Spring
2018

Spreng Capital Management Inc.

Spreng Capital Management is an investment advisory firm with the Securities and Exchange Commission. Founded in 1999 by James Spreng, Spreng Capital has grown to encompass the very best in service and support for our clients.

Our client base is quite diverse. With clients in 23 states, we offer structured, customized investment management for individuals, profit sharing plans, Foundations, endowments and businesses. We are fee only investment managers, receiving no commissions nor do we sell any financial products. We are paid only by the investment management fees of our clients. We advise our clients on financial planning and manage their assets, making recommendations based entirely upon our clients' needs and goals. Everyone on the Spreng Capital team has a vested interest in the success of our clients' portfolios. Our team has a unique blend of experience, youth and business credentials.

Our use of high quality stocks and mutual funds along with investment grade bonds, allows us the opportunity to deliver consistent long term returns. We focus on minimizing risk and volatility, striving ultimately to deliver the very best after-tax returns possible, within the constraints you have established.

There is nothing that signals success more than referrals from existing clients. Our success is a result of our clients' continued confidence in us and their willingness to recommend us to their family and friends.

"It depends upon what the meaning of the word "is" is."
President Bill Clinton

"Mission Accomplished"
President George W. Bush

"If you like your doctor you can keep your doctor."
President Barack Obama

"Trade wars are good, and easy to win"
President Donald Trump

Oh, for the good old days of Presidential politics before audio and video tapes that preserve all a President's quotes for posterity. Prior to the ability to pull up a tape and repeat the President's words verbatim, a President could always claim to have been misquoted, misunderstood or that his words had been taken out of context. Those days are long gone. Now the archives can pull up a tape from long ago or very recently and a President can be pummeled by his own words. You will note that we did not pick on any one President or political party. There are enough gaffes to go around no matter the subject matter or the political persuasion of the President.

	Quarter
DJIA	(2.49%)
NASDAQ	2.32%
S&P 500	(1.22%)

The latest revelation was President Trump's attack on global trade by imposing tariffs on steel and aluminum to benefit US producers in the name of national security. Immediately, there were "carve outs" for steel and aluminum producers that were deemed to be friends of the US like Canada, Mexico and the European Union. This simply means that these countries will be exempted from the tariffs which squarely puts China and to some degree, Russia, in the tariff crosshairs. President Trump followed this up by imposing $60 billion in tariffs directly on China at which point in time the US stock markets trembled with trepidation and gave up $1.8 ***trillion*** of value in just a few days of trading according to Wilshire Associates. After it was disclosed over the weekend by the Wall Street Journal that China and the US were negotiating over trade issues, the market snapped back on Monday March 26th and recovered some of the previous losses attributed to the tariffs only to falter again on the next day.

Historically, tariffs have always been bad for consumers. The Smoot-Harley tariff act of 1930 is widely believed to have been the ultimate driver of the Great Depression. The act raised US tariffs on over 20,000 imported goods. It is important to understand that the fact is that, by definition, ***all*** tariffs are inflationary. Tariffs increase the cost of goods imported by whatever the amount of the tariff, no matter how small or large the tariff. If steel tariffs are 25% then any steel imported from

any country that is affected by the tariffs will cost 25% more. Tariffs also limit supply which is inflationary and drives up prices too. If there is a tariff placed on steel, not only does it cost more for imported steel, but because of the tariff, less steel is sold to the country with the tariffs. Economies hate inflation! Think of the 1930s in Germany and Venezuela in 2018. It took 1 ***billion*** German marks to buy 1 stamp to mail an envelope to relatives in the United States at the height of Germany's hyperinflation during the Great Depression. Inflation is not necessarily good for an overall economy.

To be fair, this is exactly the platform on which President Trump campaigned. He said repeatedly that all trade pacts have been bad for US jobs and he was going to renegotiate all of them. Were his steel and aluminum tariffs, then the carving out of Mexico and Canada, just ploys to get them to renegotiate NAFTA on more favorable terms for the US? Will they fear that they might have the metals tariffs imposed on them if they are not more pliable in negotiations? Just for context, the US exported more to Canada in 2017, $282 billion, than the combined amount to China, $130 billion, Japan, $68 billion, and the United Kingdom, $56 billion. My only comment is that trade wars are called wars for good reason and are not always easy to win.

