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Economic & Market Summary
July 2019

US GDP growth of 3.1% exceeded expectations in the first quarter, but consumer spending and business investment slowed. Consumers are not a concern at this point. Retail sales have accelerated over the past three months after weakening late last year. Payrolls have increased 192K jobs per month on average over the previous 12 months, and wages are still growing one point or more above inflation. Also, household debt loads seem manageable. Household debt-to-GDP has been trending higher for 30+ years but is nowhere near its crisis era peak. We are, however, concerned about the business sector. Financial leverage is growing with business debt-to-GDP close to its 2008-2009 top. Lending standards are also weakening. Companies are struggling to find and retain qualified workers in the midst of a tight labor market. Manufacturing activity has decelerated since peaking in the middle of 2018, but this likely reflects slowing growth in China and Europe along with US-China trade tensions. On balance, we expect GDP growth to moderate but remain in a healthy range of 2% - 2.5% for 2019.

Trade negotiations between Washington and Beijing are back on track after stalling in May. The direct impact from Chinese tariffs will be modest at 0.3% - 0.7% of GDP by our estimate. The indirect impact is much harder to calculate. Companies will likely spend time and resources planning around tariffs which could lower efficiency. Profit margins may contract which means productivity-enhancing capital projects could be delayed or canceled. Even the lingering threat of tariffs is enough to curtail business activity and hinder growth. The political and economic incentives for both parties to reach a deal remain in place. However, the road forward will probably have more twists and turns before a resolution is reached.

While leaving interest rates unchanged in June, the Federal Reserve strongly suggested through its policy statement and commentary following the meeting that cuts are imminent. Indeed, the case for softer policy is strengthening. Inflation has run below the Fed's 2% target for ten consecutive months, and expectations for future inflation have declined. So far, a tight labor market has not led to higher inflation - one of the reasons cited for raising rates the last few years. Rate cuts are likely if inflation continues to soften, the trade conflict with China worsens or expands to other countries, or the labor market weakens.

After declining 6% in May, the S&P 500 rebounded to record levels on the prospect of easier monetary policy and the resumption of US-China trade talks. The forward PE ratio on the S&P 500 is 17x - above the long-term average of about 15x. The market's aggregate valuation isn't excessive, but enthusiasm for speculative investments seems high. A number of profitless companies touting disruptive technologies or business models have gone public this year. There is nothing wrong with investing in an unprofitable company; young firms need to spend vigorously to establish themselves. Investors run into trouble when they forget that eventually a company must exhibit sustainable and profitable growth to be a compelling long-term investment. Hot IPO markets typically occur late in an economic cycle so this environment warrants close observation. The current economic expansion is now the longest yet slowest since WWII. The moderate pace of growth gives us some confidence in the expansion's longevity. Risks to monitor include rising corporate debt, slowing manufacturing activity, global trade tensions, and a potential Fed policy error. Despite a few concerns, we believe the economic and investing landscapes remain healthy.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address above.