

Campbell Capital Management

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Dear Money Management Client:

Rising U.S. interest rates have caught investors' attention, and are becoming a head wind for equities. Not that rates have gone up all that much, but it's the trend in rates that has everyone concerned. Central banks around the world kept interest rates artificially low for the past ten years; but now our Federal Reserve is leading the way to higher rates by reversing their previous accommodative policies. The goal is to reach some "neutral" rate which is neither stimulative nor restrictive. We wish them luck.

While this rate search goes on, we favor defensive portfolios with higher cash balances. Our "income" assets and "value" stocks, which served us so well since the great recession, will labour in this rising rate environment. However on a risk-adjusted basis, their rewarding dividends and reasonable valuations will provide sound returns over time.

The current economic expansion has now entered record territory. Two of the most famous valuation models championed by Warren Buffett and Nobel laureate Robert Schiller are signaling the market is overvalued. With equity indexes and corporate earnings near all-time highs, we are on "peak" earnings watch. Peak earnings can be expressed; if it can't get better, it won't. And peak earnings, which you only know in hindsight, are not good for stock prices.

The U.S. is benefiting from lower corporate tax rates and business friendly policies. But, businesses are beginning to suffer from margin erosion due to the rising cost of wages, input costs, and energy. Add in the tariff rifts, midterm elections, and trillion dollar budget deficits and now you have something to worry about.

In summary, corporate earnings are on track for a good year-end, but we are not nearly as optimistic for next year. We don't expect interest rates to move much higher, but the Fed could overshoot. Ten year government bonds are getting far more attractive at these levels, and offer a compelling alternative to equities.

As always, we remain committed to a conservative investment philosophy, which emphasizes the preservation of capital. If you have any questions or would like to discuss your portfolio, please do not hesitate to call.

Very truly yours,

Clay Campbell, CPA