

SUMMER

2019

After a long, cold, wet spring, summer has finally arrived in Maine. As usual we seem to go instantly from cold and dank to hot and humid as July arrives in all its glory. The stock market has bloomed also as June saw an advance of 6.9% in the S&P 500 which was, according to Barron's, the best June performance since 1955. The June surge put the year to date total return for the S&P 500 at 18.5%. According to Barron's, this was the best first half of the year for the S&P 500 since 1997. Comparisons to 1955 and 1997 are heady indeed as the S&P 500 rose 26.4% in 1955 and 31.0% in 1997.

While a strong first half of the year usually produces a good full year performance there are certainly several reasons to temper the current enthusiasm evidenced in the S&P 500. Many analysts expect a significant slow-down in both the economy and corporate earnings in the second half of 2019. Unresolved trade and tariff issues continue to temper investor's enthusiasm and engender caution in many corporate executives as to capital expenditures. A recent article in the Wall Street Journal cited this caution in corporate executives as one reason behind the decreasing company stock buybacks which could weaken one important support for the stock market.

Concerns about a slowing economy in the second half of 2019 have led the Federal Reserve to the brink of a reduction in interest rates at its upcoming meeting. Some economic indicators such as the jobs report remain quite positive but others like select manufacturing data indicate weakness. The consumer, the backbone of the economy, seems very healthy but trade and tariff issues plus ongoing international economic weakness have impacted capital spending and future earnings. Recent remarks by Fed Chairman Jerome Powell indicate that the Fed wants to do all it can to prolong the economic recovery and that despite many positive signs in the U.S. economy it may be time for lower interest rates. Even at what appear to be very low levels in interest rates domestically, we are still at far higher levels than many other countries.

Whether the anticipated rate cut in late July will be enough to reverse the current decline in manufacturing results is uncertain. Much of the slowdown in some industries is due to economic conditions abroad and the tariffs or threat of tariffs imposed by the Trump administration. However, it appears from the recent performance of the U.S. stock market that investors are certainly in favor of the Fed's more accommodating stance. This stands in stark contrast to the decline in the market in late 2018 following, among other things, the last rate increase by the Fed.

While some manufacturing results, particularly for companies or industries with significant overseas operations, have been weaker lately, the consumer health measurements remain robust. It is often quoted that the consumer drives 70% of the U.S. economy and given the remarkable employment numbers, consumer spending is very strong. Wages are growing as well and we don't seem to have the consumer debt issues that lead to so much trouble in 2007-2008. The strong employment numbers and growing wages normally would lead to inflationary pressures but at least for now, inflation is muted. This benign outlook for inflation is also a factor in the Fed's decision to ease interest rates.

With interest rates remaining low for the foreseeable future, stocks, even after this recent advance, do not seem unusually overvalued. With the S&P 500 flirting with 3000 and consensus 2019 earnings estimates for the index somewhere near \$165-170, the Price/Earnings (P/E) ratio is about 18X. While this is somewhat above the historical average (15-16X), in an environment with the 10 year U.S. Treasury Note just over 2.0%, stocks don't seem overly expensive. However, as we saw last year, volatility can return in an instant and markets can lose a lot of ground in a short period of time. There are still important unresolved trade issues with China, foreign economic weakness, the always unsteady Middle East and a presidential election next year among other factors.

We don't know what will happen in the short term for the stock market, but we believe it is important for investors to review their holdings after an advance like we have had in 2019 to make sure their portfolios are aligned with their long term goals. We look forward to discussing these issues with you and we wish you the best for our long-awaited summer.

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