MORSE ASSET MANAGEMENT, INC.

805 Third Avenue, Suite 1120, New York, NY 10022

<u>2019 Q2 Investment Outlook-</u> July 17, 2019

US economic and corporate growth are trending positively. The Fed remains supportive and interest rates will likely be low for the foreseeable future. Corporate share buybacks are at a record high. Liquidity is available. The weight of the evidence remains positive.

Stocks generally move in the direction of earnings. As we noted in our last letter, earnings growth has recently slowed, but we do not believe we will see a protracted earnings decline. In fact, we believe we are entering another period of acceleration. Both corporate and analyst estimates have become overly conservative. As is often the case, estimates are cut too far too fast and overshoot to an extreme. For example, this quarter marks the second highest number of S&P 500 Companies issuing negative guidance since 2006 (Chart 1). We think the market got it right with the rally in June and we expect an upward revision of earnings estimates to follow.

According to Factset's *Earnings Insight* on July 12th, the year-over-year S&P 500 blended earnings growth rate is expected to be -3.0% for Q2 2019. Long term earnings expectations still point to a clearly positive trend (Chart 2). S&P 500 forward 12-month P/E ratio is still reasonably valued at 17.1, only slightly above the 5-year average of 16.5. The current bottom-up price target for the S&P 500 over the next 12 months is 3,228, +8% above yesterday's close. Buybacks are at a record high and that is good. The net reduction of share supply, more shares being taken off market through buyback and M&A versus new share issuance, causes stock prices to increase.

Monetary policy remains supportive of the market. Inflation is benign and range bound. During Federal Reserve Chair Powell's congressional testimony earlier this month, he admitted the Phillips Curve, a supposed inverse relationship between the level of unemployment and the rate of inflation, is no longer valid, and that their estimation for the neutral rate of interest was too high. The translation is that the economy can be allowed to run "hotter," at lower rates of unemployment than previously thought, before inflation becomes a concern. This also allows for additional interest rate cuts, which we believe will be kept low for the foreseeable future. Unless forward earnings are much worse than expected, this should fuel the market to push further into all-time highs.

Mixed signals between consumers and business have recently drawn attention. The Bloomberg Consumer Comfort Index, a measure of consumer sentiment, is at the highest level since 2000. However, The Conference Board's CEO Confidence Index is moderately pessimistic, citing trade and tariff uncertainties, and signs of a slowing global economy. We continue to believe the current trade conflict is just holding back near-term corporate spending and not diminishing it in the long term. Companies are not sitting on their hands. Capital expenditure plans are being prepared, and their ultimate execution will be accelerated following the resolution of the trade dispute with China.

Recent volatility is statistically normal. Deceleration from a period of heightened growth is reasonable and healthy. Growth was accelerated by tax cuts and repatriation, which ultimately led to an inventory build in goods and services that now needs to be absorbed. To put things in context, the intra year decline for the SP500 of ~7% in May is still below the historical average intra-year decline of 13.9%.

We are disciplined; focused on the facts, fundamentals, and long-term trends most relevant to your investments.

Our outlook remains bullish. The path of least resistance for the US markets is up.

