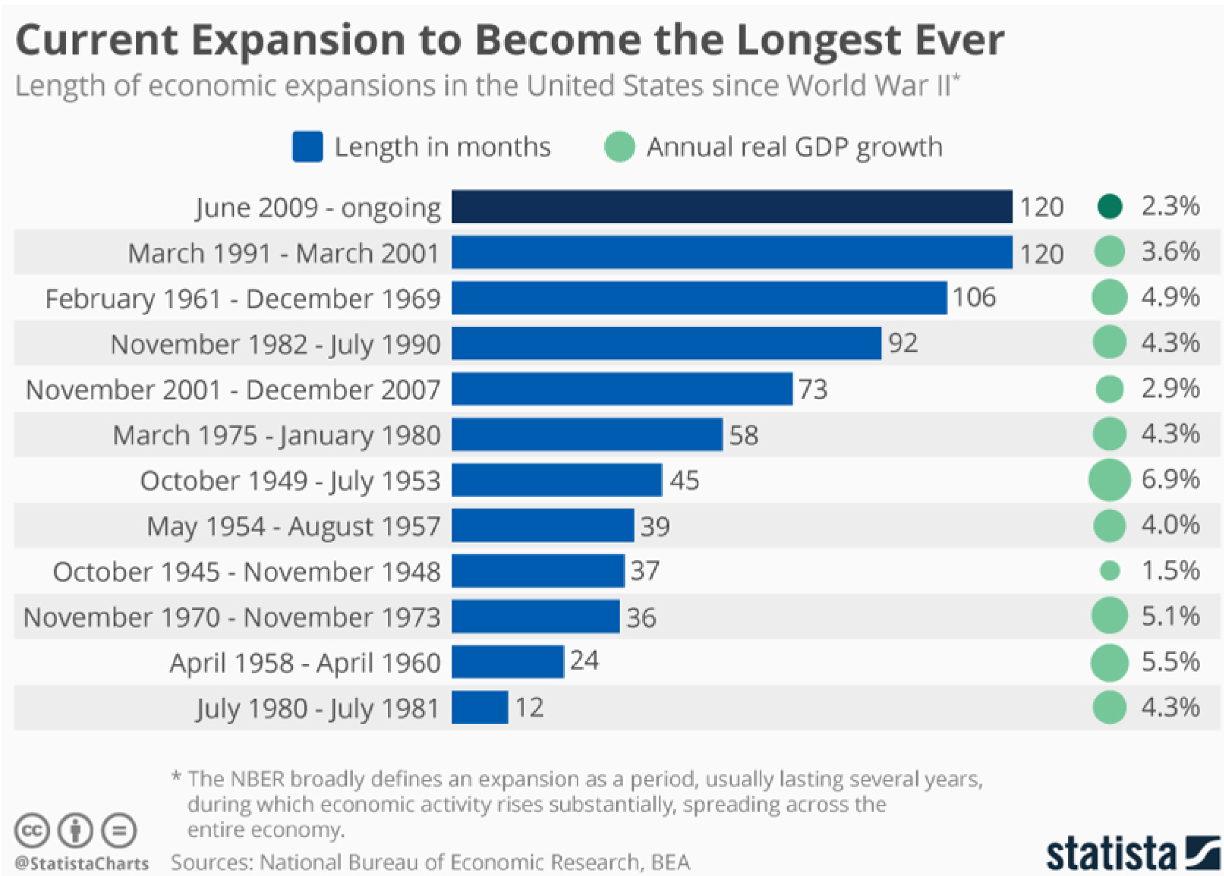
Second Quarter Commentary
The Coming Recession & What To Do About It

With the first half of the year in the record books, it is hard to draw a singular conclusion. Last month the stock market fell 7%. This month, we are knocking on record highs with the best June performance since 1938 and the best first half performance in 20+ years.



As this commentary is penned, it is Sunday evening, June 30. The “Breaking News” is that Trump and Xi have come to terms for no ***additional*** tariffs.

The Dow futures are indicating the market will open up more than 200 points on July 1st.

Although we have been navigating this game for 25 years, we continue to be surprised by how fickle and fast-changing the financial markets remain.

