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Quarterly Commentary

After an up and down start to the year, equities reached mid-year with the S&P500 up roughly 2%. Yet, it has felt like a loss given all the negativity surrounding trade disputes, election investigations and other concerns including ongoing immigration issues.

Our investment perspective continues to be positively reinforced by the strong corporate earnings growth reported in Q1 and expected for Q2 and the balance of the year. We still feel optimistic about the issues we discussed in our Q1 Commentary, especially relating to economic fundamentals, earnings and valuations. We do not expect the current tariff disputes to materially slow global economic growth; however, if the S&P 500 broke below support at 2600, it may be an indication that this view is too bullish and we would re-evaluate circumstances in that event.

Clearly, for many there is bewilderment and a lack of confidence in the Trump administration's tariff tactics, which The Economist refers to as "reckless." These emotions run deep and have contributed significantly to the "wall of worry" that has held back stocks this year. However, we believe there are some underappreciated aspects of the current US strategy. First, the US is negotiating from a position of overwhelming economic strength. Second, the US can readily absorb some economic pressures which would assist the Fed as it continues to raise interest rates to cool off our economy. Finally, the main trade dispute is with China, and much of the developed world is on our side against China.

During the upcoming Q2 earnings season, we will be interested to hear how management teams incorporate the current uncertainties into their discussion of future business trends. Some companies, like Harley Davidson, have already communicated their strategic reaction to potential higher tariffs by announcing relocations of facilities to Europe and Asia. We are not expecting this as a common strategy. It would not surprise us, though, for management teams to use the opportunity to rein in earnings guidance somewhat, with the hope of exceeding guidance later in the year.

Of course, we invest for the long term by selecting strong businesses with the potential to generate high cash returns relative to their current price. One positive that may come from the current trade disputes is a more level playing field for many US multinationals. Progress here would boost future earnings growth above already high rates of growth and should be positive for equities.

Finally, we are bemused by current low long-term interest rates. We feel that a slow rise in long term rates would be healthy while a sharp rise or a lack of increase (currently) is concerning. The bond market moves slowly and we will keep monitoring. In our opinion, the current risk/reward still favors equities over bonds.

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