**Investment Commentary** **October 2019**

Historically high employment rates across all demographics and a tamed inflation picture form the backdrop to our currently robust economy. Despite what some media outlets would have you believe, The Economy is in good shape. Wages are rising and the consumer is healthy and confident.

Rates are low, plus the Federal Reserve has now embarked on balance sheet additions through massive purchases of three month Treasury bills. The Federal Reserve cut the Fed Funds rate twice during the third quarter, each time by ¼ of 1%, on July 31st and on September 18th. The Federal Reserve is expected to drop the Fed Funds rate one more time when they meet next on October 30th. There is an 90.4% chance, based on implied probabilty, that at that time they will drop rates to a range of 1.5% to 1.75%.

Corporate earnings are surprising to the upside. More people are working, so more people are earning, so more people are spending and so consequently more people are paying taxes too. This scenario does not appear to be heading towards a recession any time soon. After all, consumer spending represents roughly 2/3rds of our total GDP.

A couple of economic indicators have raised warning flags, such as a small decline in the Leading Economic Indicators in October (down 0.1% versus an expectation of flat) and some softening of certain manufacturing segments of the economy. General Motors continues to carry on a strike which, while it is headline grabbing, has had no demonstrable impact on the overall manufacturing landscape.

Factories are humming. The October Richmond Fed Manufacturing Index came in at a reading of +8 versus an estimate of -7. The Oct. 22nd report showed Shipments rose, New Order volume increased, Order backlogs rose and Capacity Utilization increased. The Richmond Fed Manufacturing Index surveys manufacturers in the Carolinas, Washington D.C., Mayland, Virginia and West Virginia. This District accounts for 9.1% of the nation's gross domestic product.

## Consumer Price Index

September consumer prices were flat, relative to a slight rise that was anticipated, according to the Labor Department report that was released on October 10th.

Energy prices fell 1.4% month over month, as gasoline declined 2.4%. Electricity prices were flat for the month and Utility Gas service prices declined 0.7%.

The food component of the CPI increased 0.1% after being unchanged in each of the prior three months. Prices for cereals and bakery products rose 0.5%. Meat, poultry and egg prices rose 0.3% and dairy and related products increased 0.2%. Meanwhile, the cost for fruits and vegetables dropped by 1% in September.

The headline CPI rose 1.7% in September versus an estimated rise of 1.8% based on a survey of seventy economists. The "Core" CPI, which excludes energy and food prices, was up 2.4%.

The weaker than expected CPI numbers reflect a 1.6% monthly drop in used car prices, while new car prices fell 0.1%. Apparel prices decreased 0.4%, marking the first drop since April. Shelter, which makes up about a third of the total CPI, rose 0.3% in September. Owners-equivalent rent (rental prices) increased 0.3%. Prices for medical services rose 0.2% and health insurance costs rose 1.4%, while prices for prescription drugs actually dropped 0.5% in September.

The following chart will give you an idea of the current Low inflation environment as seen in the total Consumer Price Index and also in price increases excluding food and energy (Core CPI) through September of 2019, relative to historical readings of Inflation going back to 1997:

| | | | | |
|---|---|---|---|---|
| July 2019 | CPI | 1.8% | CPI Core | 2.2% |
| August 2019 | CPI | 1.7% | CPI Core | 2.4% |
| September 2019 | CPI | 1.7% | CPI Core | 2.4% |

| | CPI | CPI Core | | CPI | CPI Core |
|---|---|---|---|---|---|
| 2018 | 1.9% | 2.2% | 2007 | 4.1% | 2.4% |
| 2017 | 2.1% | 1.8% | 2006 | 2.5% | 2.6% |
| 2016 | 2.1% | 2.2% | 2005 | 3.4% | 2.2% |
| 2015 | 0.7% | 2.1% | 2004 | 3.3% | 2.2% |
| 2014 | 0.8% | 1.6% | 2003 | 1.9% | 1.1% |
| 2013 | 1.5% | 1.7% | 2002 | 2.4% | 1.9% |
| 2012 | 1.7% | 1.9% | 2001 | 1.6% | 2.7% |
| 2011 | 3.0% | 2.2% | 2000 | 3.4% | 2.6% |
| 2010 | 1.5% | 0.8% | 1999 | 2.7% | 1.9% |
| 2009 | 2.7% | 1.8% | 1998 | 1.6% | 2.4% |
| 2008 | 0.1% | 1.8% | 1997 | 1.7% | 2.2% |

**Consumer Sentiment Rises**

U.S. consumer sentiment showed a surprise jump in October, rising to a three month high. The increase underscores that the American consumer continues to expect rising incomes coupled with lower inflation. Within the report, issued by the University of Michigan on October 11th, Inflation expectations over the next five to ten years dropped to 2.2%. This is the lowest level in records dating back to 1979. Consumer outlook of inflation-adjusted incomes also increased to the "most favorable level in two decades" the report showed.

