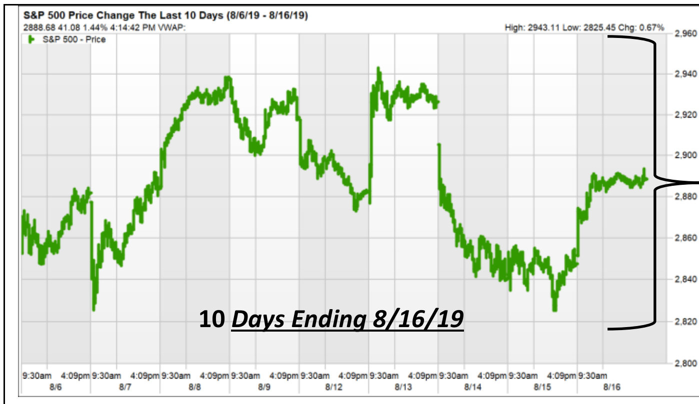
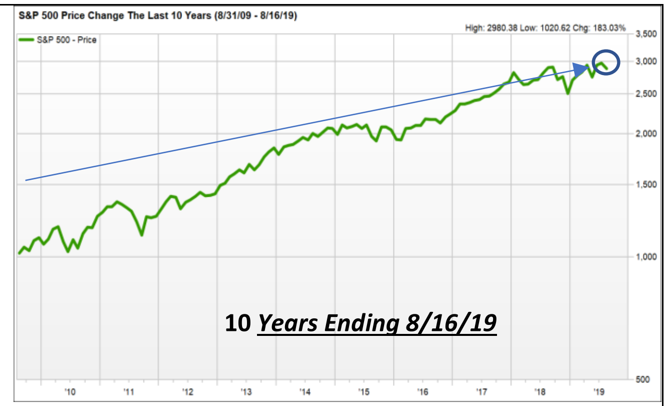
Uncertainty/Anxiety/Volatility – One Begets The Other

Our Thoughts On The Current Economic/Financial Market Environment





Source: Factset Research Systems

THE PRESENT:

Hong Kong, Brexit, China/U.S. trade negotiations, weakening global growth, North Korea, slowing but positive corporate profit growth, declining U.S. investment spending, and negative government bond yields in Germany, France, Switzerland, Japan and other countries (total: $15+ trillion[i]). The topics just listed are among uncertainties that investors have been confronted with during the past several weeks and months and that are the primary factors leading to high investor anxiety. When anxiety is high, investors often react (sometimes too) quickly to the "news of the day" whether positive or negative e.g., "I need to do something". These actions lead to volatility, which results in the sharp price swings that we have seen recently (see left-hand chart above). Despite negative "headlines" and the recent volatility, the S&P 500 has risen 15.2% year-to-date[ii] and off only 4.4%[iii] from its all-time high reached on July 29th of this year.

The concerns described above deserve a good deal of attention, analysis and some action. With respect to investment action, although we are not short-term traders, the S&P 500's rise to a recovery high last year provided the opportunity to modestly reduce portfolio equity exposure, while the lows of last December provided the opportunity to modestly increase that exposure at attractive prices. Since mid-summer of this year, we have again reduced equity exposure as the equity markets approached all-time highs and the uncertainties described in the first paragraph weighed on our thinking.

Volatility is not unique to the recent past. During the economic expansion and bull market period we have been experiencing (2nd longest bull market & longest economic expansion[iv]), heightened volatility has been a trademark of the period. As an example, during the ten plus years of this bull market, the S&P 500 has experienced 17 of the 20 ***largest daily point gains and losses***[v] in the history of the S&P 500. In addition, during the same period, the S&P 500 has experienced 18 of the 20 **largest *intraday* point swings**[vi]. To "survive" and potentially benefit during this long period of occasional high volatility, but very positive returns, required analysis, patience, discipline, a focus on quality, and regular communication – a "steady-Eddie" approach. We work hard at all of these responsibilities, all of the time, as we manage the assets clients have entrusted to us.

THE FUTURE:

People/investors fear that a number of the factors described in the first paragraph warn of an impending recession, and certainly there are pieces of the puzzle that lead to that possibility. ***HOWEVER***, a recession is thus far a fear and not a reality. The global economy is still growing, but at a pace slower than last year. The U.S. economy, the "engine" that, in large part, drives the global economy continues to grow at approximately 2%[vii], unemployment is at a near fifty-year low[viii] and job growth continues, inflation and gas prices are low, corporate profits are growing, consumer net worth is at an all-time high[ix] and consumer spending is healthy (an important factor considering that almost 70% of U.S. GDP is consumer spending dependent[x]).

While the rising level of credit and debt is a factor we monitor closely, we don't believe that "bubbles", similar to the housing market or the dot.com environment that preceded the previous two recessions, exist today. In our opinion, the complacency that was evident during those two previous pre-recession periods is no where to be seen. The recent 10-year bull market has often been described as the "most hated bull market" for just that reason. Complacency has been replaced by anxiety, as individual investors have consistently reduced their exposure to equity (stock) investments during the past ten years based upon the consequences of the "great recession". We don't believe a condition of "irrational exuberance" exists.

WHAT WE ARE DOING AND WHAT WE ARE WATCHING:

As previously described, and for reasons other than just concerns regarding the possibility of recession, we have modestly reduced equity exposure in client portfolios. As sales have taken place, we have generally re-invested those proceeds into high quality, short-term investments e.g. CD's and Treasuries and have sought to take advantage of the inverted yield curve[xi] where very short-term fixed-income investments yield more than intermediate or longer-maturity investments. We have further enhanced the diversification and quality of portfolios and maintained patience and discipline in the face of volatility.

As the summer ends and we look toward the end of the year, we will be watching for signs that the "easing" actions of central banks around the globe have had a positive effect in reducing anxiety that a global recession is imminent; we will monitor capital spending trends in the U.S. in order to gauge the confidence of corporate America; we will continue to monitor and look for a reasonably quick and amicable end to the trade "wars", and in general continue to maintain a vigilant watch on all events impacting the economy and financial markets.

Currently we believe portfolios are well structured and we anticipate no *significant* actions in the near future. However, we will continue to be proactive in our actions and opportunistic if volatility continues.

Kindly do not hesitate to call or email any of us if you have any questions, concerns, or comments.

Regards,

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[i] The New York Times, 8/18/19 edition
[ii] Barron's Market Laboratory 8/19/19
[iii] Factset Research Systems, 8/16/19
[iv] Current bull market 3/9/09 to 8/16/19, 3, 812 day; longest bull market 4,494 day (12/4/97 – 3/24/00); National Bureau of Economic Research, economic expansion 6/2009 – 8/2019, 122 months
[v] Factset Research Systems, 8/18/19
[vi]Factset Research Systems, 8/18/19
[vii] The Economist, 8/17-23/2019
[viii] Federal Reserve Bank of St. Louis 8/18/2019 49 yrs.
[ix] Federal Reserve Bank of St. Louis; JP Morgan Asset Management Guide To The Markets 8/16/19
[x] Federal Reserve Bank of St. Louis, 67.6%
[xi] U.S. Department of The Treasury; Barron's 8/19/19, The New York Times 8/18/19 edition, Factset Research Systems