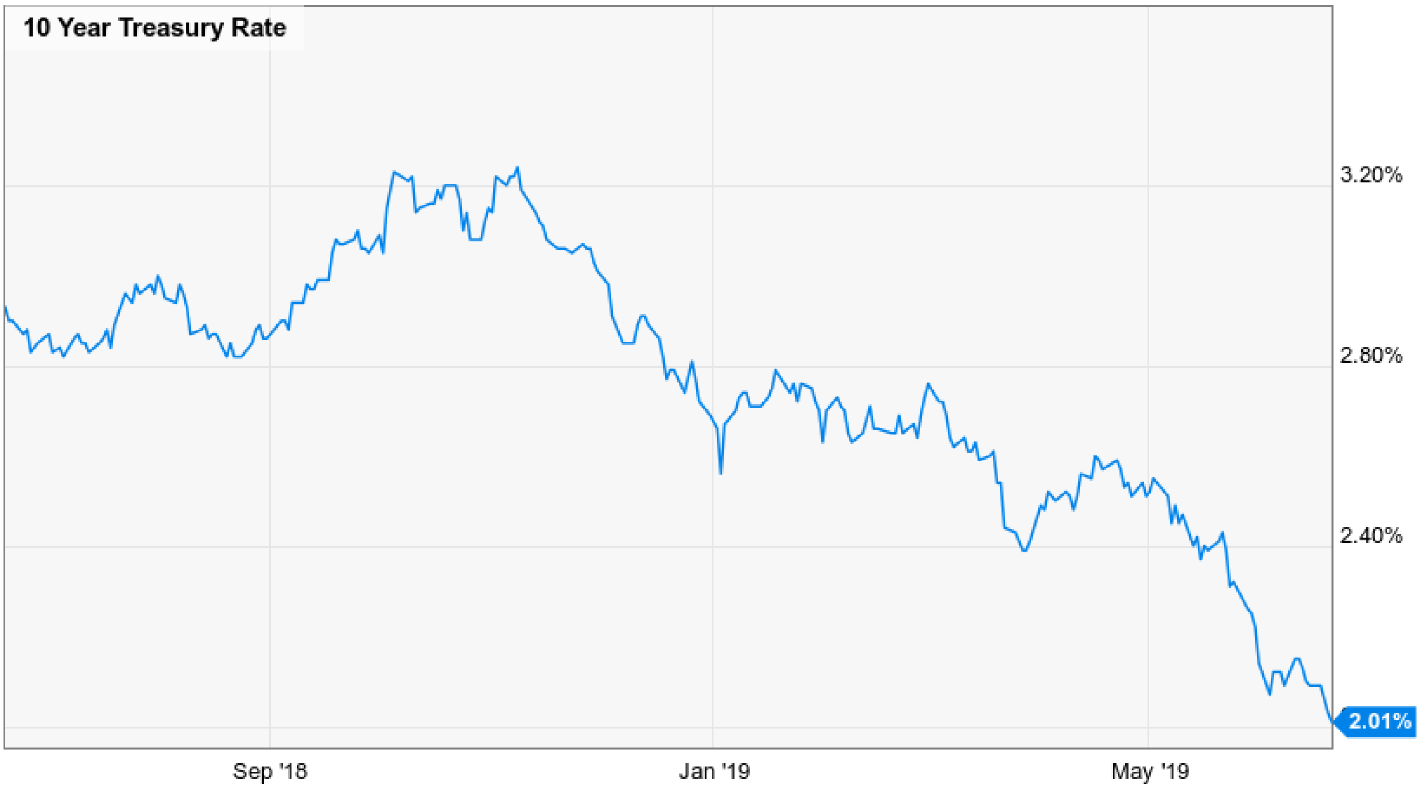
We have set a record for economic expansion, but there are daily grumbles concerning an impending recession.

Six months ago the Federal Reserve was raising interest rates. Today, it appears a certainty the Fed will lower rates before the end of the year.

We are now hearing statements from respected individuals that interest rates will stay low permanently.

That is a bold statement that we cannot verify.

However, for the time being, low interest rates continue to act as rocket fuel for the equity markets.

