Making Sense of Finance

Karagosian Financial Services 7/12/2019 Volume 22, Issue 3

Second Quarter 2019 Review

STOCK MARKET

Stocks in the U.S. experienced a roller coaster ride in the second quarter. April continued the first quarter gains; the month of May saw a large selloff after new tariffs were put in place on US imports from China and retaliating tariffs placed on US exports to China. By June there was a huge rebound as the market became optimistic about resolving the trade tensions. Although no resolutions to the trade standoff with China happened that month, no new tariffs were invoked so that was considered a positive by the market. By the end of June, the S & P 500 had realized a gain of 3.8% for the last quarter. Other major indexes performed similarly, the Nasdaq increased 3.6% and the Dow Jones Industrial Average rose 2.6%. The effect of the existing tariffs may take a little time to work their way through the economy as someone eventually has to absorb the extra costs. Also lurking in the background was the Federal Reserve and the predictions not only of no increases in interest rates in 2019, but now more chatter of an actual cut in interest rates this year. "Cheap" money for a longer period of time may extend the current economic expansion, which is now the longest period of economic growth in US history. This past quarter was also noted for noteworthy IPOs (Initial Public Offerings). It was the most active IPO quarter in four years, with names such as Uber, Lyft and Beyond Meat as some of the more talked about names.

Technology stocks in the second quarter were one of the better performing sectors as they had been in the first quarter. Financial stocks however had the largest sector gains. All stock groups were positive performers last quarter, except for energy stocks which posted a loss. Oil prices slightly dropped in the quarter after a huge rise in the previous quarter. Oil prices in the past twelve months, similar to stocks, have been experiencing considerable up and down swings. Healthcare stocks, although positive for the second quarter, continued to lag the overall market. Concerns regarding what some candidates (if elected President) might change in terms of US healthcare weigh on these companies. Real estate investment trusts also lagged last quarter, but this was after a spectacular first quarter performance as interest rates remain very accommodating for these debt laden companies. Gold stood out last quarter with a 9% rise in price.

Foreign developed markets had similar gains to domestic stock markets as measured by the MSCI EAFE Index in dollar terms. This index's gain for the second quarter was near 3%. In particular European markets did well, such as Switzerland, Germany and France. These stocks in the

Making Sense of Finance

• • •

Everyone and their neighbor has an opinion. At Karagosian Financial Services, we have a combined 40 plus years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is geared toward making sensible and prudent choices based on logic and experience, and not based on emotion.

Contributors:

Seaver T. Wang

Christine Terry

1 Baltic Place suite 201D

Croton On Hudson, NY 10016

www.toinvest.com

aggregate have higher dividend yields and lower price to earnings multiples than US stocks. A notable laggard was the United Kingdom market, as uncertainties around Brexit still create a headwind for British companies. Emerging markets did not perform as well as they did earlier in the year, with the outlier being Russia, where the stock market had double digit percentage gains last quarter. The Chinese market declined in the second quarter as the trade war standoff continues to affect the Chinese economy despite their government stimulus.

BOND MARKET

Bonds did well in the past quarter as interest rates continued to decline. The 10 Year Treasury yield ended the first quarter at 2.4% and was 2.0% by the end of June. The yield curve continued to be inverted as a 3 Month Treasury Bill at 2.12% was higher than the 10 Year yield. Does this indicate a slowing down of the economy to the point of recession as so often is the case? Time will tell. However, a frequently stated explanation for this inversion is that globally, the US is the only established country with such an attractive government bond yield. The 10 Year German Bund and the Japanese bond each have <u>negative</u> yields. This leads to more demand for US Treasuries from foreign investors. All categories of bonds did well, but the best performing sector was corporate investment grade bonds. Municipal bonds, though generating positive total returns last quarter, lagged other bonds. The same as in the first quarter, the longer the bond maturity the better the bond performed.

The Federal Reserve has an effect on bond yields, particularly on the short end. In the last newsletter, we mentioned that the Federal Reserve went from the standpoint of continuing to raise interest rates to the point of “policy normalization”, maintaining the status quo. That stance has changed somewhat, and there is now a very good possibility of an interest rate cut (or multiple cuts) this year. There are four Fed meetings remaining this year where cuts may happen.

OUTLOOK

Tariffs, Fed rate cuts, Trump tweets; for a moment, even we were distracted by all these news headliners. Even as professionals, it is easy for us to get distracted by all the noise, however, at the end of the day, we try to make decisions based on what we do know and basic fundamentals of the economy and corporate results. As we write this newsletter (mid-July), the stock market continues to forge ahead. The general consensus is that most people are pricing in an interest rate cut. That may be, and if it doesn’t happen sooner than later, then we may be in store for some negative volatility. But we must be reminded that our goals are long term and those who have shorter investment horizons already have their portfolios adjusted accordingly based on age and personal risk tolerances. What we do know is that interest rates are low and are likely to stay low or even decline. That means that the stock market is in a favorable atmosphere. Many economies outside of the U.S. are struggling too and the thought is that we must follow suit, but is this necessarily true? An alternative view may be that we benefit in the future when these economies recover. We really do not know what is in store for the economy or markets in the next 12-18 months, although most of the news isn’t horrible.

The one factor that we continue to watch closely is consumer debt levels. There is no definitive ratio or level that is ideal, but larger than normal debt levels are usually what cause large downturns in markets. Consumer debt has reached record levels, but that has coincided with extremely strong employment and solid economic growth. More importantly, lenders seem to be more discriminatory, illustrating some industry restraint.

The U.S. seems to be the strongest player in the global economy, in our opinion. Stock valuation is on the higher side, but reasonable, in our view. Short term bonds have become the only reasonable fixed income investment with the current flat yield curve. But recall that the long-term rate of inflation is 3%-3.5%, so a 10 year treasury bond is actually losing buying power every year at a current yield of 2%. The low interest environment has also been a positive for publicly traded REITs (Real Estate Investment Trusts). We observe that hot markets like New York City, South Florida, and the Bay area in California seem to be cooling off. Again, the changes have not been particularly dramatic, excluding the very high end. We view these cooling off periods healthy for those particular markets as it helps avoid bubbles from popping suddenly. Still, this does not mean there won’t be a decline in markets in the coming year; it just means that the magnitude may not be as severe.

As a firm, we continue to stay the course. Economies will eventually decline into recession but always rebound, as well. With the upcoming Presidential race heating up, volatility will almost definitely increase. A more socialist bent on U.S. culture could prove to make growth in corporate profits more of an uphill battle but also doesn’t have to be the end of capitalism. Our simple long-term investment thesis is based on the belief that companies we invest in will make more money in the future than they do now, and for nearly 250 years, America has delivered.