THE INVESTMENT COUNSEL COMPANY

Quarterly Insights October 2019

The global economy continues to weaken, with some countries, such as Germany, on the brink of a recession. Less than ten percent of developed countries are now expanding. Fortunately, the U.S. is still experiencing between 2% and 3% moderate growth. Most others are experiencing a slowdown, such as many parts of Asia and Europe. There are few indications that the current trend will reverse course anytime soon. So why does the U.S. stock market continue to meander near all-time highs, waiting for the next development in the trade war and a catalyst to resume the global bull market?

There are several reasons. First, interest rates are low and continue to decline, flooding markets with cheap money from low interest rate loans, spurring consumers to purchase more goods and services. Likewise, corporations have been buying their stock at record levels, providing support to current prices, and can continue to do so due to their ability to also finance purchases through low interest borrowing.

Second, investors have been frequently rewarded throughout history by riding the coattails when the U.S. Federal Reserve provides economic stimulus. The stock market typically rallies after a first interest rate cut. Similarly, investors are now eagerly anticipating at least one more cut by the Fed. Over 70% of investors believe that the Fed will act again before year end. In the past, the U.S. stock market has often gained 20% one year after a second rate cut, unless recessionary conditions develop. The U.S. does not appear to be heading in that direction. Investors have learned that more times than not it can prove costly to "fight the Fed" by ignoring its power to positively influence an economy and the stock market. That is another reason investors are reluctant to sell stocks, bonds, real estate, and other long-term assets to place their money in low interest bearing money market instruments.

Third, another historical trend that investors are mindful of is that the stock market is the strongest in year three of the U.S. presidential election cycle. Some believe it is because pre-election years are when a president is motivated most to implement policies to improve economic conditions as well as avoid adverse circumstances for upcoming voters. It is not unusual to see stock returns in excess of 20%, as already evidenced by 2019 gains year-to-date. The only exception was during President Barack Obama's term in 2011, when the market advanced 5.5%.

What factors can add volatility to the stock market and threaten today's price levels? Geopolitical risks continue to escalate. Uncertainties such as the U.S. China trade war, Brexit, and threats between the U.S. and Iran are just a few of the causes for concern. Then there's the attention focusing on the U.S. Treasury market's yield curve. Investors remain on alert because yields are flat across treasury maturities, strengthening the belief that the U.S. may fall into recession due to a misstep/poor judgement by the Fed, Congress, or our President. The other factor that no investor disputes is that stock valuations are high in relation to profits, limiting further potential long-term gains. Although not in bubble territory, the U.S. stock market remains vulnerable to downside risk until corporate profitability can catch up and support current prices. Less obvious is the fact that most investors make unnecessary and unwise decisions, underestimating the stock market's tremendous ability to grow wealth over time. Crowd psychology greatly influences stock prices in the short-run, but growth in corporate profits is responsible for more meaningful longer-term results. And with the global population certain to expand, corporations will grow accordingly.

Although current conditions are now mixed, we are still in a bull market until circumstances confirm otherwise. We recommend patiently staying the course while the economy sorts out its direction. Time will tell if more accommodative monetary policy from the Fed and over 30 other central banks will win over rising geopolitical risk. With such massive and aligned efforts, it will likely require a counterforce of equal or greater strength to derail the central banks' resolve to continue the global recovery. We sincerely hope that these explanations provide clarity and additional perspective to better understand today's complex factors influencing our global financial markets. Thank you for the opportunity to share our views and outlook.

Sincerely yours,

Randy

Randy Garcia
Chief Executive Officer