Investor Insights & Outlook

January 2019 4th Quarter Concorde Investment Management

Domestic Economic Overview

A Message from Concorde Investment Management

Last quarter we rolled out a new client access portal and app for your phone or tablet and we hope you are enjoying. We are doing our best to provide our clients with an improved and more transparent view and welcome any feedback or suggestions you have with using the portal or app. Please contact us if you need any assistance using the new portal or app.

As we write about the performance of the economy during the 4th quarter it is important to remember that equity markets are leading indicators and sometimes they are wrong and sometimes they are correct. "The stock market has predicted nine of the past five recessions" -a joke from master Keynesian of decades ago Paul Samuelson. As we mention in the equity markets section, there is anticipation of slowing economic growth during 2019 in the U.S. driven by slowing in Europe and China in tandem with fears that trade negotiations won't be solved. However, the performance of the U.S. economy during Q4 continued with strong overall growth. We won't have actual numbers given the current government shutdown however we will provide indications of performance.

One positive development for the consumer that took place during the 4th quarter was oil prices collapsed from mid $70's to mid $40s. While there are lots of opinions and discussion about why prices dropped, there is no debate that lower oil prices are good for the U.S. consumer, which as our clients know, accounts for over 68% of Gross Domestic Product. When consumers spend less on gasoline, they have more money to spend elsewhere.

The charts we review regarding consumer finances, cyclical sectors such as residential investment, business investment, wage growth, and unemployment are all strong. Wage growth specifically picked up during the 4th quarter at 3.3%. This growth percentage is the highest since 2009 however still below the 50-year average of 4.1%. Wage growth is exactly what we've been looking for in order to improve the economy and lives of our citizens however with wage growth we can get

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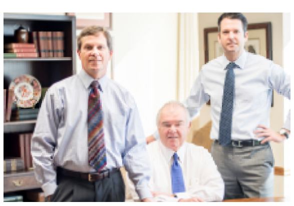
The Concorde Team



CONCORDE

Concorde Investment Management

A Registered Investment Advisory Firm

(972)701-5400
www.concordeco.com

Gary B. Wood, Ph.D.
President

Greg B. Wood
Vice President

John A. Stetter
Principal, Sr. Portfolio Manager

Barbie E. Spicer
Dir. of Portfolio Administration

Marisa A. Parrott
Office Manager

Domestic Economic Overview (continued)

inflation, which is one of the dual mandates to control by the Federal Reserve. They control inflation by turning the interest rate dials which in turn can slow the economy. Curiously, after raising rates again during December, they have since announced a more prudent review of the economy prior to raising rates again. Perhaps they realized that headline consumer price inflation, core consumer price inflation, food inflation, and energy inflation are all .7% to 2.6% below their 50-year averages.

We continue to be concerned over government expenditures with the 2019 federal budget baseline forecast showing a $981 billion-dollar deficit with interest payments accounting for 9% of the government's total spending. Revenues to the government in the form of tax receipts are increasing however not as fast as the government is spending money. Unfortunately, there is no political will or appetite to get spending under control.

International Economic Overview

Tariff impacts related to China finally got President Xi and President Trump to agree to a pause during Q4. The two leaders agreed to a 90 day trade truce during December and President Trump indicated that it could be extended as long as trade talks are continuing to progress. This is good news and may be playing into a possible future outcome that the Chinese are starting to consider. Recently, a French diplomat mentioned that the U.S. retreat from global activities did not begin with Trump and some of the possible Democrat candidates for President in 2020 share the same views. The Chinese may be thinking it is better to deal with the devil you know rather than the one you don't.

We discussed slowing global economic growth in our Q3 letter. During Q4, Japan, the Eurozone, and emerging markets all surprised to the downside relative to market expectations. Manufacturing momentum is slowing across the board with specific slowdowns according to the global purchasing managers' index for manufacturing in China and Taiwan. China slipped into a growth recession late in the year and they will combat it with policy-easing measures. This is a departure from their historical responses to a slowing economy when they would command infrastructure spending combined with monetary stimulus. The effects of tax cuts are slower than infrastructure spending. Last May the government cut value added taxes for multiple industries and cut personal income taxes and added deductions. Earlier in January of 2019, the State council announced tax cuts for small companies. The Chinese are over leveraged so tax cuts are more palatable than debt spending on infrastructure. These actions combined with a trade deal with the U.S. could ease any of the restrictions on Chinese economic growth which is critical to any export economies in the region.

