
Sound Investments Inc.

3rd Quarter 2019

DJIA - 26916 S&P 500 - 2976 Nasdaq - 7999

Summary

Fewer Stocks Participate in Market Rally

With the December decrease in stock prices the new P/E ratio is about 14.4 times which is below the 25 year average of 16.1 times. Hence stocks look inexpensive.

Dividend yields and cash flow per share are in line with the past 25 year averages. With 10 year bonds yielding 2.8% and inflation at 2% a lot of the concerns noted above seem to have been discounted.

Economist expect the economy to grow but at a slower pace. To be sure some economic data remains uneven reflecting lower consumer confidence.

The S&P 500 eked out a modest gain of 1.8% in the third quarter, so stocks held onto their gains obtained in the 1st and 2nd quarter. However, the gain year to date, 19%, started from the low at the end of 2018.

Most investors, remember last year when the S&P 500 peaked in Sept and then tumbled nearly 20% over the next 3 months. You can see the impact of last years sell-off in the markets 12 month returns: The S&P 500 is up just 4.1% since Sept 30th, 2018.

The Wall Street Journal reports U. S. Equities are trading at record levels but many stocks are struggling to break out of a narrow trading range to hit new highs. One reason: fewer individual stocks are contributing to the rally.

The lack of breath in the stock market is concerning to some analysts who note the S&P 500 broke out 3 times since early 2018 but each time, the rally was short-lived. That marks a big difference, from 2013 to 2017 when stocks notched a series of new highs following strong bouts of volatility.

Sideways for the Last 21 Months

A picture is worth a 1000 words Please turn to the last page to see a colorful chart that shows we've been in a trading range for almost 2 years. Three times the market has tried to break through but failed. Why do we see a continual testing of the highs and lows? I believe that after the 2016 election won by Trump, investors, seeing the affects of cutting corporate taxes from 35% to 21% and lots of deregulation, bid equities up 25% in the 15 months following the election. Let's look at some of the factors that are creating a range bound market.

This investment letter is mailed quarterly to our clients and friends?

The U.S. Consumer Needs Some Help

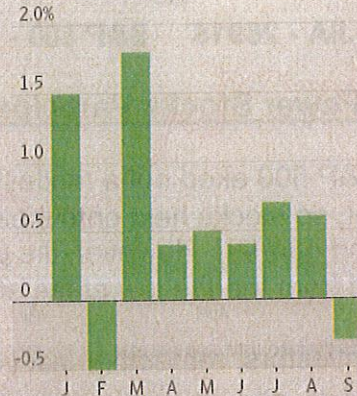
American consumers are still spending money, but it isn't a given that they can keep shouldering the economy on their own.

The Commerce Department on Wednesday reported that overall retail sales slipped 0.3% in September from a month earlier, falling well short of the 0.2% gain economists expected. It wasn't quite as bad as it seemed at first blush, since there were upward revisions to August sales figures, but it wasn't good.

Even so, overall consumer spending looks to have grown at a 2.4% annual rate in the third quarter, according to Barclays, which is basically in line with the previous four quarters' average pace.

Unfortunately, away from consumer spending, things aren't holding up so well. With slower business investment and a deteriorating trade position weighing on growth, Barclays estimates that gross domestic product grew at an annual rate of just 1.4% in the third quarter, down from 2% in the

Retail sales, change from the previous month



Source: Commerce Department

second quarter and 3.1% in the first quarter.

Without consumers continuing to pull things along, third-quarter growth would look a lot worse. The risk is that in the months ahead people could get more cautious. With corporate-profit mar-

gins coming under pressure, employers appear to be ratcheting back hiring plans. Income gains could slow as a result, taking away people's wherewithal to keep spending. The constant drip of unsettling geopolitical news and the risk that trade tensions could flare up yet again also could wear down people's willingness to shop.

This doesn't mean the economy is on the cusp of recession, but it does count as a reason to worry. The retail-sales report only stiffens the case of those Federal Reserve officials who argue that the central bank should continue to lower interest rates as a precaution, and makes a rate cut at the Fed's next meeting at the end of this month seem even more certain.

Even if the recent set of worries begins to fade, it might be wrong to expect consumers to do much more than they already are. For the economy to really flourish, something else needs to take the wheel.

—Justin Lahart



In the last 10 years Value Stocks have returned 6.8% per year while Growth Stocks have returned 10%. A big difference.

The result is that Growth Stocks are now overvalued and we have been shifting to Value Stocks.

Source: tradingview.com

Are We Stuck in a Trading Range?

Maybe. As indicated above, Equities, are drifting sideways as investors have digested news on a lower personal spending, the Chinese trade war and a slowing world wide economy. See article on the U.S. Consumer on page 2.

Caution may be warranted as reports show that global growth is slowing but it is still growing. The Federal Reserve Bank cut interest rates for the second time this year in an attempt to extend the expansion in the face of economic weakness. Political uncertainties and trade disputes weigh on the global economy. We feel there will continue to be a lack of clarity and this will remain a catalyst for volatility as investors feel uncertain about the future.

The above items are testing our resolve but they have lead to something the market loves **Lower Interest Rates** Some of the lowest mortgage rates in 50 years are luring more buyers back into buying homes as rents head higher. Indeed, housing starts increased 12.3% in Aug to a 1.364 million starts; the best level since June 2007. Most Wall Street prognosticators feel we are not on the cusp of a recession. They point to a 50 year low in unemployment, high confidence levels, a strong housing sector, low inflation and again low interest rates.

Asset Allocation

Most of the Wall Street prognosticators do not think we are on the cusp of a recession, rather, they see a **slowing but still growing economy**. They think another cut or two in interest rates will keep things rolling along. **We feel they will do everything they can to keep the economy going till after the 2020 presidential election.** What's working is value stocks (see chart) that generally pay a dividend as opposed to high flying technology investments. (see the chart on back of this page) The top sector funds are utilities, home builders, builders, and precious metals.

In my June client letter, I wrote that we thought a note of caution was in order and is worth repeating. In a number of accounts we started off with a 60% Equities to 40% Bonds Allocation. Due to an increase in Stocks, the ratio is now over 75% to 25%, so we are continuing to trim the equity stake back.

Conclusion

In the end, we think the economy should muddle through, with an understated growth rate of perhaps 1.5% seemingly in store for the next few quarters. Additional interest rate cuts should help. We think stocks are stuck in a trading range. Accumulation of equities on market weakness is a sensible approach.

We welcome your comments. Please call anytime.

Index of 7000 Stocks.

JAN 26 '18

Aug 30 2018

Sept 19 2019

47.6733

45.00

40.00

35.00

1.10

1.00

0.90

0.80

0.70

Trading Range

TRUMP Rally up 25%

New support line

Election DAY NOV. 2016.

The Market may be struck in a Trading as you can see above. It has tried to break through 3 times but to no avail.

OVERSOLD.

2015

2016

2017

2018

2019