Wimmer Associates

Quarterly Report

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Letter from Kathy

Dear Friends:

Ring out the old and ring in the new. After an end-of-year stock market swoon, that dragged all of the broad market indexes into negative territory, the S&P 500 Index posted its best January since 1987. The index rose 7.9% during the month of January 2019. We attribute much of the stock market decline in December 2018 to US economic policy missteps, which led to frantic selling leading up to Christmas Eve.

First, the Federal Reserve (the "Fed"), with its new Chairman Powell, mistakenly thought that the markets might quietly absorb four promised new interest rate hikes. Raising interest rates in the US, when our economic competitors are enjoying negative real interest rates, creates an over-valued and uncompetitive US dollar.

Second, the Administration and Congress failed to pass a budget or continuing resolution in December, which led to eight hundred thousand Federal employees being furloughed, four million government contractors being sent home without pay and DHS agents and the Coast Guard not being paid for their ongoing work.

Third, Brexit. Britain and the European Union (EU) have not been able to negotiate a satisfactory exit from the EU that the British Parliament will approve, one that will allow Britain to stay within the customs union while freeing itself of the burdens of EU regulations and open borders. Time is running out to find a solution precluding a "hard exit" that kicks the UK out of the EU, its customs union, and free trade agreements with Japan and Canada.

Fourth, trade wars (or skirmishes) between the US and its allies, Mexico and Canada, continue to impede economic growth with corporate managers concerned that additional tariffs might be imposed on steel, lumber and agricultural imports. Likewise, the nascent trade war with China has resulted in retaliatory Chinese boycotts on US agricultural products, creating hardship for some mid-western farmers. Tariffs, quite simply, are taxes on consumers, who ultimately are penalized with higher prices.

We believe there are better ways to address the real issues of China's theft of US Intellectual Property, unfair subsidies to Chinese companies competing with US corporations and the forced transfer of US technology to China as the cost of access to the Chinese market. The US could: 1) exclude Chinese companies, such as

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Key Facts for 2019

- *Annual gift exclusion $15,000*
- *Estate, gift and generation-skipping tax exemption $11,400,000 per individual*
- *Highest marginal estate tax rate 40%*
- *IRA contribution limits $6,000, plus another $1,000 for those over fifty*
- *SIMPLE IRA and 401(k) contribution limits $13,000, plus another $3,000 for those over fifty*
- *401(k) contribution limits $19,000, plus another $6,000 for those over fifty*
- *SEP IRA contribution limits 25% of compensation, max of $56,000*
- *Top Federal tax rate is 37% on income over $510,300 (single filers)*
- *Top Federal tax rate is 37% on income over $612,350 (married filers)*

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Huawei and ZTE, from the US 5G infrastructure build out: 2) fine, prosecute and bar Chinese imports from companies that spy or steal from the US, and; 3) coordinate with World Trade Organization (WTO) partners to sanction unfair and illegal actions by the Chinese government and its subservient corporations.

Before reviewing 2018's financial and economic performance below, let us be thankful for low unemployment, rising wages, record corporate earnings and relatively strong US GDP growth, all of which are the envy of developed nations around the globe. We have already seen the Fed reverse its December misstep, which has heartened the markets in the New Year. We must be hopeful that mutual self-interest will rule the day concerning the terms of trade between the US and China and Britain and the EU. As the 2020 US presidential campaign has already kicked off, further political polarization is expected and potential policy advances will remain gridlocked. Wall Street has an old adage, albeit a cynical one: "gridlock is good". The rationale is that the markets will perform better if the government gets out of the way or is unable to pass any legislation. Since 1958, a divided Congress has outperformed a unified Congress by an average 18.7% higher annual return.

On that happy "note, we wish you a Happy New Year and are always pleased to discuss any life changes that might warrant us to revisit our approach to your individual portfolio.~

Cordially,

Kathy Wimmer, CFA, CIC
President

2018: Fourth Quarter

The fourth quarter of calendar year 2018 delivered some of the worst returns that risk assets have experienced in this ten year expansion, with the MSCI All Country World Index (ACWI) down -12.7%. Concerns over a late-cycle slowing, tightening global liquidity, trade protectionism, corporate leverage and political gridlock all coalesced to drive a re-pricing of future growth prospects.

While the broad-based S&P 500 Index had its best quarterly return since 2013 in the third quarter of 2018 (up +7.2%), the benchmark index fell -13.8% in the fourth quarter, bringing the total return for 2018 to a -4.4%. We attribute the fall in domestic equities to hawkish commentary from the Federal Reserve, which increased the Federal Funds Rate by 0.25% in December, with a near promise to raise rates three more times in the next twelve months. The Fed Chairman has since backed off on the stated need for future rate hikes, saying the Fed will be "patient" and that any additional Fed action on interest rates would be "data dependent". We don't want to pin the market's entire year-end decline on the Fed, as the trade war with China, a failing Brexit accommodation, the US government shutdown and a momentary falling out of investors' love affair with FAANG (Facebook, Apple, Amazon, Netflix and Google) stocks all contributed to lower investor confidence.

On the bright side, the US economy grew faster than 3% in 2018. Because of the partial government shutdown, the initial fourth quarter GDP economic numbers won't be available until February 28, 2019, nearly a month after the normal release date. According to FactSet, the consensus of economists is that US GDP increased by 2.6 % in the fourth quarter, a sequential decline from the 3.4 percent pace in the third quarter. The partial Federal government shutdown (which only affected the last two weeks of December), nevertheless, is believed to have shaved 0.3 percent from GDP growth in the fourth quarter of 2018.