Italy's debt issues began to reappear in the 4th quarter which should've been expected. No doubt our readers remember us discussing the PIIGS (Portugal, Italy, Ireland, Greece, and Spain) debt issues earlier this decade. No fundamental changes were made to how the countries operated and the European Central Bank began buying government and corporate debt, which essentially kicked the can down the road. Now that the ECB is beginning to slow their purchases and eventually begin unwinding, expectations for Eurozone economic growth are subdued.

Fixed Income

Credit markets participated in the volatile financial environment during the quarter, however the direction of yields and prices varied according to quality. U.S. 10-year Treasury notes held steady in October but rallied in price through year end as yields fell when they enjoyed their traditional attraction as a flight to quality asset was reinforced. Yields on the 10 year fell from 3.2% in early November (highest level since 2011) to 2.7% at year end. Corporate yields rose, especially for lower rated issues, as concerns over slowing growth and worse created selling pressure. (Note: When we mention that corporate yield spreads are widening, that is short hand for explaining that investors think corporate debt is becoming more risky relative to government debt. It is an early warning indication that economic active *could* be slowing.)

Corporate yield spreads to Treasuries had already been widening gradually since early February going into the quarter. Despite these changes from what were widely regarded as expensive valuations early in 2018, corporate yields are just now reaching historical averages. (See table below). Regarding Treasury yields, despite the drop during Q4, 5 and 10 year note yields were still around 30 basis points (0.30%) higher than at 12/31/17 as the normalization of rates from the suppressed levels spurred by the credit crisis and recession continues.

Internationally, except for Japan, most developed and emerging market aggregate indices produced negative total returns as sovereign yields were generally little changed and corporate yields rose reflecting slowing growth and the risk to leveraged companies that could follow. European high yield returns were one of the worst sectors globally as yields rose about 2.00% to a level of 5.33% during calendar 2018, producing a total return loss of greater than 8.00%.

Regarding current investment strategy, we sold our modest U.S. high yield position early in the quarter as weakness accelerated. We continue to hold shorter-term high-quality corporates, short to medium term Treasury and Agency notes and a position in agency and non-agency mortgage backed securities for core fixed income exposure. In addition, an allocation to very short tax-free issues with unusual structures and high debt service coverage is attractive for certain client scenarios in order to provide superior after-tax income and stability. We expect this current mix within fixed income to provide higher income and continued ballast going forward. We are not ready to either extend maturities of government holdings or add meaningfully to corporate allocations until either yields appear fully normalized or corporate spreads and yields become even more compelling.

U.S. Corporate Bonds	Spreads at Year-End		
Rating	**12/31/2018**	**12/31/2017**	**12/31/2016**
AA	83	36	110
BB	350	192	319
B	560	341	419
Basis point spreads to U.S. Treasuries (10 year)			
(83 = 0.83%)			Source: Income Securities Investor

Equity Markets

Domestic and international equities highlighted the brunt of the accelerating "risk-off" environment for securities markets in the fourth quarter. In percentage terms, the large U.S. indices dropped between the low to upper teens, similar to most western European markets. However, performance in most of the international markets had been very weak year to date entering October, resulting in even larger annual losses. Despite the early year and fourth quarter swoons, the S&P 500 index, a proxy for large cap U.S. equities, had a 4.4% loss for the year. The Russell 2000 index, representing the typically more volatile small cap universe, fell 11.0%. Although the intense market swings left a strong impression with the year-end selloff, the level of volatility for 2018 was only slightly above the average for the last 50 years (Source: PIMCO; BLOOMBERG). Volatility for 2017 had been among the lowest for this time frame, likely adding to market stress as a result of this stark contrast. Sectors which appear to have particularly broad risk reward appeal at the current lower levels include media, financials, energy and industrials.