The agricultural sector could be decimated by a trade war with China every bit as badly as it was by then President Jimmy Carter's grain embargo and the Olympic embargo on the Soviet Union in 1980 for their invasion of Afghanistan. By using grain as a weapon, the rest of the importing nations of the world deemed the US as unreliable for such an important import such as food. It took a whole generation to overcome the damage done to the agricultural sector by one embargo of one country. If China wants to send a message, they will slap tariffs on US soybean exports to China and buy more from Brazil. The US shipped 30 million tons of soybeans to China last year. Of every bushel of soybeans that you see in the fields in the summer, 1 out of every three bushels produced could be affected. According to the American Farm Bureau, $21 billion or 20% of all agricultural products are exported to China. Of the 9 largest soybean producing states in the United States, 8 of them voted for President Trump, only Minnesota voted for Hillary Clinton. If we know this, China knows this and a grain embargo on US grains and shipments of pork to China would most definitely affect President Trump's political base very adversely. So when we blithely say that trade wars are good and easy to win, the facts have historically said otherwise. Can President Trump be the "Great Negotiator in Chief" and leverage up a few tariffs and threats to implement more meaningful trade reform? Possibly. Without question, the world needs the US market. But let's not kid ourselves, the world needs China's 1 billion plus consumers too. The US population makes up just ***4.4%*** of the world's total population as of January 1, 2018. Granted, we are the wealthiest nation in the world and our poorest residents live better than the vast majority of the entire world's population. The growth of trade will be in providing goods and services to the populations of Africa, China and India. For a company or a country to ignore demographics would be a huge mistake.

Markets hate uncertainty. Chief Economist Liz Ann Sonders from Charles Schwab has labeled this latest market kerfuffle as a "tariffs tantrum" led by the uncertainty of China's, and the rest of the trading world's, reaction to these tariffs. Will this tariff spat turn into a trade war? Will behind the scenes negotiations minimize the damage? Will there be more carve outs or horse trading on specific industries? China has been very measured in their response so far but then again, these tariffs against China do not go into effect for 30 days. They have put forth a list of 128 products produced in the US upon which they will retaliate with tariffs of their own.

Total world trade has more than ***quadrupled*** since 1990. Union Pacific, a large railroad operating primarily in the Western part of the United States, has said that 40% of all the goods that it transports in the US have touched an international border at some point of their journey. In 1999, the railroad company had revenues of $700 million from goods going to Mexico. In 2018, less than 20 years, it has grown to $2.2 ***billion***. Few would argue that, since China's inclusion into the World Trade Organization or WTO in 2001, China has been waging a stealth war against the US on trade for many years. President Trump's election was partly fueled by this with American workers' feelings of disenfranchisement due to globalization. Poorer job opportunities and declining real incomes have led to voters demanding to be heard. Tariffs may not be the best answer. President Bush imposed tariffs on steel as recently as 2002 which ranged from 8-30%. The resulting increase in steel prices eventually led to the lay-off of over 200,000 workers who worked in industries that depended upon steel. There are currently 400,000 workers that work in steel or aluminum production. There are 6 million workers employed by industries that use these two metals as raw inputs in their industries. This is a 1 to 15 ratio of workers who will directly benefit from the metals tariffs to those that are exposed to higher input costs and at risk of possible layoffs.

"More than 1 in 3 Americans reportedly spent more on coffee last year than they invested."

Back to the discussion on inflation. The markets showed their aversion to inflation in the first 7 trading days in February. The wage growth for all workers in the US was reported the end of January. It was higher than expected, simply meaning that workers were actually getting paid more for work rendered. What a novel idea! The markets hated this specter of higher input costs due to the higher wages and sold off over 7%, taking away all of the gains of the previous month in just a little over a week. What was particularly disconcerting to investors was just how quickly stocks sold off. Stocks actually sold off over 10% before recovering some at the end of that week. This was reportedly the fastest 10% sell-off in the history of the stock markets. Why such an abrupt sell-off? It is a direct result of computerized stock trading. Large brokerage houses and banks have migrated to high frequency trading driven by mathematical algorithms that allow them to make gains of partial cents on trades of millions of shares at a time by high speed computers. Partial cents of profit per share doesn't sound like much profit but multiply this by millions of shares bought or sold at one time, then do the same trade multiple times a day and it all adds up. These firms actually locate their trading computers physically close to the trading exchange computers so that their electrons have less distance to travel at the speed of light than their competitors! Welcome to the 21st Century. Investors found out how painful computerized trading can be as sell-offs accelerated in the final hour of trading each day as the computers always kick in at the end of the day.

Individual investors also are somewhat to blame for the rapid selloff in early February. 50 years ago no one had access to trading investments on their own. You had to call a broker to request a buy or sell. The broker might try to talk an investor out of a particularly rash move or at least slow down the process. People also owned individual stocks much more than mutual funds, ETFs or index funds which are now the rage. There was personal attachment to owning IBM or DuPont shares. Now the mutual funds, index funds and ETFs are much more impersonal. An investor is much more cold and calculating without any emotions at play. This is probably a good thing to not "fall in love with a holding" but when sell-offs begin that emotional detachment can certainly exacerbate the pain.

Volatility has returned to the stock markets. 2017 was the abnormal year. We never had a drop of 3% in any trading day in 2017. That was very unusual and an aberration. Stocks are always more volatile as an investment. We have always told our clients that every investment has volatility, even prices of your house or farm land. It is just that the parabolic curve of volatility for houses or land is much more gradual and subdued than the stock market with instantaneous quotes and reactions to news, both good news and bad.

