Schroeder | Capital Management, LLC

Global Investment

# Investment Review and Outlook – Spring 2019

## Current Economic Backdrop:

A good friend of mine is Dr. Edward Yardeni, President of Yardeni Research, a provider of independent global investment research. Ed's sterling career includes serving as Chief Investment Strategist and Managing Director for several Wall Street firms, as an economist with the Federal Reserve of NY and positions at the Federal Reserve Board of Governors and the U.S. Treasury Department, Wash., D.C.

In a recent research report that I received, Ed succinctly recapped the current economic backdrop in the U.S. as we move toward the mid-point of 2019:

> *"The remarkable V-shaped recovery in the S&P 500 since the day after Christmas suggests that fears of an economic recession subsided quickly, and so did any concerns about a prolonged downturn in earnings. Now that spring has arrived, we are seeing green shoots in analyst' expectations for earnings and revenue expectations remain on the sunny side of the street. (Dr. Edward Yardeni, April 10, 2019)*

Ed's characterization of the current U.S. economy sets the stage for our discussion as to where we are currently and what we might anticipate in the months to come, good surprises as well as current challenges and concerns as we look over the horizon. This is especially appropriate when considering the length of the current economic expansion.

A very positive development occurred in recent days when the employment picture brightened rather significantly, once again. Not only have weekly jobless claims fallen to a half-century low, but this supports the view that the employment outlook is strengthening following the sharp reversal earlier this year. The March employment data also showed a stronger-than-expected rise in job creation, lessening widespread fears, only a month ago, of a possible downturn in the economy.

## Economic Challenges and Concerns:

Meanwhile, the economy has been facing some challenges. The downward revision in Q4 2018 gross domestic product growth from 2.6% to 2.2% was likely impacted by the 22-day partial government shutdown that started in late December and during the important holiday retail spending period which overlapped into early 2019. A weak report for retail spending in March was reported along with deceleration in non-manufacturing activity and slippage in U.S. car sales. Collectively, evidence of slowing business activity has begun to pile up. While there were some hints of strength along the way, overall economic activity remained below earlier levels in early 2019.

Other concerns on the global stage also linger, with much of Europe under economic stress and the U.K. in the midst of a tense standoff regarding its exit from the European Union (Brexit). Germany's sputtering economy, the largest in Europe, is of concern, especially as the important manufacturing sector has slowed. Key surveys suggest the euro zone in general could contract during the first half of the year. Trade disputes between the United States and the Continent continue along with threats of more tariffs.

Domestically, the divide in Congress has stymied most legislation. There are also questions about whether the Administration and Congress can get together on spending programs that could act as further stimulants and also avoid another government shutdown. Finally, there is global trade, where uncertainty lingers particularly between the U.S. and China, even as signs point to likely near-term progress. Collectively, these and other factors suggest GDP growth will average between 2.0% and 2.5% in 2019.

## The Current Federal Reserve Posture:

The Federal Reserve, which raised interest rates steadily in 2018, appears to be neutral at the present time and is unlikely to shift course anytime soon. The bank recently signaled that it had no intention of continuing to push rates higher during 2019. One key factor was their view that GDP growth is moderating and suggested that they will stay patient and cautious on the interest rate front. The possibility of even reducing borrowing costs later in 2019 has been speculated, should business activity soften more than expected or inflation run much below the bank's targets.

## Conclusion:

Investors have been optimistic since the end of 2018, aided by a more dovish stance of the Fed toward future interest rate hikes. And, there could be more good news on the way. The next catalyst could come from brokering a permanent trade deal between the United States and China.

The Administration is trying very hard to secure some accommodation with China, the world's second-largest economy. Such an agreement could remove additional tariffs and bolster business confidence in both countries, thus strengthening the case for a soft economic landing in the U.S. when the aging economic advance eventually loses momentum. If such a detente can be reached with China over the next couple of months, this would likely be a positive for the fortunes of Wall Street.

In sum, maintaining the Federal Reserve's present policy, at least for the duration of 2019, positive trade developments and the continuation of a solid corporate revenue and earnings backdrop, even in a slowing economy, would likely help support investor optimism and sustain the current bull market.

## Investment Strategy:

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.

While fixed income securities offer historically low interest returns, a higher level of income can be achieved from selected companies with above average, sustainable and increasing dividend streams. Schroeder Capital's securities research and security selection emphasize high quality companies with strong balance sheets, little or no debt, sustainable profit histories and high dividend income.

We seek to identify securities that possess these well-defined attributes, both domestically and globally, while implementing a portfolio strategy of balancing capital preservation and the prospect of asset development in the current economic and investment environment.

G. Frederick Schroeder
President and Chief Investment Officer

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