Investor Insights & Outlook

July 2018 2nd Quarter Concorde Investment Management

Domestic Economic Overview

A Message from Concorde Investment Management

We want to bring to your attention the slight difference in the presentation of your quarterly reports. We switched accounting software from Morningstar to Black Diamond between your Q1 and Q2 reports. We felt Black Diamond provided a better platform for Concorde from both a technology and presentation perspective and we hope you enjoy the new format.

We are in the 108th month of economic expansion (vs. the average of 47 months) and there is no end in sight. The only downside is cumulative real GDP growth since the prior peak is 14%. For comparison, the three other expansions that were in the same timeframe range of expansion length had cumulative real GDP growth of around 50%, 40%, and 35%. Q2 GDP came in at 4.1% which is the highest since the 3rd quarter of 2014 and only the 3rd time over 4% since 2011. Larger paychecks and strong consumer and business sentiment continue to give strength to the economy. There was a surge in consumer spending and business investment during the quarter. Expansion of business and hiring across all sectors are stable or growing.

An item we discuss in each quarterly newsletter is job numbers. It's a statistic that we instinctively correlate to economic growth. As long as more individuals are finding jobs than losing jobs, we expect economic growth to increase given more people are earning wages and will have discretionary income and, as we've covered, 70% of our nations GDP is driven by consumer spending. We maintained the average job growth of 200k during Q2 and avoided increased wage pressure. How are these numbers calculated? Are we missing data? It would seem the probability of continuing to add 200k jobs/month with a quoted unemployment rate at 4% is not sustainable. The only way businesses can hire when the labor market gets this tight is to offer more money, i.e. wage inflation, but we aren't seeing that.

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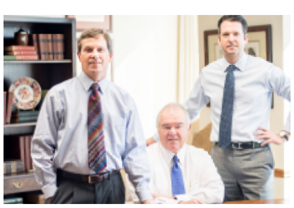
The Concorde Team



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Domestic Economic Overview (continued)

The U-3 unemployment rate comes from a survey of about 60,000 households and that rate is calculated by looking at the labor force (included are people age 16 and older and are not in the military, prison or institutionalized) and if an individual out of that pool had a job or has been looking for a job in the last 4 weeks. Meaning if an individual looked for a job 5 weeks ago but not in the last 4 weeks, they would not be included in the labor force and therefore unaccounted for in the unemployment statistic that always gets quoted. The U-6 rate is a broader measure of unemployment and it includes people that have tried to find a job in the past year but haven't looked in the past 4 weeks. It also includes people that are part time workers and would like a full-time job (considered fully employed in the U-3 rate). In June the U-6 was 8.1% which is obviously much higher than the number that always gets quoted. We deduce that employers are pulling from this broader U-6 labor pool. That is how the U.S. in continuing to add 200k jobs per month and at the same time avoiding wage pressure with a historically low U-3 unemployment rate.

We discuss the trade war/dispute in the International section, but we'd like to add a word about tariffs as they relate to the domestic economy given the daily headlines. From an economic standpoint, there is nothing positive to be gained by adding tariffs on imported goods. Tariffs are passed on to consumers and increase the price of goods which reduce overall spending power by consumers. Tariffs are regressive in their nature. That being said, the current Administration may be making the gamble that short term pain will be better for long term gain. If the Administration can get concessions from the EU/ China/ Canada/ Mexico, they will be good for the U.S. economy. It will make U.S. producers more competitive globally and improve purchasing power for U.S. consumers. The EU, China, Canada and Mexico are by far our largest trading partners and we import more than we export. Meaning the tariff/retaliatory tariffs are much more painful on those countries than on the Domestic U.S. economy. The Administration knows this and is using it to their advantage.

