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Capital Management

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So, what is going on now?
Four areas that should be watched are:

(1) Will the Federal Reserve Bank raise the interest rates? And by how much?
(2) Will US companies continue to grow profits?
(3) How will the trade wars and tariffs affect the US economy?
(4) Will tech stocks grow their profits enough to justify the prices that investors are willing to pay for their stocks?

(1) The US Federal Reserve bank has raised the rate another ¼ point on 9-26-2018 with the target in the range of 2.00%-2.25%. The Federal Reserve has indicated they will continue to raise this rate over the next year at least. This is important because most mortgages and consumer loans are based on this rate and if it rises, then these rates will rise. If you have a variable rate loan or especially a variable rate Home Equity Line of Credit loan or Variable Mortgage, watch out! The interest rates may continue to rise, if the Federal Reserve continues to raise rates. The Federal Reserve is raising rates because the rates were decreased to near zero in the financial crisis in 2008-2009, and have been slowly raised over the past few years.. Now the Federal Reserve is trying to keep the economy from growing too fast and creating high inflation. Neither has occurred yet, but the Federal Reserve is like a dentist doing a tooth cleaning and exam to protect against future cavities and gum disease with their actions. So, at least consider refinancing to fixed rates loans if that is an option for you.

As the Federal Reserve raises the rates, the overall price of many existing bonds may decline because the yields on new bonds are higher. To incentivize investors to buy existing bonds, the prices of those bonds have to be reduced (if the coupon payments are fixed) to have the yields on existing bonds equalize to the newer higher yielding bonds.

(2) The overall stock market has increased in value since it hit its low in late 2008 and early 2009. It the short run, sometimes the stock and bond markets can go up or down on speculation or rumors. However, over the longer term, stock prices tend to increase as companies' earnings and growth rates grow. Sometimes investors bid up the prices above where the profits can rationally support those prices, and eventually the stock prices come back down as investor expectations become more realistic. This happened in 2000-2002 and again in 2008-2009. However, by the end of these time frames, investors were overly pessimistic and many missed the rally in US stock prices as more realistic earnings and price expectations set in. By the end of 2017, the price/earnings ratio of the overall market and the Standard and Poor's 500 Index had climbed above the normal range of a P/E of somewhere from 10 to 20. Now, a correction of highly priced stocks can occur by the stock prices coming down OR the profits rising. In 2018, the corporate profits increased a significant amount, and the overall P/E ratios dropped without a major market correction. So, if the profits don't drop dramatically, then the P/E ratios will not be as high as was the case in 2000 and 2008. But, if investor confidence drops dramatically or external factors such as tariff wars disrupt profits, then the stock market could drop; EVEN if the profits are still good. This should be watched carefully.

(3) US equity markets and much of the rest of the worlds markets have seemed to ignore the impact of trade wars and tariffs so far. That said, even if the tariffs and trade wars do not have an overall significant impact on the economy, it may affect certain parts of the economy and the companies' profits. Farmers' income may suffer if other countries place heavy tariffs on overseas exports of foodstuffs from the USA as well as Aerospace and Entertainment industries (three of the USA's largest exports). On the other hand, steel companies may see increased profits (although their customers may see increased costs of steel). The main point is that particular industries and companies may have a more significant change in their fortunes. We are watching the overall impact of these trade disputes on key industries and companies as well.

(4) In the long run, generally tech stocks will often have higher Price Earnings ratios than industries such as utilities, especially utilities in slower growing areas such as the Northeast. That is because investors believe that the long-term growth prospects of many tech firms (especially in a growing economy) will lead to higher profits for these firms. If the price earnings ratios become too high and the economy falters or even grows at a slower rate, then investors may dump significant amounts of their tech holdings. That could pull down the overall market if investor confidence falters, even if the economy continues to grow and other segments of the overall market continue to do well. This occurred in 2000-2002 and the tech and internet stocks dropped more than the overall equity markets. The problem is that tech stocks are in many industries, so it is never clear what industries will fall, and when, so constant monitoring is important. Also, when inflection points in the economic growth or investor sentiment occurs, very few people manage to guess the timing of it correctly. That is why most investment advisors recommend having a portfolio that is not concentrated in a few companies or industries, have an adequate emergency fund, and have sufficient income from your salary, social security, investments, rental properties, etc. for expenses. While we do not know if the short-term market will go down or up, we do know that investors should have a portfolio that does not require them to sell large amounts of depreciated assets to fund current living expenses at the bottom of a stock market decline.

I hope this newsletter has given you some things to think about. As always, please call us to discuss your SPECIFIC concerns about your financial situation and investments. You should not make financial decisions based on incomplete facts or without the plusses and minuses of changing strategies to you individually. Have a great fall season.

Sincerely Yours,

Stephen P. Wetzel

Steve Wetzel and Prometheus Capital Management Corp.

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Sources: Wall Street Journal, Morningstar, Conference Call 9-26-2018-Dr. David Kelly-Chief Global Strategist-JP Morgan Asset Management Group