Argent Capital Management LLC

Market Overview – September 2019

For months I have been saying that economically sensitive, or cyclical, stocks have been trading at a steep discount to more stable, defensive stocks. As examples, think of the difference between an appliance manufacturer or a home builder versus a food distributor or soap manufacturer. The former would fall into the ‘cyclical’ bucket, the latter into the ‘defensive.’ Most likely, you would not buy a new home were you worried about your job. Similarly, you would not likely take an extra three or four showers in a day were you to feel suddenly enthused about the economy.

In September, we saw the spread between cyclical stocks and defensive stocks narrow. To be sure, as the chart below indicates, the valuation difference between the two still has a long way to go. But there was an upward tilt, favoring more economically sensitive companies.

Much of the recent economic data has been weaker, especially outside of the United States. The destabilizing political backdrop within our country and the continued, and at times escalating, trade disputes with significant trading partners outside the U.S. furthers that unease. However, given the low valuation of cyclical companies, especially relative to defensive companies, we are of the opinion that investors are overly pessimistic about the economy going forward. The U.S. economy could slip into a recession in 2020 but that outcome is far from certain. Our investment process is designed to highlight discrepancies in the *relative* valuation of individual companies, industries and sectors. We have been asked many times over the course several months what will make the markets reconnect and bring valuations of cyclical companies more in-line with their defensive peers. The simple answer is that we do not know why the spread between cyclicals and defensives began to narrow in September or if it will continue. Instead, what we come back to is market history, that valuations normalize over time and probabilities, that extremes narrow over time. The current situation is reminiscent of the late 2008 – early 2009 period when all stocks were inexpensive, and investors kept looking for *the spark*. It was during that period that we purchased Alphabet, Inc. (Google) and Mastercard Incorporated for our clients, two great companies that we continue to hold. We are optimistic that our portfolio today holds gems that will be realized fully ten years up the road, as Google and Mastercard have been.

So we will keep watching the valuation spread between cyclical companies and their defensive peers and invest accordingly. We have four successful equity strategies – Large Cap, Small Cap, Dividend Select and Mid Cap. If you have questions on any of these options, please call us.

Sincerely,

Ken Crawford
Senior Portfolio Manager

Past performance is no guarantee of future results. Views expressed herein represent the opinion of the portfolio manager as of the date above and are subject to change. The information provided in this report should not be considered a recommendation to purchase or sell any particular security. You should not assume that investments in any securities within these sectors were or will be profitable. A list of stocks recommended by Argent in the past year is available upon request.