stance toward security selection and have stepped up our research effort to identify those investment values, even in this protracted market environment, that represent above-average prospects. Substitution of attractive new ideas for some mature portfolio holdings will occur as the year unfolds. As always, the hallmark of Schroeder Capital’s investment strategy is capital preservation and growth.

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