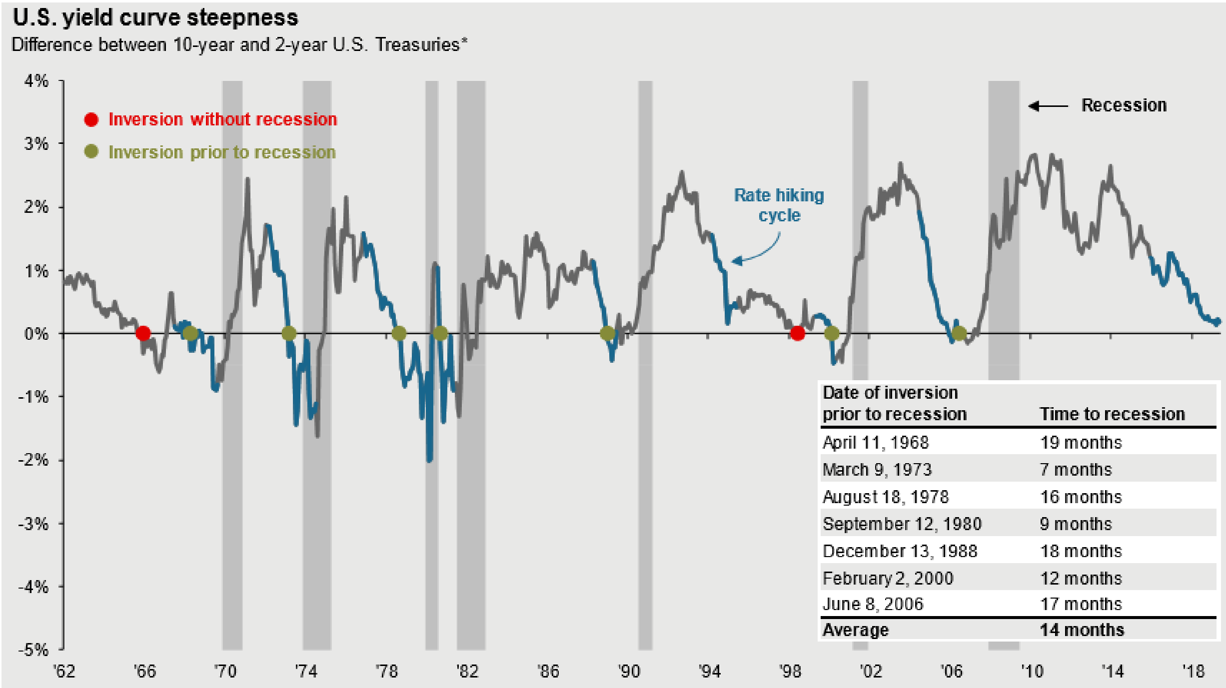


With interest rates so low the dividend yield from stocks continues to serve as a “cash flow” alternative to the fixed income market.

Not only are stocks paying nearly 2%, on average, their cash flow generally increases over time as profitability increases.

Adding complexity to the financial markets is the fact that short-term interest rates have slightly inverted—meaning short-term rates are higher than long-term rates.

Generally, this happens when the market is anticipating a slowdown or recession.

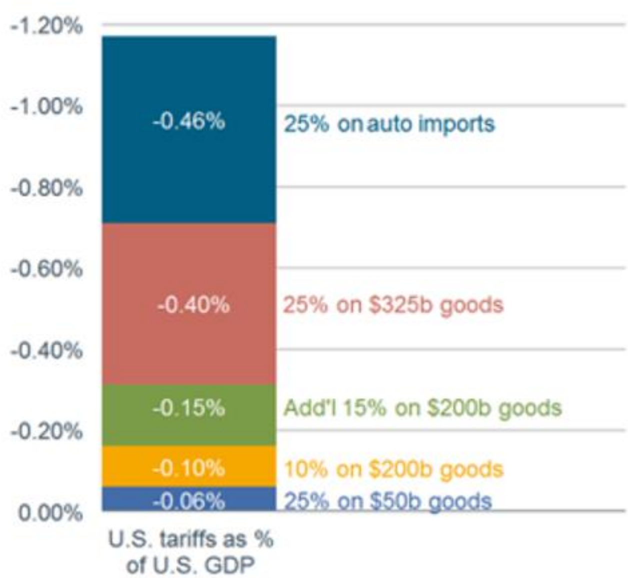


Source: FactSet, Federal Reserve, J.P. Morgan Asset Management. *From January 1962 to May 1976, short-term bond is U.S. 1-year note, and from June 1976 onwards the short-term bond is the 2-year note due to lack of data availability. Time to recession is calculated as the time between the final sustained inversion of the yield curve prior to recession and the onset of recession.

Despite the news of "no new tariffs", we remain in an economic standoff with China.

These tariffs are projected to reduce GDP by about one percentage point or $235 billion per year.

