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Quarterly Review and Outlook

"Is that all there is?" Those rather plaintive words formed the title of a Peggy Lee song, which those of a certain maturity will remember. They also seem appropriate for the current investment environment. The confusion regarding trade policies, immigration stand-offs, and Federal Reserve directives have allowed resulting noise levels to drown out equally legitimate focus on and analysis of economic fundamentals and corporate earnings prospects.

We fully acknowledge that the possibilities of a prolonged impasse on trade, mid-term elections being skewed by emotion-charged human welfare and border security issues, and shifting Federal Reserve priorities have to be weighed. But, that is not all there is for investment decision makers. The economic prospects in the U.S. are still very positive. The growth in GDP for the quarter just ending is likely to approximate 4% annualized, a pace not seen in a decade. Further quarterly gains this year are probable, as the stimulative impact of tax changes boost capital spending and repatriated corporate overseas cash reserves are deployed into U.S. operations. Corporate earnings in the first quarter grew by 25%. While the rate of growth will moderate in the remaining quarters of 2018, gains will still be in the 15%-20% range, not an absolute decline in earnings as some have declared.

Our Fed has indicated that, as part of its "normalization" of monetary policies, a gradual increase in managed interest rates is planned, in view of the decline in unemployment, modest upticks in wages, and some rises in prices for raw materials and intermediate goods. A number of observers have raised concerns about the direction and possible magnitude of the changes in Fed policies and the implications for an induced recession or destabilized monetary markets.

We have never been unquestioning observers of a generally academic-based group with predominately Keynesian leanings; but, neither do we consider the Fed to be careless and biased in its carefully considered and increasingly open decision making and willingness to adjust as conditions dictate. At this point, we are inclined to consider their "normalization" policies as a vote for the strength of our economy and banking system and their resiliency to absorb some likely reasonably small increases in interest rates.

The risk to this observation is that the new Fed chairman may want to show his resolve as an "inflation fighter" and a "sound money guardian" and misread the forces that may be counteracting inflationary pressures on a secular basis. To not respect the longer-term effects of demographic trends, significant and increasing impact of new technologies on manufacturing efficiencies and productivity, and the benefits of widening deregulation would be a mistake and result in a shorter term overshoot in interest rates.

Trade tensions have recently taken a more prominent role in the minds of investors, business leaders, and politicians. The escalation in threatened tariffs in U.S. and China negotiations, coupled with the still-unsettled NAFTA issues with Canada and Mexico, have again raised concerns about a disruptive trade war with our important global entities. As we have previously noted, "free" trade is a misnomer in reality, rather than an abstraction. In fact, many of our trade policies and treaties are outmoded agreements arising from post-war pacts such as the Marshall Plan and SEATO aimed at economic recovery and/or territorial security. Given how much the economic and political worlds have changed and strengthened in the past 50-75 years, many such alliances need to be revisited and reviewed to ensure that future trade is fair to all parties. Unless, and until, we see clear evidence that these realities are foremost, we will remain uneasy about the impact of aggressive and heated rhetoric on business confidence and world trading activity.

Given all of the forgoing cross-currents and keeping a watchful eye on the future, our portfolio strategy and structuring are under constant review. In our equity portions, we continue to believe that the broad economic trends are supportive of above-average growth in corporate sales and earnings for the next two years. We are not ignoring the current waves of concerns about trade and monetary policies, but are patiently looking for opportunities to add new holdings and bolster established positions.

Based upon our judgments for future specific company strategies and supportive product and financial strengths, we are emphasizing our existing areas of technology, financials, and specialty health care, while looking for opportunities in energy, transportation, and industrial beneficiaries of capital spending incentives. At the risk of being boringly redundant, we favor varied technology innovators because of the pervasive presence of their products and applications in consumer and industrial sectors. Banking enterprises should benefit from rising commercial and industrial loan activity and from relaxed regulations which should stimulate increased dividends and stock buy-backs. With aging demographics in developed nations, new health protocols and diagnostics will gain importance and wider applications to the benefit of forward-looking diversified medical companies.

In the fixed income sector, we continue to favor short duration government and high quality corporate issues. While the Fed seems to have a defined path of raising rates, it behooves us to remember that policies can be impacted and changed by global currency issues, trade flows, and shifts in domestic priorities. Stated differently, our Fed will be cognizant of and sensitive to numerous market conditions; and policy adjustments are always possible, even likely! With that in mind, we now consider Treasury Bills to be appropriate in our structuring to facilitate enhanced portfolio flexibility with reduced volatility and offering improved interest rate yields.

Looking ahead, we will watch intently the trends in our economy and the corporate sector. The headlines are understandably focused on trade issues, many of which seem counter-intuitive, while the positive trends in economic activity, consumer and business confidence, and still modest inflation are overlooked or deemed transitory. Now, it seems that the mystic "Swan" could be of a paler shade, if cooler heads prevail and recognize the economic damage that looms in a widening trade war. We are hopeful of such good sense, but are maintaining reasonable cash reserves as a buffer and funds to be employed opportunistically.