Ironwood Investment Counsel, LLC

Ironwood Investment Counsel, LLC constructs and manages customized investment and wealth management programs designed to meet our clients' unique goals and objectives. Our distinctive process maximizes performance through return enhancement, risk reduction, tax efficiency, and cost containment.

Paul W. Alston III, CFA
Partner
palston@ironwoodic.com

Matthew J. Carter, CFA, CFP®
Partner
mcarter@ironwoodic.com

Jeffrey E. Shiffra, CFA, CPA
Partner
jshiffra@ironwoodic.com

Bruce C. Williams, CFA
Partner
bwilliams@ironwoodic.com

14646 North Kierland Boulevard
Suite 135
Scottsdale, Arizona 85254
480-609-4700
Fax 480-609-4725
www.ironwoodic.com

Fall 2018

US equity markets ended the third quarter with a strong gain of 7.7% for the S&P500. Small and mid-cap stocks showed strength as well with the Russell 2500 rising 4.7% for the quarter and a year-to-date gain of 10.4%, just about matching the year-to-date gain in S&P500. International stocks continued to struggle with negative returns for both Developed and Emerging markets.

The well-forecasted increase in interest rates gained momentum toward the end of the quarter, in response to an improving domestic economy and the third additional increase implemented by the Federal Reserve this year. The 10-year US Treasury rate increased from 2.5% to 3.2%, just under the 30-year rate of 3.3%. This narrowing of the spread between these two maturities is also referred to as a flattening of the yield curve, and may be a harbinger of a slowdown in future economic activity. In the meantime, second quarter GDP growth was robust and the economy seems to have adjusted well to the Federal Reserve policy of raising target rates in a measured way.

The unemployment level is now at 3.7%, a historically low level. To this point, we have not seen a corresponding growth in wages. The economy grew at 4.2% in the second quarter and the third quarter is expected to come in at a level closer to 3%. We are nearing full capacity in the economy.
In past commentary, we have wondered where additional workers will come from to sustain this growth. Technology and productivity enhancements are the primary alternatives to an increase in the labor force, but evidence of these improvements has been slow to develop or at least quantify.

There are potential storm warnings on the horizon:

- Price earnings ratios on stocks are at the high end of normal ranges.
- Continued double digit earnings growth projections are questionable given existing employment constraints.
- The tax cut stimulus to GDP growth is losing its impact.
- Mortgage rates are rising which has a negative ripple effect through the housing market and across broad swatches of the economy.

The wild card is a trade war with China. In simple terms, a trade deficit is created when one country buys more goods from another country than it sells to that country. We import much more than we export to China, and while this has been interpreted by some as a sign of weakness, most economists believe that it can also be evidence of a strong economy. The makeup of the US economy has changed significantly in recent history, from an economy dominated by the manufacturing of durable goods, like cars and washing machines, to a service-based economy which produces products for media, technology and finance. It is widely disseminated that the US has a trade deficit of $565 Billion, but the existing $244 Billion surplus in services last year sometimes gets overlooked. Additionally, those dollars spent overseas on foreign-made goods usually find their way back into this country in the form of investments. So, a trade deficit is not a synonym for “lost” money.

Meanwhile China has seen growth slow as a result of our trade tariffs. But China always plays the long game. It is implementing short-term stabilizers by lowering taxes and increasing credit. China’s “Made in China 2015” vision to become a leader in technology, energy and pharmaceuticals requires opposition to U.S. demands on trade.

The US stock market may be in the process of adjusting the values accorded the technology sector, which has been responsible for virtually all of the increase in US company profit margins over the last several quarters. The 20 top-performing stocks were responsible for over 60% of the overall market return recently, and the top five stocks (Amazon, Apple, Microsoft, Google and JP Morgan) were responsible for over half of that! We are not surprised to see the market correct this imbalance, and we will continue to focus our equity exposure on quality, dividends, and reasonable prices. We believe the economy remains strong, inflation is low, Fed policy does not appear too harsh, and the markets are taking it all in stride. That could change tomorrow.

As always, we appreciate your confidence and welcome your questions. If you know of someone who may benefit from our expertise and management, please let us know.

Ironwood Investment Counsel, LLC