Economic Impact of Tariffs

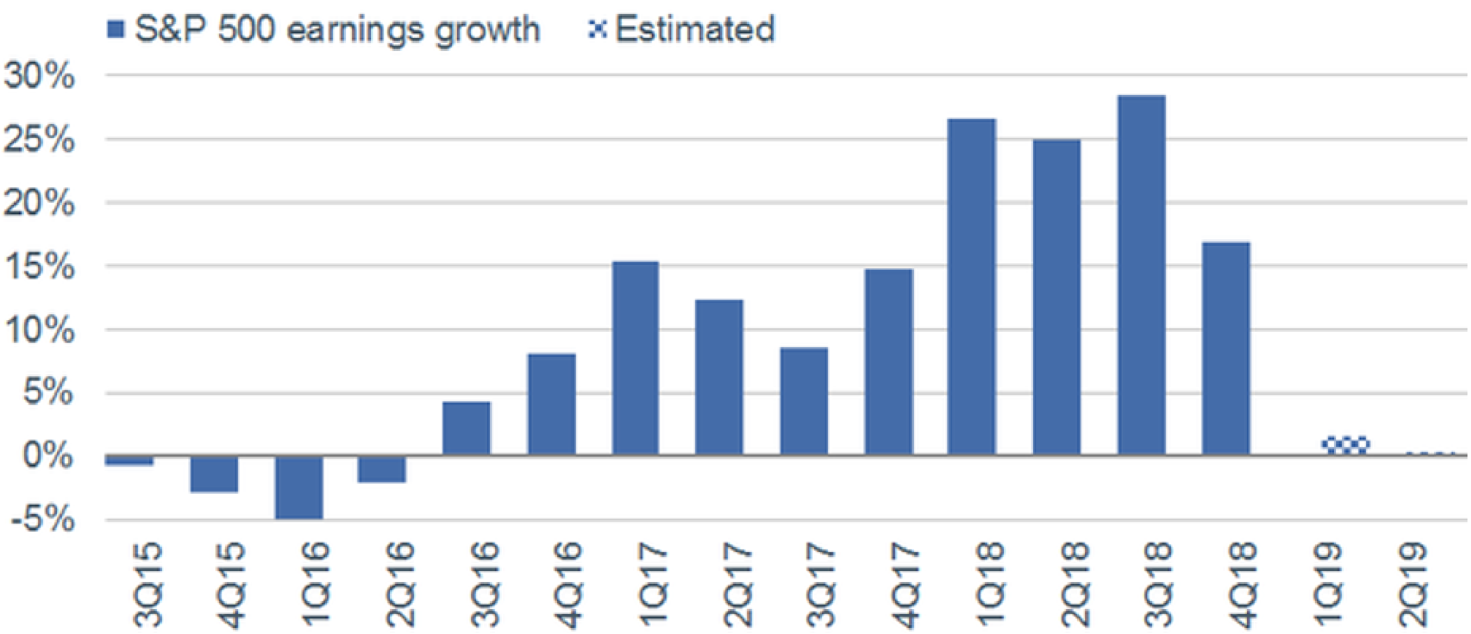


Tariff	Value	% of U.S. GDP
Steel & aluminum	$0.76b	0.00%
25% on $50b goods	$12.5b	-0.06%
10% on $200b goods	$20b	-0.10%
Add'l 15% on $200b goods	$30b	-0.15%
25% on $325b goods	$81b	-0.40%
25% on auto imports	$90b	-0.46%

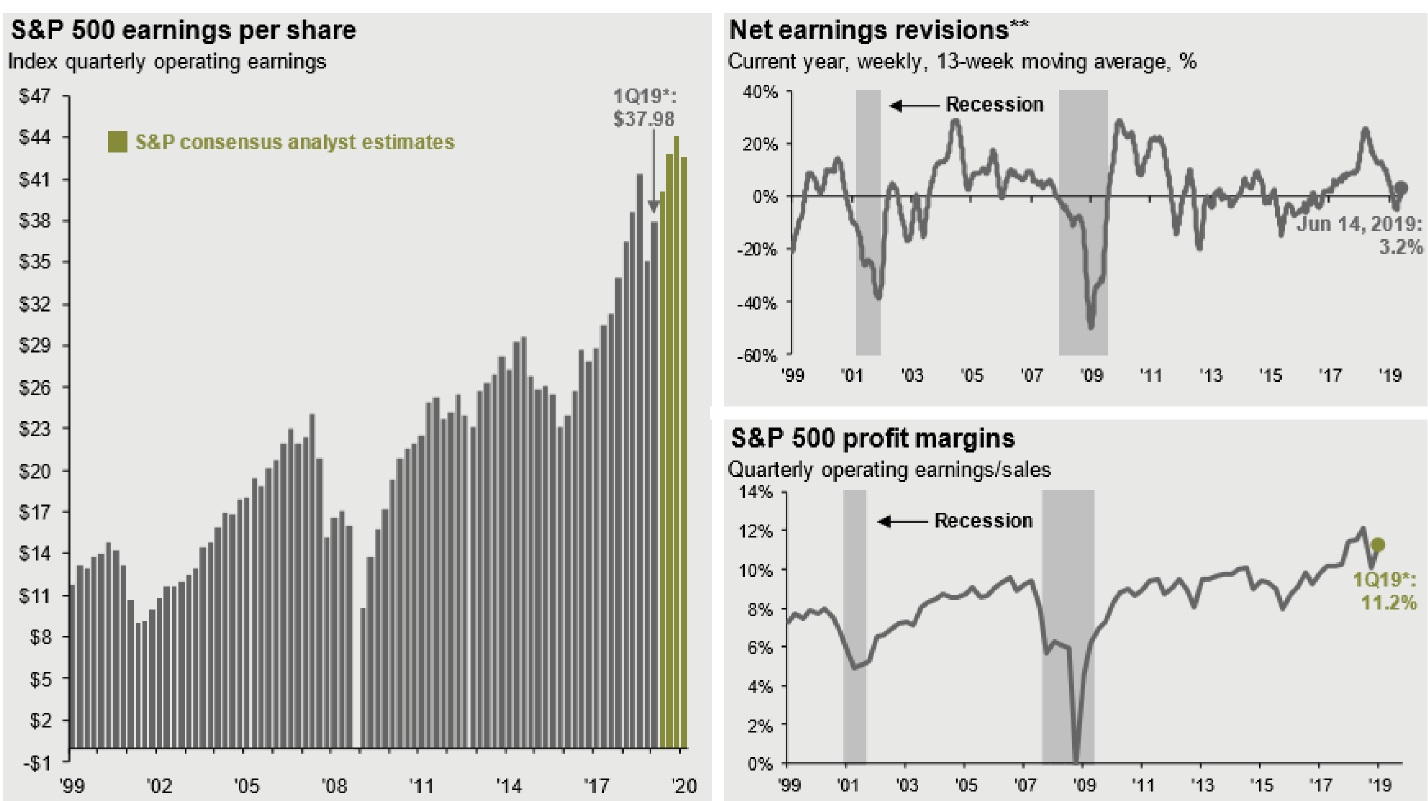
Source: Charles Schwab, Cornerstone Macro.

