Aviance Capital Partners
Investing for Generations

INVESTMENT COMMENTARY

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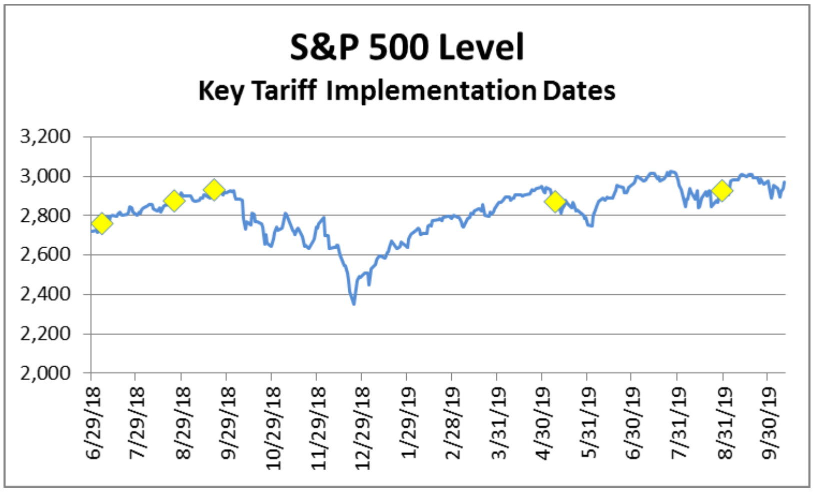
JACK BROWN, CFA

Did somebody say trade-war?

While the longer term, negative, economic impacts of restricting trade are little disputed, the results of the U.S.'s trade spat with China may turn out to be just a bit unsettling. Specifically, since the beginning of the hottest geopolitical topic of the past year-and-a-half, the stock market has reacted with a bit of volatility but ultimately normal results.

On the other hand, there are plenty of company-specific anecdotes on how this dispute is detrimental to product pricing, margins, and capital spending plans. The end result is yet to be determined. However, we lean towards the idea that related volatility in the stock market will provide an opportunity for those investors holding cash at the right time.

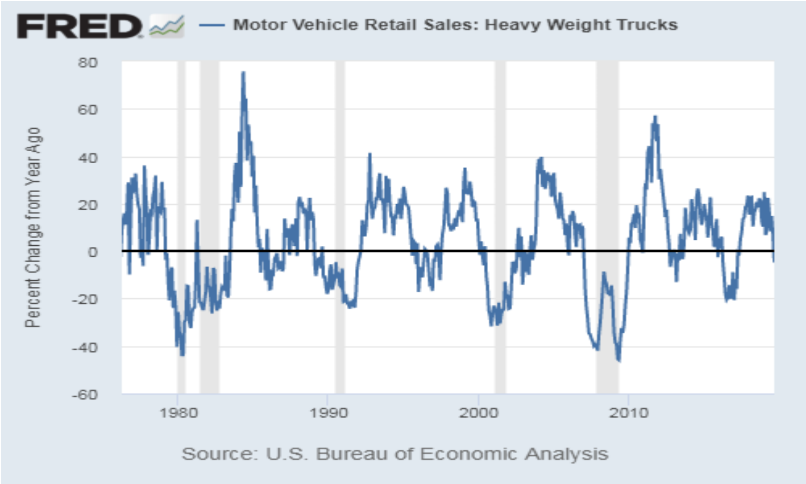


How is the U.S. economy doing?

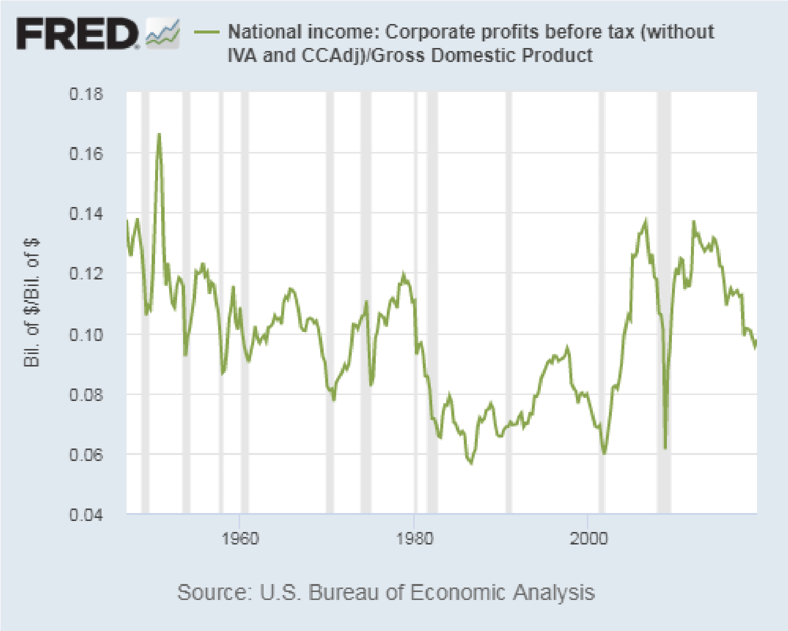
While the chance of rain has increased, we ultimately continue to believe the U.S. consumer, who is responsible for two-thirds of economic activity, is prepared for a weaker business climate, and thus will help avoid an economic recession. Supporting this conclusion, we list a variety of key charts that demonstrate some pros and cons in the economy:

