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Greetings,

Enclosed is your investment letter. Your YTD return is 19.7%. The return of the S&P 500 is 20.5%. While nothing with the stock market will ever shock me, I am surprised at how resilient it has been. With the escalation of the trade war as well as the silly, ridiculous chatter of a possible recession, I expected a larger pullback during the summer. We had a mild pullback along with some normal volatility, especially during the past few weeks as our large cap technology stocks were hit.

The trade war with China escalated on September 1 as the President not only increased tariffs that were already in existence but also slapped tariffs on consumer goods that previously did not have them. At this point in time, the global economy, in particular China, has been impacted significantly more than the U.S. economy. Our economy certainly has slowed but not but by that much. Someone on CNBC recently said "that the stock market is seeing the trade war as the new normal". I am not sure if I agree with that. With the stock market not far off its all-time highs, I can see a talking head seeing it that way. If the stock market has a 7-8% pullback, these talking heads will be singing a different tune as far as a "new normal". As long as the economy continues to be resilient, yes the stock market will do well. However, if the economy deteriorates, it will only be a matter of time before the stock market gets hit. Remember, if you look back to last year, the stock market expected a deal either by now or by year end at the latest. China and the U.S. are still far apart on key issues such as Chinese companies stealing (for the record, China does not feel that they are stealing anything, they feel sharing technology is the price of doing business in China) technology from U.S. companies. If this was just "trade" issues, then a deal could most likely be made very soon. China has no interest in allowing the U.S. to tell it's country how to do business, which is pretty much Peter Navarro's agenda. Unless the President decides to deliver a small deal (there could be political pressure to do this with the election on the horizon) under the heading a small win is better than nothing, then these trade tensions will last through the election and well into the year 2021. China is taking a big gamble if they think they will receive the same deal or better after the election.

The Federal Reserve lowered short term interest rates once again two weeks ago. They did it pretty much kicking and screaming without a unanimous vote, which is not the norm. The Fed basically gave in to both the stock and bond markets. The economy with its 3.7% near record low unemployment rate certainly does not need lower short term rates. Sure, Europe has negative real rates but guess what? Our economy is not nearly as bad as Europe's. Steve Leasman of CNBC has said more than once" if the President wants Europe's interest rates, then he will have to take all that comes along with it". The stock and bond markets demanded two rate cuts, so the Fed caved rather than taking the heat if the stock market tanked, never mind facing the wrath of President Trump and his relentless insults aimed at the Fed chairmen. The official reason for lowering rates is to cushion our economy from the slowing global economy caused by the trade war. Sorry, I don't buy this. I can't see how slightly lower short term rates will prevent this economy from a big slowdown or a recession. If the potential of a major economic slowdown is a real concern, then a 50 basis point (1/2 of 1%) cut was warranted two weeks ago, along with the Fed communicating further rate cuts. In case you didn't know, the Fed cut rates just 25 basis points. The Fed also gave no definitive guidance as far as future rate cuts.

Right now there is a "flat" yield curve. A flat yield curve in plain English means that long and short term Treasury yields are about the same, hence flat. This is not a big deal in itself unless you are a bank trying to make money by lending at the long end and borrowing at the short end. Things get dicey when there is an "inverted" yield curve. This is when the short term Treasury bond yields are higher than the long term bond yields. The reason it gets dicey is because in the past, this has been an accurate predictor of recessions. What is most important is how long the yield curve stays inverted. Last month for a brief period of time, there was an inverted yield curve. This caused much chatter as well as some written columns stating that a recession was possible. I found those column ridiculous. If the yield curve remained inverted for several months as opposed to hours, it would be something to think about. While a recession will eventually occur, I see the possibility of it happening next year remote. As far as it happening in 2021, it is still too early to tell. If a trade deal with China is not signed next year, the chances of a recession in 2021 will increase. I will keep my eyes and ears wide open for signs of trouble as I always have. Bond yields are only one of many things I will be watching. More importantly, I will be watching the labor market. It continues to be strong. It will be a near impossibility to have a recession occur with an unemployment rate below 4%. Please don't forget that with election season underway, certain people will be looking to talk down the economy with a goal of having a new President in office in 2021.