Earnings growth rates for US companies is ***slowing***. There is no minimizing that fact. However, it is "slowing growth" versus "negative earnings." Growth continues, just at a slow pace.

Earnings Bloom Off the 2018 Rose



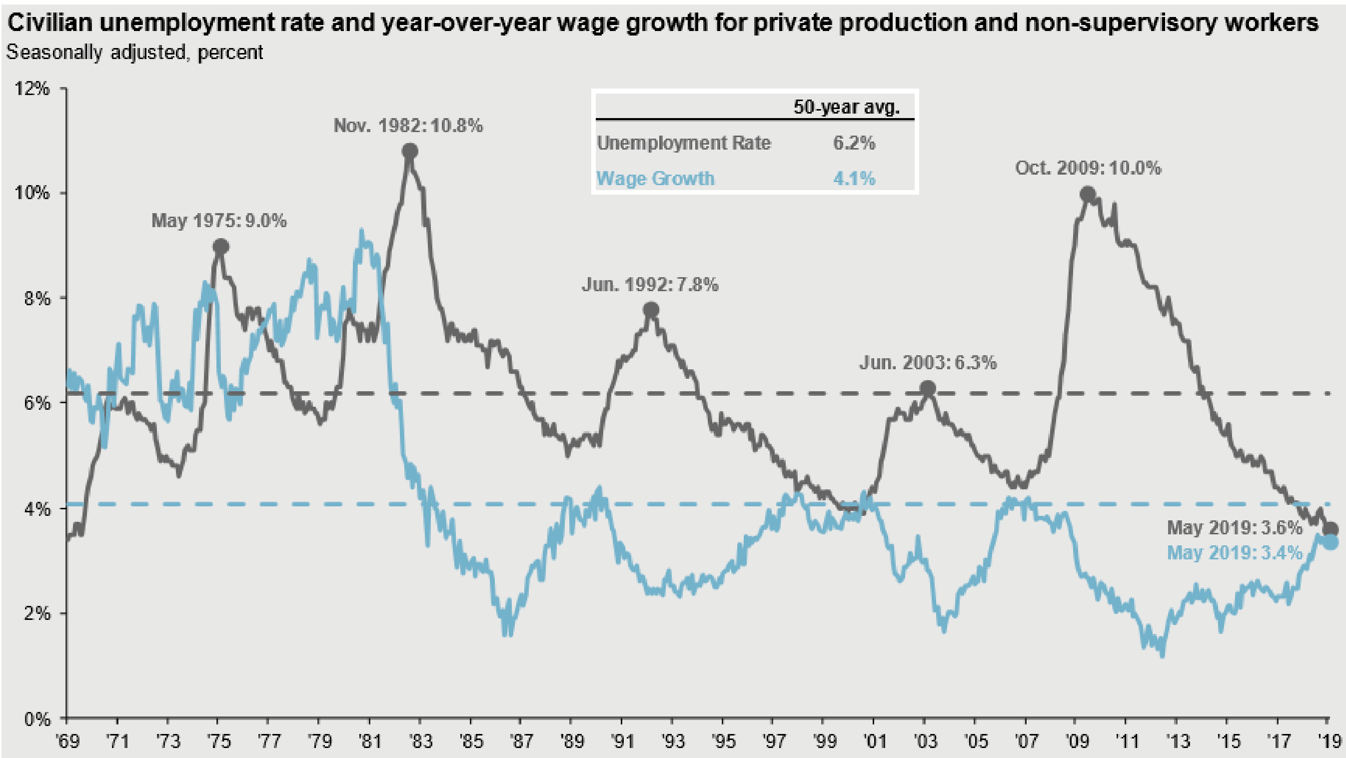
Source: Charles Schwab, I/B/E/S data from Refinitiv, as of June 19, 2019.



