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## Q3 2019 Commentary: One step forward, a half step back…

The drum beat of serious concerns for the stock market hammered on during the summer, yet we find the S&P 500 just a few ticks off its all-time high levels. We've heard of the impending recession from many different sources, yet the unemployment rate is the lowest in 50 years. Economic growth continues quarter after quarter (for more than ten years now) and the US economy is projected to grow comfortably in 2020. It is quite a conundrum to be inundated with such pessimism in the face of an economy that continues to chug along. In the third quarter, the S&P 500 advanced 1.7%. Helping the stock market was declining interest rates in the US and around the world. Lower rates also contributed to another strong quarter for the bond market resulting in a 2.3% return for the Barclay's US Aggregate bond index.

Of course, context and perspective are everything when viewing financial markets. The S&P 500 return in the first nine months of the year are the best since 1997 when the tech bubble was just getting going. However, the market has just been regaining ground lost in last year's 4th quarter retreat. In fact, the stock market has barely advanced since the beginning of 2018, 21 months ago. Stalled earnings growth and political and trade uncertainty have certainly increased investor caution and kept the market from breaking through to new highs.

To categorize the current environment, we are inclined to drag up from the past an idea popularized by Pimco, the bond investment company, of the "new normal" in which economic growth coming out of the financial crisis would be modest for an extended period. So it has been, and so it appears still to be. The pattern has been re-established after a spurt of higher growth following the passing of the "Tax Cuts and Jobs Act of 2017." In 2019 we have settled into growth that is plodding along in the 1.5% to 2.0% vicinity. Clearly, both the US and the global economy are slowing. The Fed has responded by cutting interest rates. Still, the US continues to add jobs and the consumer is in good shape and remains optimistic. With consumer spending representing 2/3 of economic activity, we think the economy can continue to muddle along as it has for so long now.

At heart we are contrarians. We believe the best values are found by going against the consensus opinion and this perspective informs our current outlook. Yes, Europe, China and Asian economies have slowed and Europe's economic engine, Germany, is probably already in a recession. All of this is well understood and already reflected in current stock prices. It is the primary reason the stock market has barely advanced since the beginning of 2018. However, as contrarians, we want to be fearful when others are greedy and greedy when others are fearful, to paraphrase Warren Buffett. In other words, invest when current conditions are poor, but subject to improvement.

The global economy will respond to low interest rates. Significant fiscal stimulus is likely and will lead to a turn in the global economy and improving conditions in 2020. The trade and tariff wars are likely to recede for political reasons. A recession could be catastrophic to the President's re-election prospects. If it looks like tariff escalation could seriously impede the economy, we believe the President is likely to back away from further trade conflict. Under this scenario, the investment environment has plenty of room for improvement in 2020 and as pessimism abates, enthusiasm for stocks can rise. With the stock market valued at a reasonable 17x earnings, there is more than enough reason to stay the course we have maintained through the expansion.