First the bad – as you will notice, the concerning economic indicators are generally tied to business:

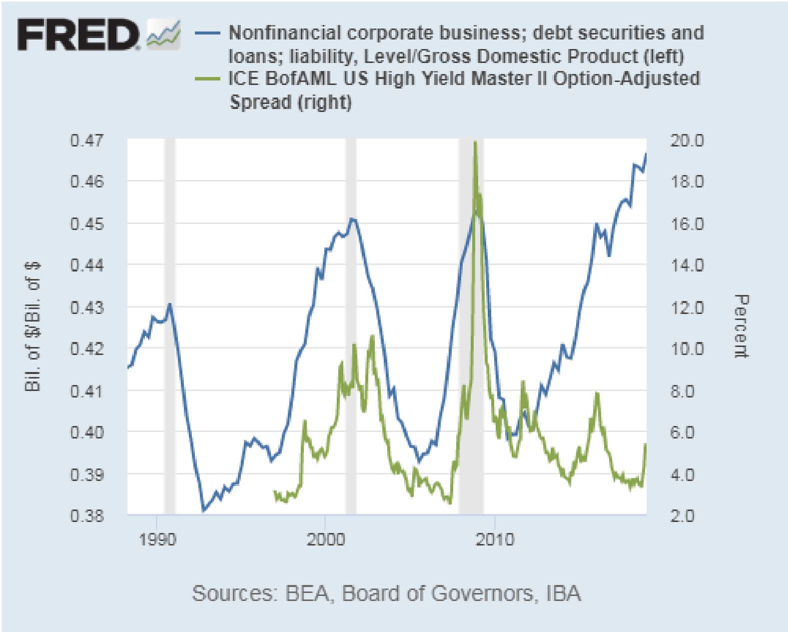
- Growth of heavy truck sales has dipped into negative territory which seems to demonstrate softness in transportation, agriculture, mining, and/or trade.



- Corporate profit margins continue to decline which could negatively impact spending plans, employment, and borrowing activity.

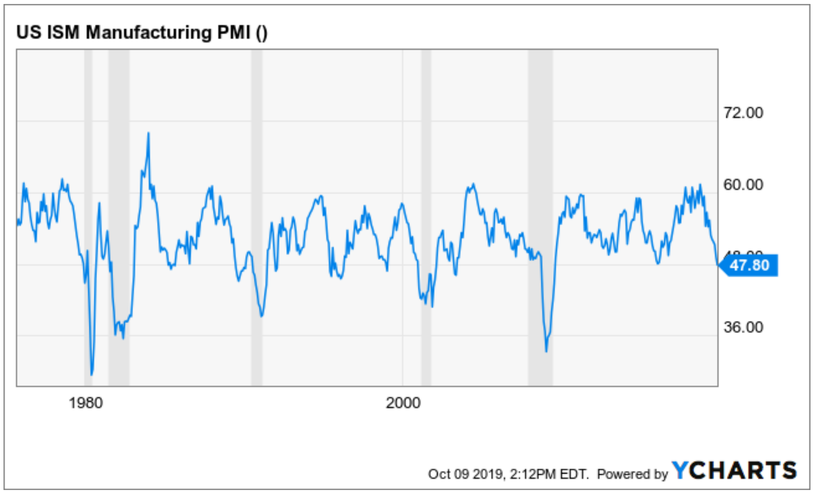


- Corporations are borrowing quite a bit of money with overall corporate-debt-to-GDP levels at record highs. Higher debt levels could make refinancing more difficult especially if margins weaken or rates rise.