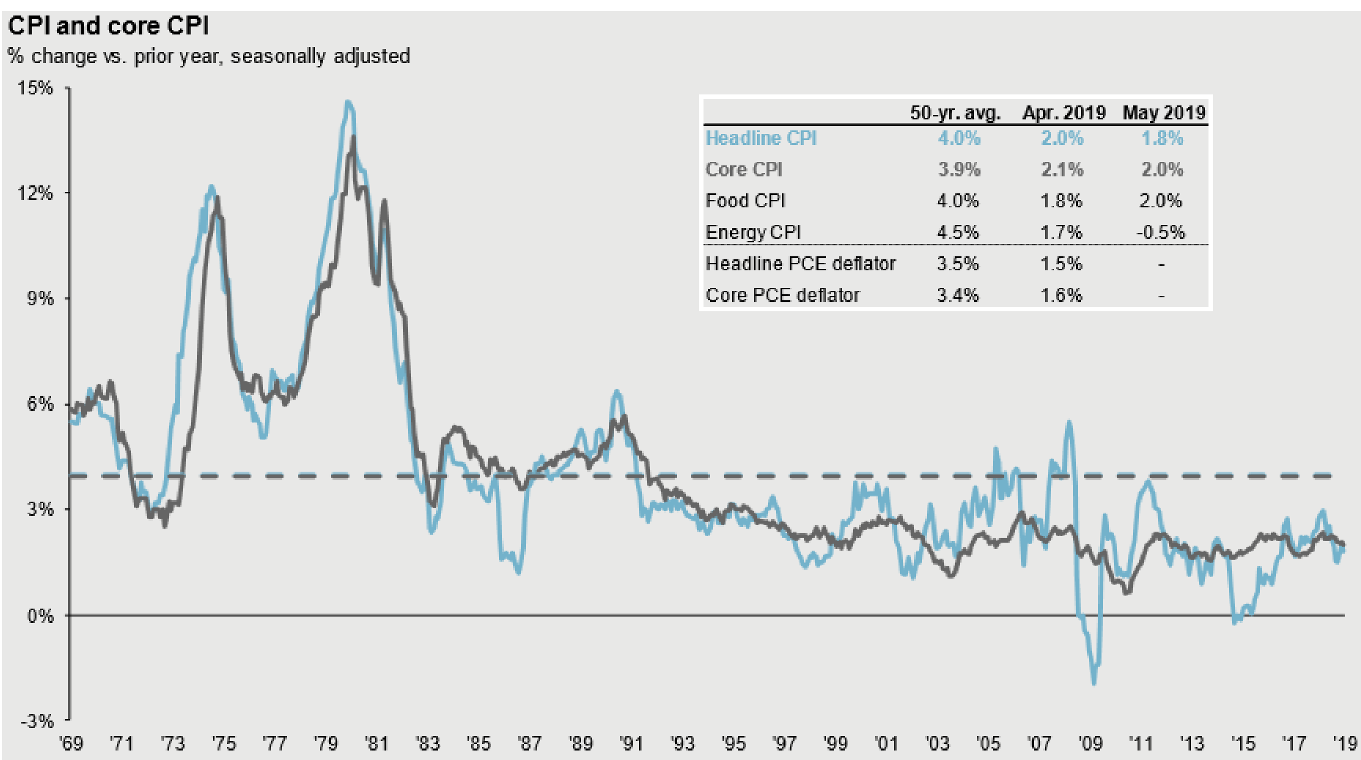
Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.

If you ask us to prognosticate about what will happen with tariffs, GDP, the stock market or interest rates the simple answer is that we don't know. These items fall in the category of "important, but unknowable."

What we do know is that current data on inflation is quite contained (low) at 2%. Although there are legitimate concerns about certain segments of our society being left behind, unemployment remains at very, very low levels.



