



INVESTMENT COUNSEL

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Quarterly Commentary

Continuing their climb up a wall of worry, US equities rose 1.7% during Q3. Valuation multiples remain reasonable and we hope to see continued modest market appreciation from here reflecting modest earnings growth expectations – recognizing we'll experience the inevitable bouts of volatility.

Dominating this past quarter was uncertainty created by the escalation in the US-China trade war, the continuation of social unrest in Hong Kong, an expansion of the impeachment inquiry of President Trump, and the ongoing negative ramifications of Brexit. These topics collectively impact economic and investor confidence and raise uncertainties about the trajectory of US and global economic growth.

During Q3, US manufacturing activity declined slightly while German manufacturing contracted significantly. Industrial indecision caused by the uncertainties of the US-China trade war is the primary contributor and indirectly affects economies around the world. Changes to supply chains and other considerations have reduced capital investments. Several central banks have responded by loosening monetary policies this quarter with expectations for easier money during Q4 and heading into 2020.

While manufacturing has weakened, it represents less than 20% of the US economy. Overall, domestic economic fundamentals remain solid. Jobs are plentiful, unemployment is very low, and wages are continuing to rise at levels near 3%. We view annual wage growth as a particularly important component of strength in the underlying services (or consumer) economy. From 2010 thru 2015, US wage growth remained between 2% and 2.5%. From 2015 until the middle of 2018, US wage growth ranged from 2.5% to 3.0%. But since the middle of 2018, annual wage growth has remained above 3%. The recent downtick to 2.9% raises a concern but these numbers do not presage a recession.

Expectations for Q3 earnings growth have been reduced to 4%-5% reflecting more modest management outlooks provided during Q2. We'll soon see how companies have actually performed in the current environment and whether they'll see a need to further reduce their expectations going forward. Many companies will also provide their first glimpse into 2020 and will likely want to keep expectations low.

As we've suggested previously, negative interest rates around the world indicate that bonds may be in a bubble. Comparatively, modest earnings growth expectations combined with low interest rates, low investor confidence and reasonable valuations suggest to us that equities provide the better risk/reward for investors going forward if they can look past the uncertainties and volatilities of the present.

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