Unemployment is at historic lows (3.9%) at the end of the year, while wages rose +3.2%, the largest full year gain since the recession. Not only are wages rising, but workers

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2018: Fourth Quarter (continued from page two)

who heretofore dropped out of the employment census (those who essentially gave up on finding further employment) are returning to work, because there is strong demand for labor.

US consumer sales are the major driver of the US economy, accounting for nearly 70% of total US GDP. Consequently, US retail sales (which are reported monthly versus quarterly GDP numbers) are closely watched for early signs of slowing or acceleration in the overall economy. Although numbers initially reported for December retail sales (the pinnacle of holiday shopping) showed a decline of -1.2% from November, we believe we may see those numbers revised upward. MasterCard and Amazon both experienced strong sales growth in December. Macy's, Kohl's, and Target also saw sales gains during the reported period. It is possible that the government shutdown affected statistical reporting, but the shutdown didn't seem to dent brick-and-mortar sales this past December. We will keep our eyes on future reporting of consumer sales, but are skeptical that the current December reporting is correct.

Another important economic indicator is the non-farm Production Manufacturers Index (PMI), supplied by The Institute of Supply Management. The PMI reflects the health of US manufacturing supplies. The December PMI showed reason for concern, as it dipped to 54.1, down 5.2 points from the previous month's reading. It should be noted that December is traditionally the weakest month of the year for manufacturing. January, moreover, saw the PMI climb 2.3 to 56.4, which is the 29th consecutive month above 50.0 (indicating growth.

According to FactSet, the fourth quarter corporate "earnings growth rate for the S&P 500 is 13.1%. If 13.1% is the actual growth rate for the quarter, it will mark the fifth straight quarter of double-digit earnings growth for the Index." As to overall stock market valuation, FactSet further states: "The forward 12-month P/E (price/earnings) ratio is 16.0. This P/E ratio is below the 5-year average (16.1) but above the 10-average (14.6)." Market valuations vary over time based on numerous variables, but the current premium market valuation clearly benefits from a lower corporate tax base, which increases corporate cash flow allowing for increased earnings, dividends and stock buybacks.

We should note that earnings growth doesn't necessarily mean that stock valuations will automatically rise and, conversely, earnings declines do not always translate into lower equity prices.~

2019: The Path Ahead

As we highlighted in our opening comments, we believe there are four key factors (listed sequentially in terms of consequence) that affected the fourth quarter decline in market returns. The Federal Reserve remains the first and most consequential factor in the ongoing economic expansion of the economy and, ultimately, the ongoing bull market in equities. We believe the Fed took a misstep in December when it said it would raise interest rates 3-4 times in 2019. The Fed has since made a U-turn in policy and now claims that it will be flexible as to future rate hikes and the winding down of the Fed's balance sheet (quantitative tightening) will stop in the mid-year. This will leave the Fed with a balance sheet of approximately $4 trillion in assets, including US Treasuries and mortgage-backed securities.

Second, the Administration and Congress run a close second behind in the ability to hold back economic expansion and corporate earnings growth. With tax reform unlikely to be touched before the 2020 election and general dismay with the third orchestrated governmental shutdown in twenty years, it is unlikely we will see another attempt to self-inflict economic damage through a shutdown or furloughs in

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WIMMER ASSOCIATES

Investment Counsel

155 North Lake Avenue, Suite 440
Pasadena, California 91101
626-683-3150

www.wimmerassociates.com

We strive to optimize our clients' financial well being by coordinating investment decisions with other professionals in the fields of taxation and estate planning.

2019: The Path Ahead (continued from page 3)

the near future. We believe that both the Administration and Congress are keen to have an infrastructure bill that would serve as a fiscal stimulus to the economy. An infrastructure bill would most likely extend the economic expansion for another 2-3 years, notwithstanding the additional burden on the budgetary deficit.

Third, we appreciated EU Council President Donald Tusk's acerbic comments on Brexit: "I've been wondering what that special place in hell looks like, for those who promoted Brexit, without even a sketch of a plan how to carry it out safely." The "Brexiteers" were naïve, or simply cynical, to think that they could continue to enjoy all the benefits of the customs union with the EU, while shedding common regulations, financial contributions and free borders. We understand Britain's frustration with the EU's lack of reform and stifling bureaucracy, but Britain already has its own separate currency and the Atlantic to protect its shores from unwanted migrants. If Britain is allowed to leave the EU without paying its pound of flesh, there would be little to keep other members from leaving or demanding better terms within the alliance. A hard Brexit, without agreement on terms of separation, could cripple Britain's economy and presage the further breakup of the EU. Moreover, Scotland and Northern Ireland might separate from Britain if Brexit leads to the aforementioned being expelled from the common market. At this point, both the EU and the mutinous Brits should sue for a continued armistice, so that reality might settle in and both sides see the great (still preventable) harm to come from a divided EU.

Fourth, we are not sanguine in believing that the political jockeying will end smoothly in the near-term between the US and China over China's egregious intellectual property theft and confiscatory industrial policies. While we do think that both sides understand the negative consequences of a drawn-out trade dispute between the two largest economies in the world, the US and China. It is unlikely that both sides will come to a comprehensive agreement before the arbitrary March 1, 2019 date set by the White House. We do expect, however, some initial agreement to be forged, with the promise of further ongoing negotiations.

In summary, we remain constructive as to our outlook for the 2019 US economy and US equity returns, but are concerned that misguided economic and trade policies might derail what has been a tremendous economic recovery over the past ten years. Should Congress fund an ambitious infrastructure bill and cooler heads prevail on trade issues, one might expect another two to three years of domestic economic expansion. ~