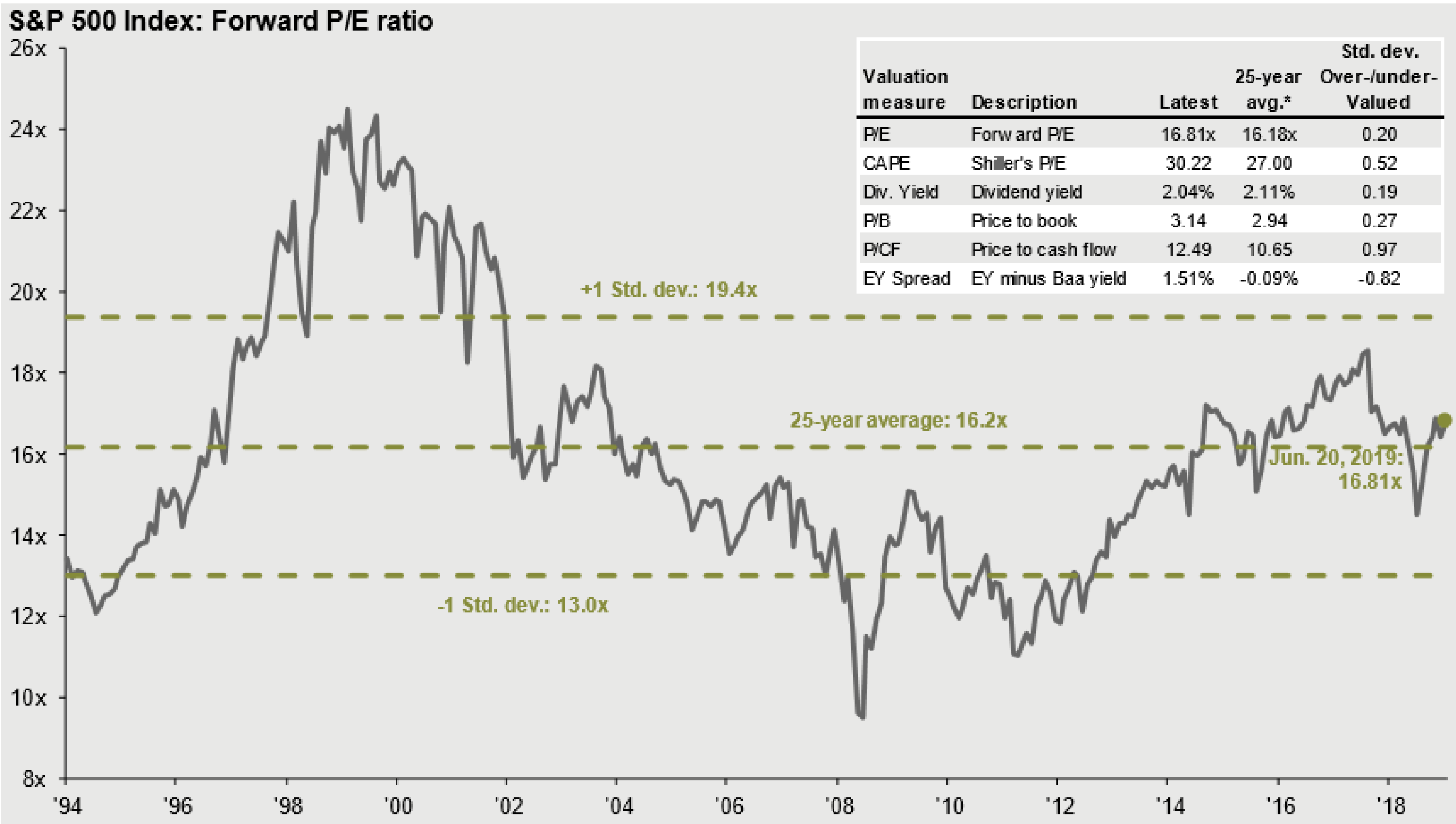
Source: BLS, FactSet, J.P. Morgan Asset Management.



	50-yr. avg.	Apr. 2019	May 2019
Headline CPI	4.0%	2.0%	1.8%
Core CPI	3.9%	2.1%	2.0%
Food CPI	4.0%	1.8%	2.0%
Energy CPI	4.5%	1.7%	-0.5%
Headline PCE deflator	3.5%	1.5%	-
Core PCE deflator	3.4%	1.6%	-

Source: BLS, FactSet, J.P. Morgan Asset Management.

Despite the increase in stock values, the Price/Earnings Ratio for the S&P 500 remains slightly above its 50-year average. Leading Economic Indicators are Stable to Positive—however, there are some indications that the trend is sliding to the negative.