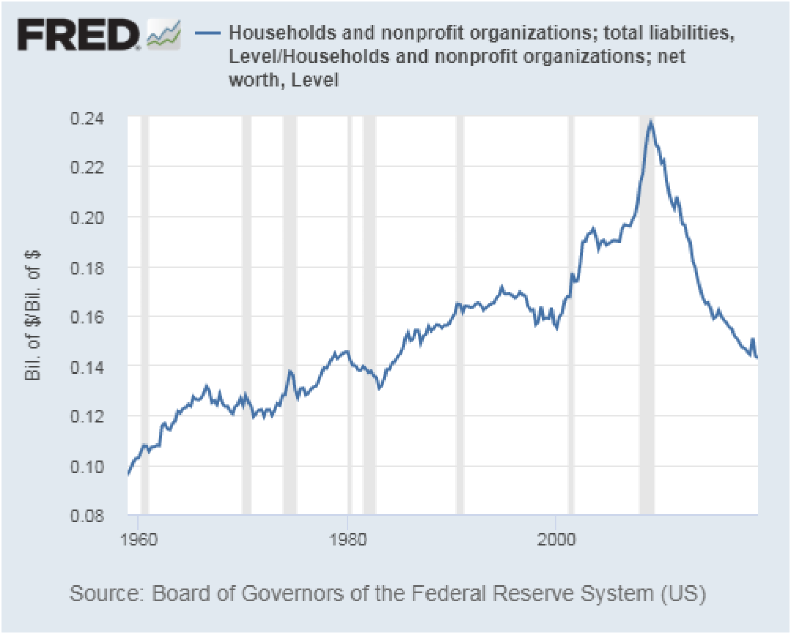
***The blue line is corporate-debt-to-GDP / The green line rises when investors sell corporate bonds.*

- The Purchasing Managers Index (PMI) is below the magical "50" signaling sentiment among manufacturing executives does not support growth.

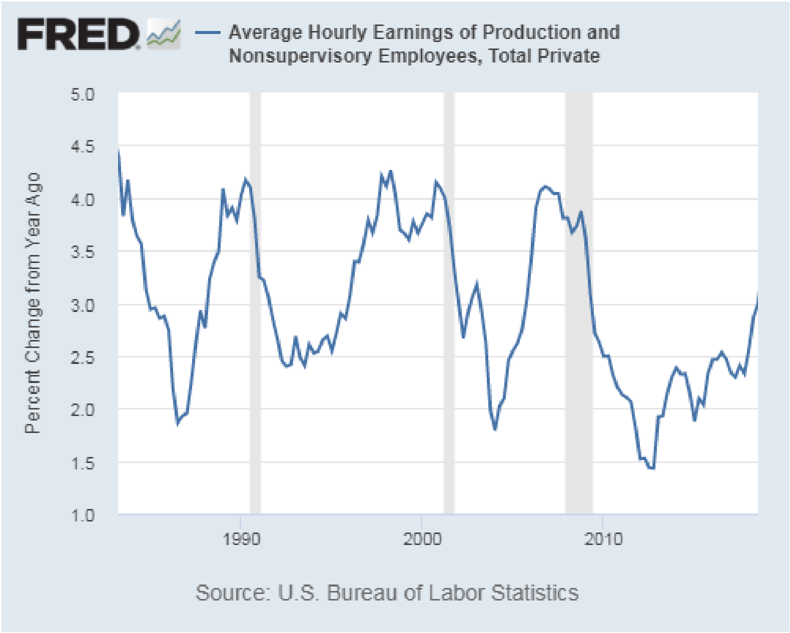


Now the good –we find strength in the consumer/household area of the economy:

- Household debt levels are quite normal looking again. Consumers have financial flexibility which was quite the opposite in 2008.



- Workers are getting raises. Not only are unemployment levels low, but increases in pay are heating up.



- The composite of economic leading indicators remains strong.

The economic bottom-line presents a balance of good and bad news. Since the consumer is the larger factor and appears healthy, we expect economic growth to remain positive with continued revenue growth for most companies.