The report showed a measure of buying conditions for big ticket durable goods increased to a four month high of 160. Also, a gauge of current personal finances increased to a seven month high of 135, up from 131. The report also contains a measure of expectations concerning the Unemployment rate, which currently stands at 3.5% (the lowest level in over 50 years). That gauge showed that two-thirds of consumers expect the Unemployment rate to stay the same or to drop even further.

Interestingly, the report showed a widening gap between consumer expectations based on political party. Republicans are growing more confident in the economy while Democrats' sentiment is the lowest since October of 2008, back in the throes of the Financial Crisis. Overall, the report said, "The impeachment inquiry has not had a significant negative impact on economic prospects."

**Labor Department Expands Overtime Pay Threshold**

The Trump administration has issued a rule that will make overtime pay available to 1.3 million additional workers. On September 24th, the Labor Department said that it would raise the maximum salary level under which companies will have to pay workers for overtime to $35,308 per year, up from the current cap of $23,660. Workers earning less than $35,308 per year will now be eligible to receive overtime pay for any work over 40 hours per week.

The new rule will be specially helpful to lower level managers who often put in well over 40 hours per week. The new rule is expected to benefit retail managers, restaurant managers and home healthcare workers the most. The previous cap of $23,660 had been in place since 2004.

**Workers Are Making More**

A Labor Department Report issued on October 10th showed that real average hourly earnings rose 1.2% in September, following a 1.4% increase in August. Average weekly earnings were $966.30, up from $941.85 in September a year ago. Earnings for those aged 25 – 54, in their prime earning years, rose by 5%. That is the fastest growth for that age demographic since 2001. Full time wages gains were strongest for minorities. For Latinos they rose 9.1%, for Blacks they were up 9.5% and for Asians wage gains were up 10.8%.

There was also good news for the retired worker, who will now be "earning" more. An official Social Security cost-of-living adjustment will be 1.6%, taking effect next year. That number is based on the annual change in a Q3 measure of consumer prices.

**Corporate Earnings Beating Estimates at a Higher Rate**

More companies have beaten their earnings estimates than did a year ago, with 82% of the Standard and Poor's 500 companies that have reported through October 22nd exceeding their analysts EPS estimates. So far, 82% have beaten, 4% have matched and 14% have missed their EPS estimates. These blossoming earnings are consistent through all sectors of the economy, as seen in the following table:

| | EPS Beat | EPS Met | EPS Miss |
|---|---|---|---|
| Communications | 100% | 0% | 0% |
| Consumer Discretionary | 81% | 0% | 19% |
| Consumer Staples | 75% | 8% | 17% |
| Financials | 80% | 3% | 17% |
| Health Care | 86% | 14% | 0% |
| Industrials | 79% | 0% | 21% |
| Materials | 100% | 0% | 0% |
| Technology | 88% | 12% | 0% |
| Utilities | 100% | 0% | 0% |

Although we still have a ways to go through Q3 earnings season, with only about 95 of the 500 having reported so far, some earnings highlights from some of the larger holdings in the Old Point Trust Standard Account Composite for Q3 include:

| | Earnings/sh | EPS estimate | % Beat |
|---|---|---|---|
| Accenture (ACN) | 1.740 | 1.713 | 1.58% |
| BB&T (BBT) | 1.035 | 1.031 | 3.78% |
| Johnson & Johnson (JNJ) | 2.120 | 2.009 | 5.53% |
| Lockheed Martin (LMT) | 5.660 | 5.022 | 12.70% |
| NextEra Energy (NEE) | 2.393 | 2.289 | 4.41% |
| PepsiCo (PEP) | 1.555 | 1.507 | 3.52% |
| Proctor & Gamble (PG) | 1.368 | 1.241 | 10.39% |
| United Technology (UTX) | 2.210 | 2.034 | 8.65% |

## An Indian Tax Cut

India's government instituted a $20 billion tax cut on September 20th, taking their corporate tax rate down to one of the lowest rates in Asia. Domestic Indian companies will now pay 22% on their income from April 1st, 2019. Previously the Indian corporate tax rate was 30%. New businesses formed after October 1st will be subject to a 15% corporate tax rate. (That brings the rate down to match the corporate tax rate in Singapore.)