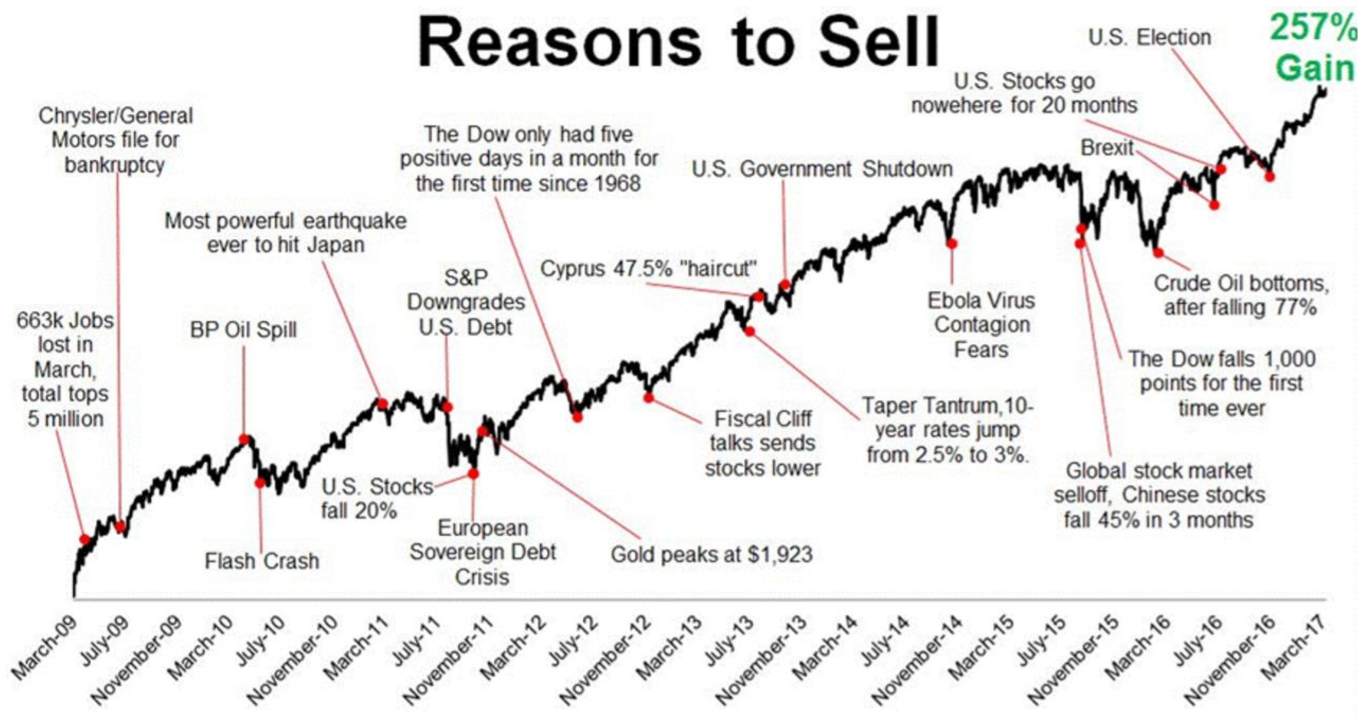


Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.

	Level	Trend
Leading Economic Index (LEI)	Strong	Stable
• Average workweek	Fair	Worsening
• Unemployment claims	Strong	Improving
• New orders: consumer goods and materials	Fair	Improving
• ISM New Orders Index	Fair	Stable
• New orders: nondefense capital goods excl. aircraft	Fair	Worsening
• Building permits	Fair	Stable
• S&P 500	Strong	Improving
• Leading Credit Index	Strong	Improving
• Interest rate spread	Weak	Worsening
• Avg. consumer expectations for business conditions	Strong	Improving
	Level	**Trend**
Coincident Economic Index (CEI)	Strong	Improving
• Payrolls	Strong	Worsening
• Personal income less transfer payments	Fair	Stable
• Industrial production	Strong	Stable
• Real manufacturing and trade sales	Fair	Improving

Source: Charles Schwab, FactSet, The Conference Board, as of May 31, 2019.

Given all these data points, will we have a recession? At some point it will certainly happen. However, we have little idea as to when. In the meantime, whether dealing with recessions, inflation, tariffs or some other issue, portfolios must still be managed with logic and discipline.



Source: The Irrelevant Investor, Michael Batnick, CFA

You simply cannot run for the hills with your head in the sand.

Rather, logic dictates that our clients keep a portion of their capital liquid to deal with short-term issues or unexpected emergencies.

Secondly, identifiable needs that fall two to five years out can be logically served with the purchase of fixed income securities. Not only will they produce a modest amount of cash flow, but they will have a natural maturity. That maturity should coincide with anticipated needs.

Lastly, if your goals are more than five years, and you can tolerate the volatility, the stock market remains the best option for investing in a manner that will outpace taxes and inflation.

As such, proceed with caution and with an eye on your goals (not your neighbors). And proceed understanding the goals and time frames for different parts of your portfolio.

Lastly, we wish you a happy and safe 4th of July. Our nation may not be perfect, but there is no place we'd rather be.

Sincerely,

Dave *Warren*

Dave Sather, President
CERTIFIED FINANCIAL PLANNER

Warren Udd, Vice President
CERTIFIED FINANCIAL PLANNER