Intrinsic Investors

Timely Insights into Markets and the Economy

Investors Quarterly

Christopher P. Shea, CFP®

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Equities

- We closed the third quarter of 2019 on a mixed note. It became evident that the U.S. economy is moving on two divergent tracks. One negative and other more positive.

- On the downside, last month's *manufacturing data* shows the sector moving into *contraction*. This does not mean we are going into recession anytime soon, however. Manufacturing only accounts for 10% of GDP, but it is a concern and bears watching in case uncertainty spreads to the broader economic picture.

- The *good news is that the service sector*, representing the other 90% of GDP, *remains healthy*. Consumer spending, which accounts for roughly two-thirds of economic activity, remains strong as record employment (for the most part) and wage growth continue to bolster the case for continued, although slowing growth. We *expect growth to slow* as we get into the later stages of the longest recovery period on record.

- *Earnings growth* continued to moderate in the third quarter, with trailing earnings *falling by almost 5%.* Still, year-over-year, earnings are up about 8%, off their highs, but still positive. We are just *entering third-quarter earnings season* and we will be watching to see how the reporting unfolds. We are not expecting any miracles, but are prepared to be pleasantly surprised.

- Despite renewed volatility, stocks prices continue to enjoy solid double-digit returns. We still need to get through the month of October, a month famous for being unkind to investors. Any setbacks present a buying opportunity, even though the markets are fairly valued at current levels Relative Value chart (click on the link).

Fixed Income

- Fixed income markets continue to simultaneously intrigue and befuddle Fed watchers, including yours truly.

- The Fed picked up a *second "insurance policy"* in September, lowering interest rates by another 0.25%! Mission accomplished? Too early to tell, although it is now believed we have seen an end to rate cuts for the year.

- *The main job* of the Federal Reserve is to *promote employment and constrain inflation*. Unemployment just hit a 50-year low at 3.5%. Inflation, as measured by the Fed remains subdued. Therefore, the Fed appears to be doing its job but for some reason cannot seem to put a positive face on the fact.

- Not only is the economy still growing, but also, *strong employment data is translating into a more competitive wage environment* with incomes on the rise. This will continue to bolster consumer spending and hopefully, extend demand into the holiday spending season. We also see signs that *productivity is once again on the rise*. This has been one of the last things to improve during the current economic recovery.

- All is not "Seashells and Balloons" to quote the late great Al McGuire. Continued *concerns* over a slowing global economy *have safe-haven seekers flocking to the US Treasury markets*. This fact, coupled with the recent liquidity scare in the short-term securities market drove our proprietary Recession Predictor (click link to view) over 96%. When the markets corrected the anomaly, the predictor receded to a safer, but still high reading near 85%.

Conclusions

- If we can get through October without too much pain, stocks promise to post a good full year's performance. That might be asking a lot, but we continue to be *cautiously optimistic*. It is late in the game, but not too late.

- We still face numerous challenges on trade, Brexit and global economics. Apparently, on the *China front*, we can now *add professional basketball* to the list of things upsetting the Chinese. You cannot make this stuff up!

- In summary, the economy continues to slog along, albeit at a slower pace than in recent years. The market continues to bump its head on fair value, but that should only be temporary. It is also struggling with some technical issues, which are of no interest to anyone but techno-dweebs (like me). *Bottom line* is that once we are into *2020*, our relative value suggests a move on the Dow closer to *30,000*, giving us room to move on the upside next year. Stay tuned.

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