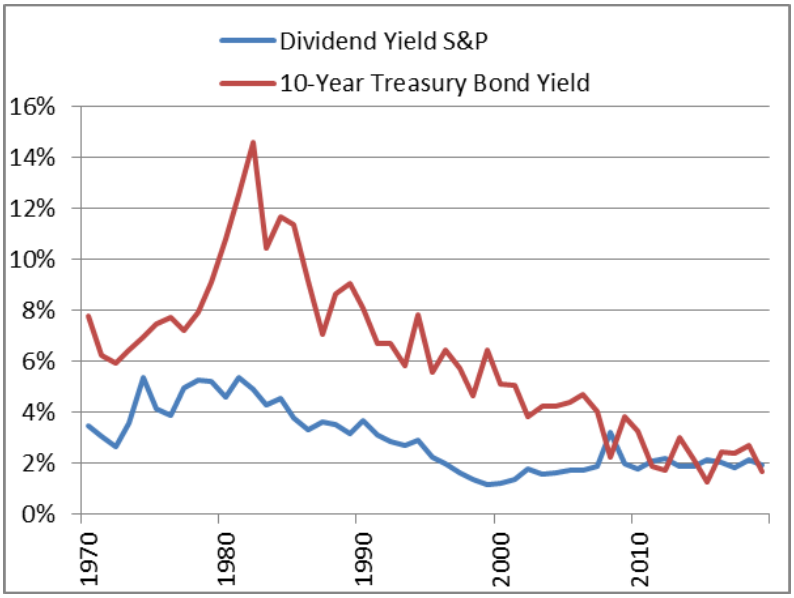
Despite increasing revenues, profits may continue to weaken as a result of higher costs stemming from the trade dispute with China, lower net interest income for banks, and weakness in non-U.S. segments. Should layoffs pick up in a meaningful way as a result of normal cyclical behavior or something more-specific such as the aforementioned trade-war, our optimistic outlook would likely change.

Is it a good time to invest in stocks?

Continued geopolitical fears means continued market volatility. Combined with softer earnings, some investors will exit the market. Periodic sell-offs and continued economic growth, on the other hand, spells opportunity for investors. This tug-of-war between volatility and growth is perhaps why we may be entering a period where individual stock selection makes sense – as stocks of first-rate businesses get discarded alongside those of lower quality.

In a broader sense, stocks do not seem overly expensive when compared to other markets. Specifically, consider bonds. With the 10-year Treasury bond yielding 1.8%, the overall dividend yield for the stock market looks appealing. Dollar-for-dollar, the same investment in stocks currently generates more income than treasury bonds.

Dividend yields for stocks have drifted up over the past 20 years – the opposite has occurred with bonds.

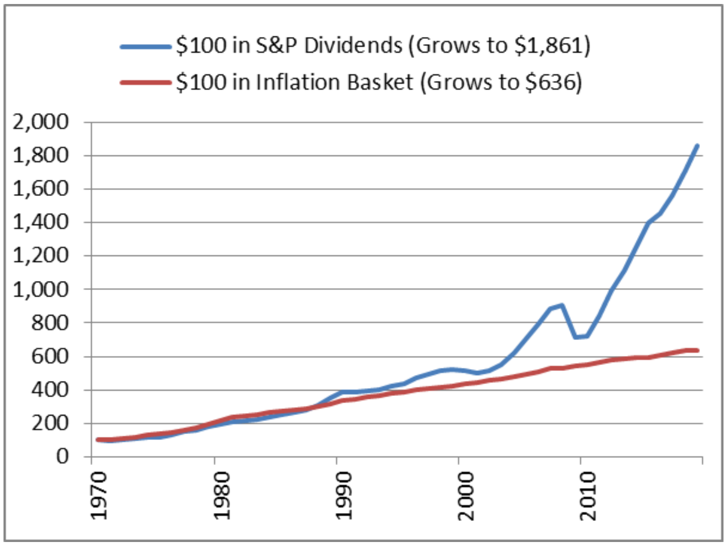


Source: Standard & Poor's, Robert Shiller.

The other advantage of stock dividends is companies tend to increase dividends with regularity. In fact, the rates of dividend increases have, on average, clobbered that of inflation.

To that point, let's say for example you had made an investment in the S&P 500 in 1970 whereby you were receiving $100 in dividends for that year as well as the dividends for the subsequent years including any increases. Let's then compare that $100 in dividends to a basket of goods also worth $100 in 1970. As inflation increases, the basket of goods gets more expensive.

The chart below illustrates this comparison. Even when accounting for the 1970's era inflation, dividends increased value more rapidly.



Source: Standard & Poor's, Robert Shiller.

In conclusion, the economy seems to be in decent shape, stocks do not appear to be overpriced, and investors tend to go where they are treated best. A resolution of the trade spat with China could potentially lead to a boost in overall confidence, a pickup in business activity, and a refinancing boom given the low rates – spurring a wave of economic and earnings growth.

In the end, investors should, in our view, adhere to their longer-term, strategic asset allocations with the potential to deploy some extra cash during periods of volatility when the markets become overly fearful and favorable investment opportunities present themselves.