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Economy & Market Valuation

The two factors that are moving the US stock market are

- US Federal Reserve policy
- US -China trade negotiations

The US Federal Reserve cut interest rates by 25 bps, or 0.25%, on July 31. The Federal Reserve said that the interest rate cut is an *insurance cut*, and that it does not guarantee further interest rate cuts. The market wanted to hear that it is the start of a long cycle of interest rate cuts and not just a one-time cut. As a result, the market was disappointed.

US China trade negotiations are not making progress. As a result, Trump has said that US will impose 10% tariffs on an additional \$300 Billion worth of imports from China from Sep1'2019. This will put a 10% tariff on retail items like clothing, iPhones and so on, for the first time.

Both these factors resulted in the recent market drop. We still do not see recession in the near future, but trade issues could result in further slowdown in US growth and increase market volatility.

Globally, economic growth rate is slowing down, and major economies are lowering interest rates. The European Union where the interest rates are already negative, has said that it will further reduce interest rates, which means that they will make it more negative. The Federal Reserve will be forced to keep interest rates low and likely reduce interest rates

because of the global pressure. Donald Trump has been putting pressure on the Federal Reserve to reduce the interest rates. The thinking is that lower interest rates will lead to higher economic growth rate and help Trump get reelected in 2020. Lower rates are known to help the stock market as people and institutions are forced to move to higher risk assets as the return in bonds and fixed assets is very low.

At OCA, we have added to our defensive positions. Approximately 50% of the portfolio is in cash or defensive positions. The defensive positions are Cash, PFF (preferred ETF) and Berkshire stock. PFF has a dividend yield of >5% and is not directly correlated to the direction of the US stock market. It behaves more like bonds than stocks. We will deploy the cash and change allocations at the opportune time.