October 1, 2019

Dear Clients and Investors,

Fall has arrived and, so far, the weather has been spectacularly beautiful here in Connecticut with warm, dry weather as the foliage begins to turn.

GDP growth registered a gain of 2.0% in the second quarter and current estimates for Q3 GDP growth are at 2.1%. The S&P 500 gained 1.2% in Q3 and is up 19% YTD 2019. Despite such a great year to date for the equity markets it's important to remember that over the last 12 and 21 months the market is up just slightly due to the ongoing trade war with China amongst other uncertainties. Speaking of uncertainties, we have another big news story out of Washington last week, as House Speaker Nancy Pelosi announced an impeachment inquiry into whether President Trump interacted improperly with his Ukrainian counterpart. Obviously, at this point, there is no way of knowing how the drama on Capitol Hill will play out as the impeachment proceedings are just beginning and according to our Constitution the House of Representatives has the "sole power of impeachment" and gives the Senate "the sole power to try all impeachments". Given that the Republicans control the Senate and a two-thirds majority of the Senate must vote for impeachment my conclusion is that this process will divide down the middle along party lines with impeachment unlikely unless the offense proves indisputable. Even if the President is impeached, history tells us that the markets can eventually handle impeachment proceedings in stride no matter what the outcome.

I continue to be surprised by the lack of progress on the trade front. The new NAFTA treaty called USMCA is sitting in Congress waiting for a vote while the China Trade war continues with the news flipping back and forth between positive and negative rumors on how those talks are progressing. The good news is that the Federal Reserve lowered the Fed Funds rate by ¼ of a percent due to trade concerns which are affecting different areas of the US economy. I view this cut as an "insurance cut" in case talks stay stalled or are terminated. With 2% GDP growth and low inflation numbers the Fed can afford to be Dovish and make insurance cuts at this stage of the economic cycle.

The economy continues to muddle along with housing statistics out last week showing strength as mortgage rates have dropped all year making new home purchases and re-fi's more viable. Optimistic consumers, a strong labor market and low interest rates should continue to support the housing sector and service sector of the economy. Consumer confidence for September came in weaker than expected at 125.1, down from 134.2 in August but remains well above the median over the last 30 years. Industrial production numbers have slowly been weakening as the trade war takes a toll on this sector of the economy – the US manufacturing PMI was 49.9 in August, below the neutral 50.0 threshold for the first time since 2009. New orders dropped the most in 10 years while data also showed export sales tanked to the lowest level since 2009 as well.

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So, where do the markets and the economy stand as we head into the final quarter of 2019? As always, the crosscurrents are many and the answers are never easy or clear. Last year in the 4th quarter we had a swift and nasty pullback of 20% and as it turned out the reasons given for the pullback turned out to be fleeting. As we head into Q4 this year the economy appears stable to me. The biggest threat remains the trade war with China and now the possibility of impeachment. It's possible that the Chinese would continue to hedge towards a Trump loss next November, especially if impeachment gains credibility, causing a trade resolution to be pushed further into the future and risking further the possibility of a global and US recession. This scenario could easily result in a poor economy and difficult market period in the final 3 months and into 2020. Alternatively, the Chinese could conclude that a mutually beneficial trade resolution is in everyone's best interest, Congress could pass the USMCA and the economy and markets would react positively. Either scenario is logically possible. In the mean-time the US remains the best country to invest, the dollar is the best currency to invest in and very little should disrupt that in the period ahead regardless of the above outcomes.

On the Geo-Political front many hot spots remain, and some new ones are heating up. North Korea, Afghanistan, Venezuela and especially now Iran and the Middle East are still potentially very troublesome. The situation in the Gulf and with Iran seems as serious as anything since the last Gulf War broke out and so far, I am relieved at how the situation has not escalated. Oh, how things have changed from 10 and 20 years ago when the US was so dependent upon Middle East oil. Today, thanks to the huge and growing US energy complex, the US can choose when to intercede in Middle East politics and when it's in our best interests to sit on the sidelines. No one in the US wants a repeat of the Iraq Wars with all the casualties and wealth destruction that went along with them. My belief is that many countries in the Middle East and elsewhere (allies and adversaries) would like to see the US drawn back into a shooting war in the region.

To summarize, as we head into the final quarter of 2019, I think for the S&P 500 has slightly more downside than upside potential. This may result in more cash, T-Bills and short-term bonds in the portfolios in the months ahead. These investments are not exciting but do dampen volatility in the portfolios and if the markets do pull back, which they will at some point, we have funds to put to work at lower levels. And because the market is constantly mispricing great businesses, like in Q4 2018, we will be patient. We love businesses with irreplaceable brand names, high barriers to entry, wide margins, can raise prices, grow their dividends and have modest debt. They are out there, and the US marketplace is still the best place to find them!

Interest rates, Inflation, employment, corporate earnings, the dollar and energy prices all remain supportive of a moderately growing economy and what I often refer to as a "Goldilocks Economy" so let's hope that the Fed and the politicians are able to keep this, longest ever running expansion, on track for the foreseeable future.

At this time, I continue to favor large-cap, dividend paying, multinational corporations with strong balance sheets. Emerging markets especially in Asia appear undervalued. Risk/reward continues to favor equities over fixed income. Select MLP's and specialized bond and alternative funds continue to look good as income producers. T-Bills are attractive for short-term assets. Take care for now.

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