DANDA TROUVÉ
INVESTMENT MANAGEMENT
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July 2018 Thoughts and Insights

We have exciting news to share to start off our summer letter!

DTIM has added a new position and team member to the firm. Kyle Stewart will be joining us as our dedicated Research Analyst. Kyle has undergraduate degrees in both Finance and Economics from the University of Iowa. In addition, he has just received his Chartered Financial Analyst (CFA) designation, the highest level of certification in the industry measuring competence and integrity in investment analysis. He is an experienced equity and asset analyst and we look forward to adding more depth and knowledge to our investment process. Kyle begins on Monday, July 16th and he will work under the direction of Michelle on all matters regarding investments.

Our equity market outlook has not changed much from April. We noted then that the market cycle was at its peak and that we needed to be prepared for a cyclical rotation. The conundrum is the historically long time that the market has been hovering at the peak. There are countering factors that we are watching which could result in either a continued bull market or the downturn that will eventually come.

The US is still growing and unemployment is at an all-time low of 3.9%. Corporate cash remains ample. In fact, $308 billion has been repatriated in the first quarter following the tax reform. Both business and consumer confidence remains healthy.

However, China and the rest of the world have uncoupled from the US as their data has weakened and the US dollar has strengthened. Volatility has certainly increased over the past quarter, mostly driven by trade concerns. Contentious trade negotiations have occurred in the past, but the current publicity is resulting in rising market volatility. As of now, the $34 billion in tariffs that the US is putting on Chinese goods is insignificant to a $20 trillion economy, but the 'second derivative' effects could be more serious. If the confidence of consumers or business is shaken, the potential for spending and capital investment will fall which could lead to the end of economic expansion and the current bull market.

Tighter monetary policy and financial conditions, along with higher inflation, have also kept stocks from making headway since February. Inflation is one of the most important factors we are watching right now: the flattening of the yield curve, further rate increases from the Fed, and fiscal and trade policy all impact the outlook of inflation. So far, inflation has been very stable and contained. The Fed's efforts to shrink the balance sheet by selling bonds that were issued during quantitative easing has never before been tested. The risk is that they will flood the market with too much liquidity and rates will rise too quickly, causing runaway inflation. Also, the current 2-year rate is 2.53% and the 30-year rate is 2.97%. If the Fed raises rates another 25-50 basis points, the 2-year will be paying more than the 30 year, which historically indicates the arrival of a recession 6 months later. For now we remain confident that the Fed has little desire to invert the curve purposely.

We continue to be fully invested in equities, but will be ready to make any necessary cyclical adjustments which could include underweighting Financials, Materials and Consumer Discretionary positions and adding to Healthcare, Consumer Staples and REITS.

As the 2-year yield has increased, prices in our fixed income portfolios have come down slightly and you may see some capital depreciation. When we buy fixed income, we focus on the income/coupon, which always pays regardless of current rates. The income paid over time will outweigh any temporary price declines. The fixed income market is extremely tight right now, meaning that we are not able to find bonds under 7 years near 5% at the quality level we trust. We are holding larger cash positions as we wait to invest in high quality bonds when 5-10 year rates do eventually rise. We are purchasing “money funds” with the cash that yield near 2%, so the good news is that cash is paying interest again.

As always, we will continue to be disciplined and diversified as we navigate through the current volatility and potential market shifts. We are excited to have Kyle with us as his full attention will be to monitor the markets and investments and be ready to make portfolio changes as needed.

One final note, mark your calendars for October 17th. DTIM will host Brian Portnoy of Virtus Investment Partners for a talk on asset allocation/portfolio diversification followed by drinks and hors d’oeuvres. More details on this will follow in the fall.

We welcome you to call the office if you have any questions or would like any further details on our current thoughts.

Michelle