International Economic Overview

In the Q1 letter we discussed the trade war/dispute with China. It started as a tit for tat amount of goods to impose tariffs on until recently President Trump announced $500B worth of goods he could apply tariffs to. Recall, "in 2017, the U.S. goods deficit with China was $375 Billion (they sold us $505 Billion worth and we sold them $130 Billion)". He's basically saying he can apply tariffs to the entire amount of goods the Chinese send to us. One thing to remember about the tariffs is not just their economic purpose but also their strategic purpose. During Q2 Trump sat down with Kim Jong Un of North Korea for nuclear disarmament. The North Koreans will do what China tells them to do and when the trade negotiations started to get a bit bumpy, all of a sudden the North Koreans made some claims about how the U.S. is acting against the agreed terms. This will continue. At some point, however, the Chinese will back down. They have an export economy and their biggest trading partner is the United States. They can ill afford the impact on their economy of reduced trade due to tariffs from the United States. An additional comment we made in the Q1 letter was "The U.S. has also decided to bring its case to the WTO which signals that we are willing to go through normal trade-dispute channels.

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International Economic Overview (continued)

If Europe joins the U.S. via the WTO, then China will have to give in without a major fight." The EU signaled the last week of July that they would join the U.S. in reforming the WTO. This is a positive development in resolving the trade dispute with the Chinese.

During the second quarter the other trade dispute that made headlines was with the European Union. Again, there are trade barriers and subsidies that are in place that impact the United States exports to the EU and President Trump is making headlines in order to get people to the negotiating table. European Commission President Jean-Claude Junker was in the U.S. the last week in July to find some sort of common ground with the United States. The outcome of the meeting was light on details, but the two men agreed that the EU would buy U.S. liquefied natural gas and soybeans (one of our main exports to China) in return for the U.S. pledge not to impose new tariffs on European vehicles. They also agreed to reduce tariffs on industrial goods and, as we said above, cooperate against unfair Chinese trade practices. While we tend to disagree with some of the verbiage and style of the President, in trade he's making progress and starting to get results.

Fixed Income

Domestic bond yields rose modestly during the quarter as progress towards normalization marched forward. As has been the trend since late 2013, shorter term (2-5 year) Treasury yields rose faster than longer term (10-30 year) issues. Total returns on essentially all fixed income aggregate and sector indices except for convertibles (equity oriented) and U.S. high yield were negative for the first half of the year. The 10-year U.S. Treasury Note yield rose above 3.00% briefly in May, the high point in this cycle since lows were hit in mid-2016, however ended the quarter at 2.86%. Stronger economic results and modestly higher core inflation provide fundamental support for this trend. The Federal Reserve also continued its recent pattern by raising the short-term target rate by an additional 25 basis points. This also represents progress towards normalization of policy and may not necessarily be seen as tightening at this point. International sovereign and corporate yields rose varied amounts but most notably in emerging markets and individual countries like Italy where specific concerns surfaced. Looking forward regarding U.S. markets, investment grade and high yield corporate credits have relatively narrow historical spreads to Treasuries but could still generate good current yield and diversification as long as the economy continues at least in a slow growth mode. This segment of the market should be monitored closely, and investors should be in position to adjust holdings downward if either a significant inflation surge or a meaningful economic slowdown (admittedly difficult to detect early) appear to be unfolding. The prospect for higher medium to longer term yields leads to our continued strategy of emphasizing shorter issues, both in corporate and government holdings. Mortgage backed securities, short term revenue-based tax-free bonds and some diversified international exposure also contribute to an appropriate mix that will provide good current income with modest principal risk if/and when yields rise significantly.

Equity Markets

The second quarter was generally positive for U.S. stocks of all styles and capitalizations as strong macroeconomic and corporate results continued to outweigh rising interest rates and concerns over potential global trade disruption in driving investment returns. Smaller cap and growth segments have outperformed this year as has been the case for most of the current bull market beginning in March 2009.

An increasing driver behind the outperformance of large cap and growth-oriented indices is the influence of a handful of very large cap technology and consumer stocks which have an outsized impact with the cap weighted construction of the popular market indexes. Although valuations for this group have risen in recent years even as fundamentals have grown considerably, most of these larger company stocks are not near the extreme valuations seen leading up to the tech/ media/ telecommunications bubble in 1998-2000. However, volatility should be expected for the large high-profile names (see Facebook and Netflix for examples post their Q2 earnings calls).