Volatility is a reaction, many times, to fear or greed. Often times our fears get the better of us and we overreact. People fear sharks. In 2015 only 6 people were killed by sharks in the entire world. 500 people were killed by hippopotamus attacks and the largest number were 830,000 deaths attributed to the tiny mosquito. Perspective is always needed in evaluating risk. We thought that the sell-off in early February was ridiculous based upon the fact that consumers were receiving more money in their take home pay to purchase items. Isn't that what capitalism should be, everyone benefitting from the good times? A few final interesting numbers trying to quantify risk. From 1926 to 2017 which is 91 years of data, an investor had a 54% chance of having a positive rate of return on any given 1 day time interval in the market. An investor investing for 3 months had a 68% chance of positive returns. If you have a one year time frame you have a 74% risk of generating a positive return. If you lengthen it out to 5 years your chances of a positive outcome rise to 86%, ten years rises to a 94% chance of a successful investment. In every single 20 year rolling period over the last 91 years, there has been a 100% chance that you would have made a positive rate of return in the S&P 500. Perspective, another of the lost virtues in today's world.

The Federal Reserve raised interest rates by another 0.25% in March. The move was highly anticipated and the Fed announced that they anticipate raising interest rates another 2 or even 3 times in 2018. Every significant stock market decline or economic recession over the last 70 years has been preceded by the Fed raising short term interest rates. Interest rates are still at incredibly low rates. 10 year US Treasury bonds are yielding 2.77% a year. Japan's 10 year government bonds are yielding .03% a year, France is .073% a year, Italy is 1.82%, Spain 1.19% and German 10 year bonds yield 0.50% a year for the next 10 years! It's no wonder that the rest of the world is willing to finance our entitlement programs, budget deficits and tax cuts……at least for now.

As interest rates rise, returns on dividend paying stocks tend to lag the overall stock market. Investors have the option of receiving a risk-free 2.7% return a year from a 10 year US Treasury bond or a 3.5% dividend return from a stock but are asked to assume more risk and volatility with the stock. We have never shied away from

"Detroit was the 5th largest city in the US in 1950 with 1.9 million people. It is currently the 23rd largest with 673,000 people. Phoenix was 99th in 1950 with 107,000 people. It is currently the 5th largest city with 1.6 million people." Source-Census Bureau

expressing our preference for dividend paying stocks. As we would expect, our returns lagged some in 2018 as our dividend stocks underperformed the overall market especially when compared to the "FANG growth darlings" of Facebook, Amazon, Netflix and Google. As Facebook deals with the fall-out from their privacy debacle and Amazon fends off talk of anti-trust complaints, our good, old, dull and boring dividend stocks don't look quite so stodgy.

The jury is still out on how corporations are going to spend their tax refunds. Everyone hoped that there would be a combination of hiring more workers, spending more money on plants and equipment, buying back their own shares and increasing their cash returned to their shareholders in the form of higher dividends. As should have been expected, the results are to this point, a mixed bag.

To summarize, we are neither pro-President Trump nor anti-President Trump so don't misconstrue our comments in this newsletter. We have been taught over the last 90 years that tariffs are not good economic policy. They have been tried as recently as 2002 by President Bush and they were an utter failure then. Common sense would dictate that we be skeptical that they will be beneficial now. The US, and the global economy, are all doing well right now. Rising interest rates, Russia behaving badly, and the implementation of tariffs leading to at the very least, trade spats, have added to the uncertainty for the markets. Investors should be prepared for more volatility in the markets. 2017 was an abnormal year in that it was so quiet in the stock markets. It is highly unlikely that 2018 will be so placid.

Please mark September 5th 2018 on your social calendar. This will be our Annual Client Appreciation Event and we do hope that you will be able to join us. We are excited and optimistic about the future both for you and for our firm. We continue to receive large influxes of new funds thanks to you and your many referrals that we receive every month. No one said securing a viable financial future is easy; nor should it be. There are many challenges and headwinds that we will face every day. The markets contain risk and they offer reward. Our task is to balance the two and to deliver good returns with an acceptable amount of risk.

If you have questions about your holdings or about the general condition of the economy, please contact us at once. If we do not have a current email address for you would you please email us and allow us to add you to our regular list of clients with whom we correspond. Our email addresses are jspreng@sprengcapital.com, tbrown@sprengcapital.com and lemory@sprengcapital.com. Please be assured that we are monitoring market situations at all times.

If there have been any changes in your financial circumstances of which we should be made aware, please notify us at once. If you would like a copy of our most recent Form ADV or our Privacy Policy, please call the office. If you have not visited our website, please do so at www.sprengcapital.com.

We appreciate the opportunity to work with you, your families and your businesses. We are very grateful for the many referrals that you have provided to us. We can think of no greater compliment than to have you recommend us to your family and friends. We will continue to do our very best to provide you with healthy, consistent returns with a minimum of risk. Always remember, "Investing is a marathon, not a sprint." ***"Risk means more things can happen than will happen!"*** Elroy Dimson-London Business School

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