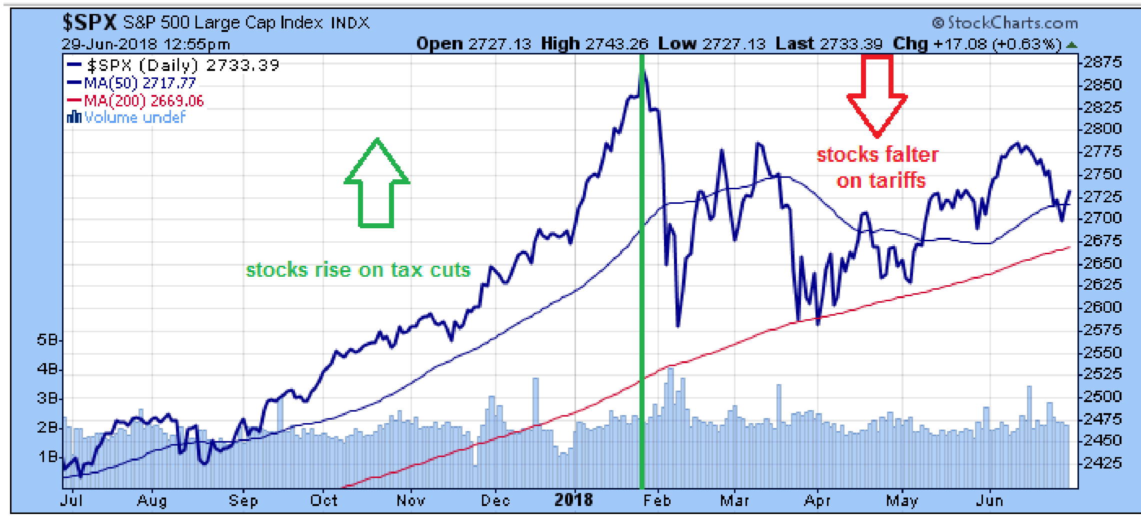
July 2018

Dear Valued Clients and Friends,

How stocks have reacted this quarter has really been no surprise. Back on January 22nd, the White House announced tariffs on solar panels and washing machines and the effect on stocks was dramatic (date indicated in green on the chart below). Since that time the President's lead economic advisor has resigned and been replaced; and a whole array of further tariffs have been announced. In response, China, Canada, and Europe have all announced tariffs on US goods and the rhetoric shows no signs of dissipating. Fortunately, this has had no impact on actual corporate earnings thus far. Those earnings continue to be very strong and remain a key support for the stock market.



The Federal Reserve raising interest rates, a large concern last year, has clearly taken a back seat now to trade. Long term rates are not rising nearly as quickly as short term rates, indicating that the bond market does not foresee the economy continuing to grow at its current rate. This market behavior suggests that the Fed will eventually slow down or stop the rate increases – e.g. that the economic growth outlook itself is not enough to force longer-term rate increases. This presents some cause for concern as a flat to inverted yield curve (when short term rates equal or exceed longer term rates) almost always portends a recession: an inverted yield curve has preceded every recession since 1960. In all that time, there's been only one false alarm, in the mid-1960s. While an inverted yield curve has not yet occurred, rates are heading this direction (note the waning delta between the 2yr and 10yr treasury rates in the following chart) and do warrant some vigilance. Investors are wise to pay close attention now however, given that stocks will typically decline around 6 months BEFORE a recession actually occurs and recessions are only labeled as such AFTER they start.

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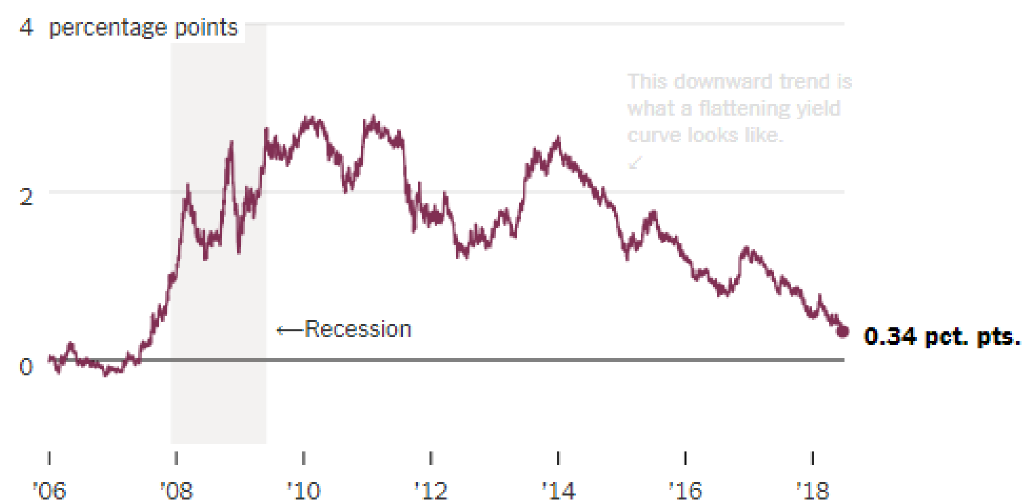
The **yield curve inverted** — or fell below zero — before the recession hit in late 2007.



By The New York Times | Source: Federal Reserve Bank of St. Louis | Note: Data as of June 21

For the present however, the US economy continues to hum along as unemployment is at record lows, wages increases thus far have been modest, and inflation is still in check. Housing price trends, rising fuel prices, and rising healthcare costs are all potentially inflationary. Some economists fear these hints of inflation will lead the Fed to raise rates too much, leading to a 'policy mistake' and causing a recession. As of now, these concerns appear overblown.

In the near term, tariffs and trade issues will continue to dog stocks and even the mere hint of an impact to corporate earnings could topple the stock apple cart. We continue to monitor the economy and the market sentiment closely and remain poised to take protective action if necessary.

To future profits,

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