VAN LIEW TRUST COMPANY

as we see it

Winter 2019

THOUGHTS FROM OUR CHAIRMAN

The Bull Market appears to have a ways to go. There are many scary headlines, but the glass appears to be half full. On most market corrections, it is an opportunity to put cash to work by investing in the stock of companies that have become inexpensive, but are still well-run and producing competitive products and/or services.

I remind our readers that as Long-Term-Investors, we diversify portfolios to minimize volatility. Currently, American companies are attracting investors from around the world. At times, diversification is, in part, achieved by looking to companies in other countries, but for now, the best is mostly in the USA.

My associate, Wade Walbrun, in this issue, goes into more detail about the current economic environment.

Alfred B. Van Liew

Chasing Woozles

Wade M .Walbrun

I recently had the pleasure of seeing the exhibit of Winnie the Pooh original illustrations at the Museum of Fine Arts in Boston. One of my favorite drawings illustrates the episode in which Pooh walks in the snow around a small glade of shrubs. Upon making a full circle, Pooh sees a set of pawprints in the snow and nervously thinks there may be hostile animals about. "Oh, Pooh! Do you think it's a - a - a Woozle?" proclaimed Piglet with a squeak of excitement. Pooh and Piglet then continue on together to track down the Woozle. Could it be market pundits and the Fed alike, are also chasing Woozles? In this issue of As We See It, we examine the tracks of interest rates, inflation and earnings growth.

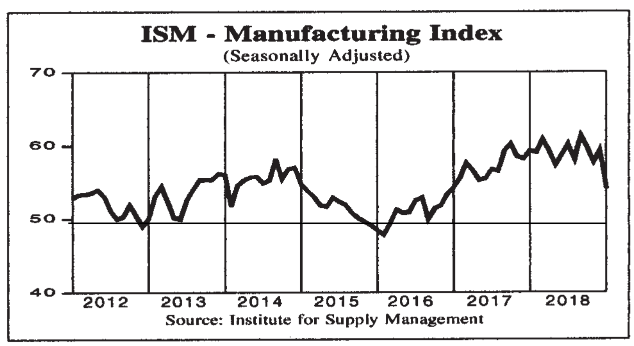
Interest rate levels have been a point of great debate by many over the last year. As the US 10-year bond yield moved smartly over the highly anticipated 3% level to within a whisper of 3.25% last November, many opined on the imminent end of the US economic expansion and bull market. Higher interest rates will increase payments for companies who refinanced their debt. It is also suggested that corporate capital spending and growth plans would suffer going forward. Additionally, bond returns at such "elevated" interest rate levels were thought to finally compete effectively with expected returns from stocks, thus marking the beginning of the great migration out of equities into fixed income obligations. So far, it appears these dire prognostications have not come to pass. Yields on the US 10-year bond promptly retreated from their high to 2.56% and currently reside in the area of 2.70%, a level last seen in February 2018. Maybe partially in reaction to the rise in interest rates, the S&P 500 Index retreated 14% in 4Q 2018 but has also rebounded over 8% year-to-date in 2019.

The rise in short-term interest rates was prompted by the Federal Reserve's increase in the Fed Funds rate. As the Fed's mandate is to foster healthy economic conditions and keep check on inflation, many concerned investors scratched their heads amidst a backdrop of robust US GDP and low levels of inflation, as to why the Fed continued its march of rate increases. Considering the historic relationship between low unemployment rates and rises in inflation, continued Fed moves seemed to suggest they feared higher inflation just around the corner. Yet, so far, levels of core inflation, as seen in the Personal Consumption Expenditure price index (PCE), have remained in check, around 2%, in spite of 3%+ wage increases for workers. Helping to keep inflation down is a strong dollar and oil prices that have fallen from $76 in October 2018 to current levels in the low $50s. At the turn of the year, Federal Reserve commentary became less hawkish on future rate increases as they saw a possible negative growth impact in continuing their rate hike program. This reduced investor anxiety.

Much concern and debate has arisen regarding the future trend of corporate profits. What does normalized earnings growth look like going forward? After a year in which overall S&P 500 earnings jumped 20%+, helped by roughly 7% from corporate tax reform, will there be a beneficial residual effect from the corporate tax cut beyond one year? It appeared, if 4Q 2018 stock market action is any indication, corporate earnings were falling off a cliff and a US recession was likely sometime in the new year. Yet, the bottom lines of S&P 500 companies are currently expected to rise 5.6% in 2019, close to long run averages. Additionally, there seems to be little economic evidence of recession near-term. While there is little consensus about future benefits to earnings from the corporate tax cuts, lower tax rates may free up capital for additional capital spending, the effects of which would not be seen for a couple years.

While stock market indexes and animal spirits have rebounded since year-end we think investor sentiment may still be too pessimistic as many cite the potential of an expanding trade war as their most significant economic concern. While we believe a resolution will eventually be reached, we are less concerned about trade wars from the standpoint of the US economic impact, but more so from a psychological standpoint. Uncertainty is never a desirable decision-making backdrop for CEOs charged with a company's capital spending and expansion plans. Still, with estimates for 2019 US GDP growth and corporate earnings at roughly 2.5% and 6%, respectively, little in the way of interest rate or inflation risk to worry about, and a healthy consumer, we feel pretty positive about the prospect for stocks. We look back at the volatility at the end of 2018 and recognize the tracks in the snow, not as something to be anxious about, but simply as a long overdue pullback we typically see in bull markets.

T R E N D L I N E S



The recent falloff in this leading indicator can be blamed in part due to tariff concerns, the government shutdown and slower economic growth going forward. Still, a mid-50s reading in this index squarely projects economic expansion. in 2019. No hints of recession.

We would be delighted to meet with you to share comments about this article, or to review your portfolio in detail.

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