The drivers that many investors appeared to be blaming for the year end weakness include the anticipation of slowing growth in 2019 spurred by observed slowing in Europe and China, fears of additional uncertainty from protracted trade negotiations, and the risk of a potentially overly aggressive monetary policy by the Federal Reserve. Fundamental economic statistics are generally still strong (see December labor report) and recent Fed statements appear to exhibit a growing sensitivity to the real and psychological impact of their policy changes, both of which seem to make the projections of a possible recession during 2019 premature. Many market strategists have commented that the biggest risk to spurring a recession in the near term might just be the negative impact on consumer and business confidence from an extended period of instability in the credit and equity markets.

Regarding valuations and investing prospects at this point, broadly speaking domestic equities at year end appear to be pricing in no growth for 2019, assuming interest rates remain close to current levels. This scenario lies between the current majority opinion of lower GDP and earnings growth for the new year and the new mantra of potential recession later in the year. Although we are likely in the later stages of this lengthy expansion, the risk of a recession (contraction of GDP) seems fairly low for 2019. Traditional causes of recessions in the post war period, monetary tightening to slow inflation in a heated economy or credit market stress caused by weak financial institutions, both appear unlikely in the short term. With this backdrop, along with the fact that many individual equities and some sectors have sold off more than the index percentages discussed above (materials -14.7%, industrials -13.3%, energy -18.1%), our observation is that there are a reasonable number of attractive individual investments to be held or purchased at year end valuations. Many could be good long-term holdings even if a moderate recession were to occur in the next couple of years as a result of recent price reductions. However, if a weaker economy than expected does surface later in 2019 or 2020, the markets will likely anticipate this and incur another downward leg of some magnitude. Our stance as long-term value-oriented investors is to be even more selective at this stage, knowing that extreme market timing is difficult and realizing that there are always some attractive relative positions even during bear markets. Long term asset allocations should also be monitored closely to avoid over exposure to risk assets. Consideration of strategic alternatives with lower market correlations and strategic fixed income allocations can also help buffer the volatile nature of the rewarding long-term profile of equities.

Donation Details

Source: Advisors Websites

Donating money to our favorite charitable organization is a year-end ritual for many of us. While monthly giving has gained in popularity in recent years, most of us still tend to open up our wallets just a bit wider at the end of the year.

But what about the organization that we're giving to? What are they required to do once they receive our donation? If you're unsure, here's a quick run-down of what you should expect.

For a standard donation, you should expect a receipt. While a charitable organization is not required to provide a receipt to donors unless the donation exceeds $250.00, most organizations do so anyway. Those that do not send a receipt will typically send a donation acknowledgement. In a pinch, donors can always use their cancelled check as a receipt should the organization not provide one.

A valuation of any items you may have received in exchange for your donation. Most receipts from a nonprofit organization typically include a disclaimer that states that you did not receive any goods or services in return for your donation. That means that if you are using your donation as a tax deduction, the amount of your deduction is the amount on the receipt. However, this process changes if in fact you do receive something in exchange for your donation. In that case, the acknowledgement letter must state the value of what was received and the subsequent value of your donation. Keep in mind that if you receive something relatively small in return such as a t-shirt or other small items, this cost is not filtered into the equation and your entire donation will remain tax deductible. However, should you receive something like tickets to a gala, a trip, or other similarly priced gifts, that will have to be acknowledged and factored into your donation total. The IRS has detailed information on their website, should you have any questions regarding this.

Goods and services donated should receive an acknowledgement, but should not include a dollar amount. Goods and services are common donations, and the organization that you are donating to should provide you with an acknowledgement letter that details what the goods and/or services donated were. The main difference between a monetary donation and goods and services is that goods and services donations should not include a dollar value on the acknowledgement or receipt. Assigning a value is the donor's responsibility. You should also keep in mind that services donated are typically not tax deductible.

Of course, writing a check or donating goods and services isn't the only way we can give to our favorite organization. Many nonprofits are able to accept alternative options such as donations of stocks and other securities. If you want to donate stocks instead of cash, be sure that you've held the stock for at least a year. It's also important that the donated stock has increased in value, which will ensure that you receive a tax break while supporting the organization. If you do donate stock, the nonprofit should provide you with an acknowledgement or receipt that provides details on the stock given as well as the number of shares, but should not place a value on the stock. If you have additional questions, your financial advisor or CPA should be able to guide you in the right direction.