DOMESTIC EQUITY PERFORMANCE (YTD)			
Capitalization	**Value**	**Blend**	**Growth**
Large	-1.7%	2.6%	7.3%
Mid	-0.2%	2.3%	5.4%
Small	5.4%	7.7%	9.7%
Source: JPM; FactSet; S&P			

DOMESTIC EQUITY PERFORMANCE SINCE MARKET LOW (MARCH 2009)			
Capitalization	**Value**	**Blend**	**Growth**
Large	346.9%	388.6%	448.1%
Mid	456.0%	452.6%	454.4%
Small	407.0%	443.0%	478.6%
Source: JPM; FactSet; S&P			

International markets have lagged in 2018, giving back some of their outperformance in 2016 and 2017. Emerging markets have been particularly hard hit by the rising U.S. dollar and concerns about a potential slowing global economy.

We continue to believe moderate positions in international equities are warranted as valuations are historically attractive and to provide diversification.

2018 YTD	
S&P 500 (U.S. Large Cap)	2.6%
EAFE (Foreign developed markets)	-2.4%
Emerging Markets	-6.5%
Source: JPM	

Valuations for U.S. equities using traditional fundamental metrics such as cash flow, price to book, and earnings multiples, dividend yield and earnings yield spreads are all within reasonable ranges. We continue to hold and find individual equities which fall within the valuation parameters which we find attractive. These holdings and potential new investments trade at discounts to our analysis of intrinsic value using very modest forecasts over the next few years. We believe holding meaningful equity positions are warranted even if bond yields (as an investment competition and the basis for valuation analysis) continue to rise modestly over the next couple of years – another .50% to 1.00% higher.

A Summary of 2018 Tax Changes

The Trump administration's new tax reform bill was signed into law in December of 2017, representing the first major tax change in over 30 years. The changes are significant and are likely to affect nearly everyone in some measure; some positively, while others may find themselves with a higher tax bill in 2018. All of the changes represented in the new tax bill will be in effect through 2025.

The first major change was the reduction of the tax rate in six out of seven tax brackets. Only the 10% tax bracket remains the same. The 15% bracket was reduced to 12%, the 25% bracket reduced to 22%, and the 28% bracket now 24%. For instance, in 2017, a married couple that has $163,000 in income and files jointly would fall into the 28% tax bracket. In 2018, that same income level puts them in the 22% tax bracket; a significant reduction. However, for a single taxpayer who earns $350,000 a year will see their tax rate jump from 33% in 2017 to 35% in 2018.

Most people are talking about the elimination of the personal exemption. While the elimination of the personal exemption is a wash for most singles and married taxpayers without dependents, families with two or more children will likely be paying more taxes. For example, in 2017, a married couple with three children would have a total deduction of $32,950. In 2018, their total deduction will be $24,000, a tax increase of $8,950. Even with the doubling of the child tax credit, from $1,000 to $2,000, their taxes will still be more in 2018 than in 2017.

More taxpayers are eligible for the Child Tax Credit. While some taxpayers will suffer from the demise of the personal exemption if they have children (see above), there is some good news for those with children. The Child Tax Credit has been doubled from $1,000 to $2,000 for qualified children under the age of 17. The new tax bill also expands eligibility for the credit from an income level of $110,000 for married filing jointly taxpayers to $400,000, making a lot more taxpayers eligible for the credit.

Another change for taxpayers with children is the more expansive use of the 529 savings plan. In 2017 and prior years, taxpayers could only use 529 plans for college expenses. The new changes allow parents to use up to $10,000 per year for other levels of education, such as private schools or even tutoring expenses.

Eligible mortgage maximums have been lowered from the current amount of $1 million in mortgage debt to $750,000 for 2018. Though many outlets are reporting that the home equity interest deduction has gone away, the IRS cautions that in many cases, home equity loan interest may still be deductible.

Other changes coming in 2018 include the elimination of deductions for moving expenses, casualty and theft losses, alimony payments, and tax preparation expenses. However, both charitable expenses and medical expense deductions allowed have increased.

With so many changes coming in 2018, now may be the best time to talk with a tax professional about the changes and how they will affect your tax situation going forward.