viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

Summer 2019 newsletter

Trade Wars & Rate Cuts?

In our summer 2018 newsletter, we wrote about being in the longest bull market in US history – of course, at the time it didn't exactly feel that way.

Indeed, while it was the longest in duration, it was also the shallowest in terms of stock market returns and economic growth. Back then, we projected that the expansion could continue as long as the economy grew and the Federal Reserve did not aggressively raise interest rates to fight inflation. A year later, we feel exactly the same way, with the added caveat that both the economy and equity markets could eventually be hindered by the current trade war.

The Federal Reserve has raised the Federal Funds rate 3 times to 2.25-2.50 since summers 2018. As interest rates have risen, both the economy and the stock market have continued to grow while inflation has reminded mild. Over the last decade, the Federal Reserve has raised rates a total of 9 times. These increases were not to fight off inflation but were to normalize rates after the historical low rates brought on by the 2008 financial crisis. This has been both the longest bull market and the longest period without a rate cut.

At their most recent meeting, the Federal Reserve changed the wording of their outlook and stated "uncertainties about this outlook (economic) have increased. In light of these uncertainties and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion." This change in wording has put the possibility of a rate cut on the table.

We believe that a rate cut at this time would be viewed as an "insurance cut" by the Federal Reserve to support the current economy and head off the possibility of a recession.

Historically rate cuts without being in a recession have been positive for the equity markets over the next year. Of course, history does not always repeat itself, the key will be what the economy does going forward. If a near-term rate cut spurs borrowing and business investment, it could/should help to lessen the negative effects of slowing growth. If successful, the economy will continue its sluggish growth and the stock market will continue upwards. If not, we could see a rough patch and enter a recession. If the economy does slow to a recession, we believe the Fed's early actions will help to lessen the sting and the recession will be mild.

It is hard to tell exactly how much the trade war has affected domestic and global economies; but, there is no doubt it has had an effect. You can see this in the continued lowering of earnings projections for companies that do business in areas affected by tariffs. Earnings estimates for the market are still positive, but if the trade war continues we could easily see both earnings growth and the economy turn negative. We are watching both of these very closely. The recent truce to raise tariffs would make it seem that negotiations are moving in the right direction. Of course this is a fluid situation and things could change quickly in either direction.

Even with all of this uncertainty, the US stock market has returned more during the first half of 2019 than in any other January-June period since 1998 – every major stock market index is up double-digit. While much of the rebound was a recovery from earlier highs, we believe some of the move is in anticipation of a resolution to the trade war with China.

So what does this mean for our portfolios? We are cautiously optimistic that the Fed's actions will be a positive factor for the market and believe some form of a trade compromise is forthcoming. That said, we are sticking to our strict sell disciplines and trimming positions and asset classes that have become too large of a percentage of the portfolio, or we are selling companies that have had lower earnings. This has us holding a bit more portfolio cash than normal. However, as we find new names that fit our strict buy criteria, this cash will be put to work.

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We now have a Portal!!

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