Schaper, Benz & Wise
INVESTMENT COUNSEL
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18 Jewelers Park Dr., Suite 200 | P.O. Box 628
Neenah, WI 54957-0628 | 920.727.1137

Economic & Market Summary
October 2019

The trade war with China is casting a shadow over an otherwise healthy US economy. As it stands now, nearly all $500B+ Chinese imports will have a tariff of 15% or more by year-end. While a decline in the Chinese yuan compared to the US dollar blunts some of the impact, these tariffs counteract the benefits from deregulation and tax reform. The rest of the world is being affected. The OECD recently cut its global growth forecast from 3.2% to 2.9%. In the US, business investment is slowing and manufacturing activity is weakening. The risk is that this pressure spreads to consumer spending, which is 70% of the economy. But with solid year-to-date retail sales growth and an uptick in housing activity, the US consumer appears to be holding up well. All in, GDP growth of 2.0% - 2.5% still looks realistic for 2019.

Central bankers around the world are getting nervous. The Federal Reserve has lowered rates twice this year in an effort to address below-target inflation and worsening trade tension. Rates have also been cut in India, Australia, and Europe. With interest rates already low, or negative in some cases, there is a concern that monetary policy will be unable to combat future recessions. Policy makers will likely rely on non-traditional tools, such as quantitative easing, to tackle the next downturn. The efficacy of these methods is questionable in our view given the perpetually sluggish growth in Europe and Japan where they were most aggressively implemented. Radical monetary policy is no substitute for a fiscal environment that fosters entrepreneurship and encourages the free flow of goods and services.

The US ten year Treasury yield has fallen from 2.7% in January to 1.6% today. Part of the yield curve is inverted which traditionally signals economic weakness. Bond markets seem to be pricing in a trade-driven recession which, in our view, seems unlikely. Furthermore, the $16 trillion of negative yielding bonds in the world could be driving up demand for comparatively attractive US bonds thus diluting the US bond market’s signaling power. A trade deal with China, the belief that a deal is in the works, or the realization that tariffs won’t push the US economy into a recession could drive yields higher and bond prices lower. Consequently, we remain cautious on bonds.

Earnings will likely grow mid-single digits this year as companies digest slowing global growth, wage inflation, trade tension, and a stronger US dollar. With a forward PE ratio of 17x on the S&P 500, equity prices appear close to fair value. However, there is a widening valuation disparity between mature companies with slower and sometimes cyclical earnings growth vs younger, faster growing companies in emerging areas such as cloud software and ecommerce. Investors tend to extrapolate current trends – both good and bad. This can cause high-quality companies experiencing transitory pressure or entire out-of-favor industries to be mispriced. Conversely, valuations of popular companies with promising but unproven business models can become overinflated. In our experience, patient investors willing to hold undervalued companies with strong fundamentals are eventually rewarded.

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