Schroeder | Capital Management, LLC

Global Investment

Investment Review and Outlook – Early Summer 2018

The Current U.S Economic Landscape:

The first half of 2018 ended on a high note, with strong progress in job creation and unemployment at an historically low level. The trade imbalance also narrowed, with the deficit declining sharply in March and April. Recent reports showed solid gains in new home sales, housing starts, retail spending that continued to rise well above forecasts and a modest rise in the leading economic indicators. Inflation data was held in check, allowing the Federal Reserve to stay on a course of gradually increasing interest rates. Overall, the latest trends suggest that the economy may have grown by as much as 4% in the second quarter of 2018.

With considerable momentum in place, the economy is expected to advance by 3-4% during the second half of 2018. Consumer spending, housing and business capital investment, largely due to new favorable tax treatment, should continue to be strong. Upcoming second quarter corporate earnings reports should also reveal how vibrant the overall economy is likely to be during the balance of 2018. Expectations for both improved revenues and profits are high, as an advancing U.S. economy coupled with a recently lowered corporate tax rate work in concert to produce strong results.

A Preliminary View of 2019:

There is good reason to be optimistic about the U.S. economy and the stock market in 2019. One of the main underpinnings will be the ongoing fiscal stimulus resulting from the "Tax Cuts and Jobs Act" that has generated a high level of business and consumer confidence. This is likely to remain for some time, resulting in economic growth of at least 3%.

While the 2019 economic landscape is quite favorable, there are reasons to approach this scenario with a measure of caution. We know the global trade situation is uncertain and needs to be watched closely, regarding the impact that any new tariffs may have on continued economic expansion. In addition, the Federal Reserve has suggested it is likely to raise interest rates once or twice again during 2018 with a trio of possible rate hikes in 2019. Our hope is that the Fed does not "over shoot" on monetary tightening that could have a dampening effect on economic growth during 2019.

Politics will also be prominent in the headlines during the balance of 2018. As the mid-term elections draw closer, intense debates will ratchet up. An important question is what potential impact the election results may have on possible future legislative action with implications for the U.S. economy.

With extreme rhetoric on both sides of the political divide getting more contentious on a wide range of issues, additional uncertainty seems likely during the balance of the year. At least for the present time, political compromise on so many issues, large and small, has become a lost art. And, then there are ever-present global uncertainties in the geopolitical arena…lots to ponder.

Investors' Sentiment and Recent Trade Rhetoric:

The increasingly contentious trade policy standoff with Mexico, Canada, Europe and China is an important factor impacting today's investor sentiment as well as the outlook for global economic growth. A lot of the rhetoric is also understood to be part of the negotiation process. Ultimately, any tariff measures put in place are not likely to be as draconian as initially expected while there can be offsetting benefits spurring U.S economic growth within some important industrial sectors. Importantly, the U.S. is the largest global economy and the world needs the U.S as a trading partner.

However, the reality is that economic tensions with China and other countries need to be monitored closely. Whatever the possible long-range outcome, uncertainty in the short run is uncomfortable for investors.

Summary and Investment Strategy:

The U.S. stock market rallied nicely for part of May and early June, benefitting from continuing strength in economic fundamentals and a positive outlook. However, equity markets faltered in the latter stages of June as there was mounting uncertainty over trade policies across the world and fears that the imposition of tariffs could disrupt global trade. Following some market volatility, the month of June ended on an upswing.

With unemployment at multi-decade lows in every demographic category, the tight labor market has elevated investors' concern that this could eventually lead to higher inflation and perhaps a more rapid pace of interest rate hikes by the Federal Reserve. On balance, however, investors are staying the course, as stock markets around the world continue to show resilience. As always, we are keeping a watchful eye for possible headwinds that could develop.

We continue to be optimistic about the U.S. economy and are identifying attractive global investment opportunities, subject to valuation disciplines. We continue to maintain a very careful approach to security selection with an emphasis on limiting risk. Capital preservation is at the forefront of our strategy. As we stated in our client letter on April 28th:

"Bull markets typically end with declining GDP, rising inflation, a decline in corporate earnings and a dramatic rise in interest-rates. None of these factors are in view at the present time."

We will be vigilant watching any meaningful trend change in these areas and other important economic developments in the months to come and into 2019.

G. Frederick Schroeder, CFA

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