The move was meant to work first as an economic stimulus to the Indian economy. Secondarily, but no less importantly, it was instituted to attract more foreign direct investment into India as Asian economies compete with each other to lure companies looking for alternative manufacturing locations to China.

## Green Bonds Grow in Popularity

Companies are financing their environmentally friendly initiatives through the issuance of what are being referred to as "Green" bonds – bonds where the proceeds are earmarked for specific projects related to energy efficiency, reduced emissions and the like.

Green bonds are a small but growing fraction of the $5.8 trillion U.S. Investment Grade corporate bond market. Over $120 billion worth of Green bonds were issued in the first half of 2019. That's up from $85 billion that were issued in the last six months of 2018, according to Bloomberg. The Environmental Bond data base puts the total world-wide value of outstanding "Green" bonds at $701.02 billion as of October 17th, 2019.

Verizon, the largest U.S. wireless carrier, first issued a "Green" bond in February of this year. The $1 billion issuance was eight times over-subscribed within six hours of offering, allowing the company to gain a pricing advantage that it did not anticipate. The company says that 92% of its emissions are from electricity powering networks and most of the proceeds from the bond were allocated to procure renewable energy purchase agreements. The remaining proceeds were earmarked for "green" buildings and efficiency investments converting transmission lines from copper to fiber-optic.

PepsiCo joined in the move to make "Green" bonds more mainstream when they brought a $1 billion issuance to market on October 7th. Pepsi plans to invest the proceeds in sustainable development goals, including eco-friendly plastics and packaging and to develop "cleaner" modes of transportation associated with the distribution of their product.

**Dominion's Offshore Wind Project**

Dominion Energy announced plans to build the largest offshore wind project in the U.S. 27 miles off the coast of Virginia Beach, according to a proposal the company released on September 19th. The proposal includes more than 2,600 megawatts of wind energy production by 2026. When completed, the project would include more than 220 wind turbines producing enough energy to power 650,000 homes. If approved, the project would be located in the 112,800 acres that Dominion is currently leasing from the Bureau of Ocean Energy Management.

From the Dominion's press release, "Dominion Energy is aggressively pursuing a clean energy future anchored by a 55 percent reduction in carbon emissions by 2030. To accomplish this goal, the company is investing in solar and wind energy partnered with zero-carbon nuclear and low-carbon natural gas. The company also has planned investments in battery storage, pumped hydroelectric storage and other resources that can support the intermittent nature of solar and wind."

**Crawling Ivy**

The fiscal year performance for Ivy League school Endowments has been less than exceptional. In fact, you could even call it creepy. Following is a list of the eight Ivy League Schools reporting their annual performance through June 30th:

| | |
|---|---|
| Brown | 12.4% |
| Dartmouth | 7.5% |
| U Pennsylvania | 6.5% |
| Harvard | 6.5% |
| Princeton | 6.2% |
| Yale | 5.7% |
| Cornell | 5.3% |
| Columbia | 3.8% |

And it was not just the Ivies that were creeping and crawling, other fine Institutions of Higher Learning also put in sub-par performances. Duke clocked in with a 6.9% return and Stanford trailed them with a 6.5 % return. The University of Virginia's Long Term Pool generated a return of 5.8%.

By comparison, for the year ending June 30th, 2019, the S&P 500 returned 10.4%. The Old Point Trust Standard Account Composite equities returned 10.9%.

For the Third Quarter, The Old Point Trust Standard Account Composite equities returned 3.6% versus and S&P 500 return of 1.7%.

Year to date, The Old Point Trust Standard Account Composite equities returned 20.9% versus the S&P 500 return of 20.6%.

For the Trailing Twelve months, The Old Point Trust Standard Account Composite equities returned 6.8% versus the S&P 500 return of 4.2%.

**Thank You**

On behalf of all of us at Old Point Trust, I would like to extend our sincere thanks for the confidence you have placed in our firm over the past year. We fully recognize the importance of the responsibilities you have entrusted to us and we are committed to the continued success of our partnership.

**McKim Williams, Jr.**
Chief Investment Officer
October 22nd, 2019