Morse Asset Management Investment Team

Robert B. Morse, Jian Wang and James Cushing

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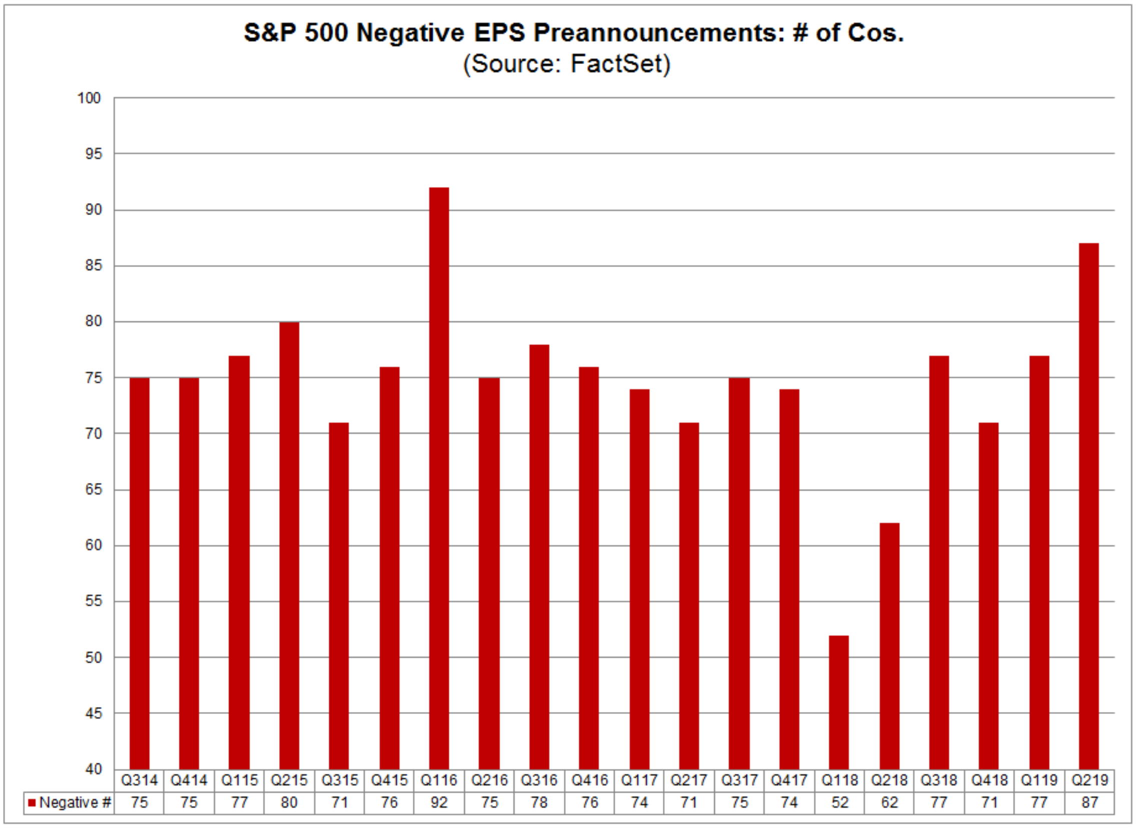
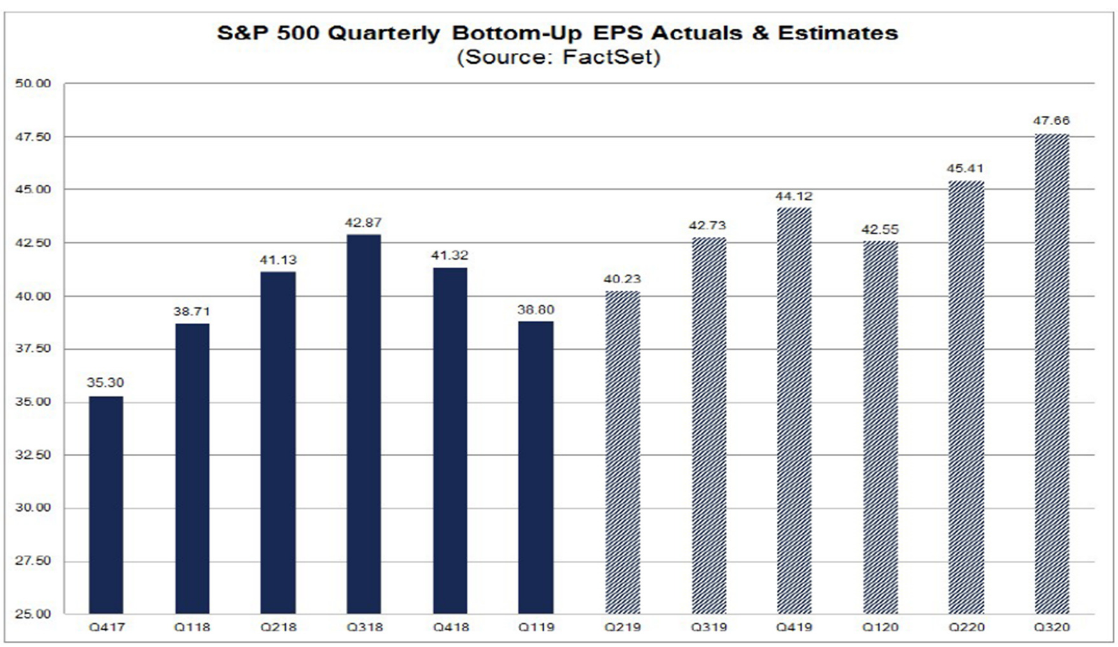
1. Negative Earnings Preannouncments by Companies in the S&P 500.



Factset. *Second Highest Number Of S&P 500 Companies Issuing Negative Eps Guidance For Q2 Since 2006.* June 28, 2019

2. Analysts Bottom-up Forward Earnings Estimates for S&P 500.



Factset. *Earnings Insight*. July 12, 2019