Reynders, McVeigh Capital Management, LLC
Invest in better.

The Long Run

INVESTMENT LETTER | OCTOBER 2019

"There was a long hard time when I kept far from me the remembrance of what I had thrown away when I was quite ignorant of its worth."
- Charles Dickens, Great Expectations

Ninety percent of disappointment is expectation. The election of Donald Trump in 2016 and the promise of reduced regulation, more business-friendly policies, and tax reform sparked extraordinary expectations for economic growth in the United States. From the week following his election to the week when his tax reform package was signed in late 2017, the S&P 500 rose by more than 20% and the 10-year Treasury note yield rose.

The promise of a resurgent United States economy buoyed expectations in developed international markets that their flagging economies might get a boost from accelerating gross domestic product (GDP) growth in the world's largest economy. Over this same period right after the election, the iShares MSCI EAFE ETF, representing developed markets outside of the United States, rose by nearly 25%.

Since the Trump tax cuts were signed into law in December of 2017, however, the reality of the new tax policies and their impact has not inspired markets. Economic incentives designed to drive new factory building and other capital expenditures instead gave way to companies buying in their own shares to lift reported earnings-per-share. Corporate tax cuts created a one-time sugar hit to earnings – but lasting benefits have been illusory.

Even with historically low unemployment in the U.S. – coupled with high consumer confidence – earnings growth for U.S. companies has, in fact, slowed from a tax-cut-charged 22% in 2018 back to tepid estimates of 2% growth in 2019. Adding fuel to the fire, new U.S. economic policies have entangled governments around the world in global trade disputes, throwing sand in the gears of potential global GDP growth.

Broad market indices have been reflecting this concern for some time. Since an initial surge in the month after the tax package was signed, the S&P 500 has moved sideways – gaining less than 4% in the last 20 months. The iShares MSCI EAFE ETF has dropped nearly 15% from January 2018 highs. Most dramatically, the yield on the 10-year U.S. Treasury has plummeted back down near multi-generational lows.

Some of this movement in yield may well be due to a flight into the U.S. of investors who are experiencing negative interest rates in Japan and Europe where governments are still providing extraordinary stimulus to keep their economies afloat. The decline in yields is also, however, a signal that bond markets do not see significant potential for the kind of growth that can spark inflation ahead.

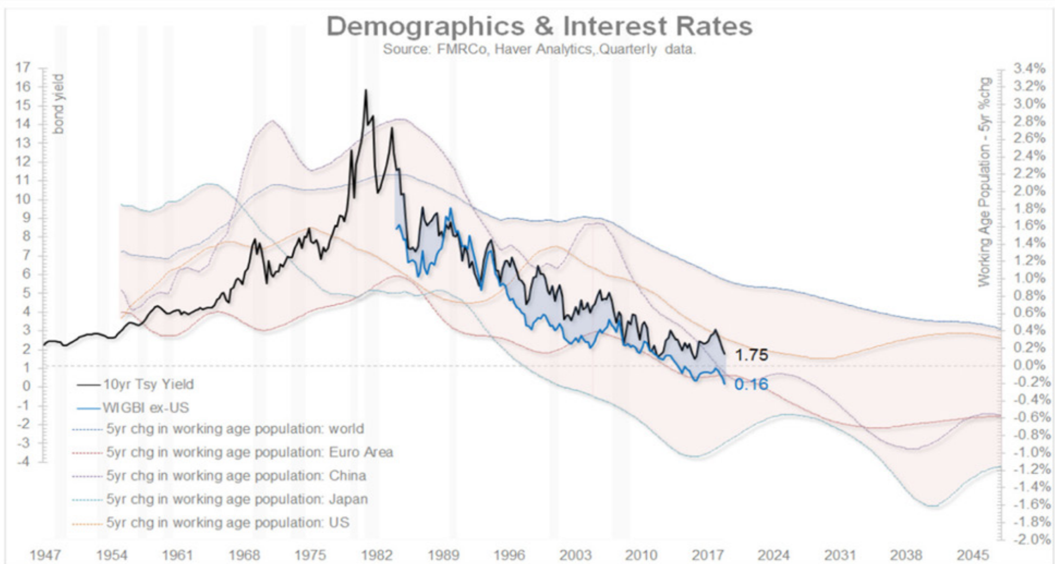
Our experience over the last 20 months has been decidedly removed from what we have seen in global market indices. Since the beginning of 2018, the Reynders, McVeigh Core Equity Composite has delivered a net return of nearly 15%. We believe there are two primary reasons for this recent break away from the market herd:

1. For many years we have been advising clients that the likelihood of a return to coordinated global economic policies was low. Disquiet in Europe (complicated further now by Brexit), weakness in Japan, advancing debt loads in China, and collapsing economic output in other emerging economies have presented – and continue to present – vexing challenges to global growth prospects. We have contended that each of these problems requires a different set of solutions and approaches that would likely force governments to focus on self-preservation strategies over coordinated global policy.

   The addition of tariffs and other complicating factors has only made coordinated global economic policy initiatives less likely. In the absence of coordinated policy, we expected that global GDP growth rates would remain slower for longer. We therefore steered clear of a wide range of deeply cyclical industries where success would largely be dependent on a return to higher global GDP growth rates.

2. We have always believed that innovation is a more reliable driver of earnings growth than government policy. Expecting slow global GDP growth, we turned our attention and research to current innovations and companies that could find new markets for their products to deliver earnings growth in a wide range of economic environments. Exciting opportunities in digital transaction networks, nutrition, new materials, infrastructure, media, 5G, and healthy living have been delivering strong earnings growth.

Looking ahead, our economic outlook has not changed. Our expectation is that slower global GDP growth is likely to be with us for longer than most might imagine. The following chart aligns the declining demographics of working age populations around the world with the continuous drop in global interest rates. This suggests we could also experience lower interest rates for longer than many expect.



Data source: FMRCo, Bloomberg, Haver Analytics, FactSet. Data as of 09/24/2019. Past performance is no guarantee of future results.

As reality sets in – and the expectations of the broader market continue to adjust – we are preparing for more volatility and maintaining our balance in portfolios. As others now recalibrate their world view and begin to throw away assets that – to us – have real long-term worth, we will be waiting. As always, we will continue our work to uncover key innovations that are reshaping our world and to invest in companies that offer exciting long-term growth potential – even when the larger economic landscape might be less than inspiring.

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