

## **“Putting on the Brakes”**

The fourth quarter of 2018 was one of volatility and change. Underlying the volatility was a change in the economic outlook for future growth and a change in control of the House of Representatives from Republican to Democrat. The election in November of 2018 changed the Congressional balance of power. In 2019, Congress will be split with the Democrats as the majority in the House of Representative and the Republicans as the majority in the Senate. This congressional split is likely to slow implementation of government spending compared to the spending that was anticipated when the Republicans were the majority in both the House and the Senate.

Furthermore, in early 2018, Congress passed legislation lowering both corporate and individual tax rates based on the principals of supply-side economics. In theory, as a result of the reduction in tax rates, economic growth was expected to increase at a faster rate which in turn would create larger corporate profits and thus generate higher tax revenues. During the first three quarters of 2018, Gross Domestic Product grew at rates of 2.2%, 4.2% and 3.4%, respectively and Personal Consumption Expenditures increased 3.0%, 5.9% and 5.2%. Although the tax cuts were initially successful in increasing economic growth, the recent increases in interest rates by the Federal Reserve have served to reduce the expectations for future growth in the US economy. The Fed raised interest rates four times in 2018 and has indicated they may continue to increase interest rates in 2019.

The combination of a more restrictive monetary policy of the Federal Reserve coupled with a less accommodative fiscal policy of government spending offsets the positive impact of supply-side economics. The lack of a resolution to global trade disputes are also having a negative impact on global economic growth. Taken together, the higher interest rates, and the slower US and global economic growth put prior optimistic forecasts in question.

We do not foresee a recession in the coming year, as we continue to see a growing US economy. However, because of the lower visibility in corporate earnings growth, we would expect the capital markets to continue to be volatile. When there is clarity on the Federal Reserve policy, global trade and the impact of the split Congress, we would expect the financial markets to stabilize. Until such time, we remain cautious in our market outlook and we are monitoring the situation closely to manage client portfolios in a market with higher volatility.

As interest rates increased, we shortened the duration of client bond portfolios to protect against bond price declines. It is now likely that the trajectory of higher interest rates will slow with a lower forecast for economic growth. Therefore, we have begun to increase the duration of client bond portfolios by reinvesting in slightly longer intermediate maturities to take advantage of the higher interest rates.

Rising interest rates and slower economic growth have reduced our forecast for the near term growth rate of corporate profits. In anticipation of slower economic growth, we reduced equity exposure in client portfolios, selling more economically cyclical stocks to create a higher cash

position. As we have positioned portfolios to have a lower exposure to economically sensitive companies we replaced these holdings with investments in companies whose earnings are less negatively impacted by economic cycles.

Volatile equity and bond markets have stimulated significant change in how investors choose to have their money invested. There has been a movement out of funds that offered investors the opportunity to “beat or equal the stock market.” That strategy worked in a rising market. As the stock market’s rise becomes less certain we are now witnessing a “flight to safety”. Investors have been exiting hedge funds for the past several years. We now are seeing a similar exit from ETFs (Exchange Traded Funds); Index Funds and others that offer the potential of above average returns without consideration to the risk and volatility associated with these investments.

Abner, Herrman & Brock’s investment team is not comfortable with a “herd mentality.” Our clients are thoughtful about having an investment manager structure their assets in a separately managed portfolio. We work with each client and/or their Financial Advisor to meet their investment objectives with consideration of personal risk, volatility and investment return.

Once again we are appreciative of the trust you have placed in Abner Herrman & Brock and thank you for your continued confidence in our investment management services.

Happy & Healthy New Year from all of us at AHB.

## **Investment Policy Committee**

### **Abner, Herrman & Brock Asset Management**

Founded in 1981, Abner, Herrman & Brock Asset Management manages portfolios individually structured to assist each client in achieving their investment objectives. Stock portfolios are managed utilizing a Core Equity philosophy, investing in both large capitalization value and growth disciplines with an objective of long-term, after-tax appreciation and below market volatility. Portfolios are diversified across economic sectors, industries and companies. Bond portfolios are managed to provide a high rate of current income and total return. Portfolios are invested in staggered maturities of U.S. Treasury, government agency and investment-grade corporate bonds and where appropriate, investment-grade municipal bonds. Portfolio managers are available to meet with clients upon request.

Please visit our website at [www.ahbi.com](http://www.ahbi.com) for a more detailed description of our investment **Philosophy, Process and People**.