Fall
2019

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.

"At the end of the day, it's not a normal condition to have interest rates at zero"
Lloyd Blankfein, retired Chairman and CEO of Goldman Sach's

What an interesting time to be alive. Social media and the instantaneous dissemination of information by the internet from the far corners of the world make for sometimes, overwhelming information overload. Before the laying of the first undersea cable under the Atlantic Ocean in 1858, it used to take weeks for information to traverse the globe. Prior to the introduction of the cable, an earthquake in Japan wasn't a big deal to anyone except the Japanese and to any investors who had lent money to the government of Japan or its companies. Now, receiving pertinent information for investors is like "drinking water from the proverbial firehose". For just a moment, let's review what occurred over just the three months since our last newsletter that we think is important for investors to absorb:

- Iran supposedly bombed oil terminals in Saudi Arabia causing the price of oil to spike, increasing the chance for military conflict in the oil fields.
- The Federal Reserve Board cut interest rates by 0.25% ***twice*** in the last three months
- President Trump "urged" the Federal Reserve to have some guts and cut interest rates to zero% or even negative, which we will discuss later in this newsletter.

Index	Quarter	YTD
DIJA	1.19%	15.39%
NASDAQ	(0.09%)	20.66%
S&P 500	1.19%	18.74%

- The United States government had a $1 trillion actual deficit in just 11 months for the current year that will end October 1st.
- The National Security Advisor, John Bolton, was fired. This is the fourth NSA in 33 months.
- England suspended Parliament, officially sending it home so that Prime Minister Boris Johnson could try to manage an exit for England from the European Union, nicknamed Brexit, without having to have the elected representatives of the voters input, or hindrance. This act has since been ruled illegal by the United Kingdom's courts.
- Hong Kong has been rioting for weeks against the tightening rule of mainland China's Communist government.
- Facebook was fined $5 **billion** for violating consumer's privacy rights over the Cambridge Analytica scandal. Don't feel too badly for Facebook. They are currently sitting on almost $50 billion in cash!
- Young people, children really, walked out of their classrooms by the millions around the world protesting a lack of effort to respond to climate change.
- And finally, General Motor's employees went out on strike.

"65% of college graduates in 2018 finished with outstanding student loan debt."
Source: the Institute for College Access & Success

Unfortunately, in today's world these events seem to be "just another day at the office". That is why the best advice that we can give our clients is to just turn everything off and go for a walk or to your children or grandchildren's activities. The reality is, that if we listed all the bad things that happened six months ago at the time of our previous newsletter, it would look just as bad! Now the good news. Unemployment remains at a 50 year low of 3.7%, down from 10% in 2009. Inflation is as low as it has ever been since the Great Depression. The Consumer price Index is up 19% over the last 10 years. That is an average of 1.9% a year! Over the last twenty years it is up 54% which is 2.7% a year. And finally, for the last 30 years, the CPI is up 106% or an average of 3.5% a year. Granted, health care costs, college funding and costs of taking care of aging parents have surged way more than the average. These are the areas that drive what we have named in our office as ***"middle-class angst"***.

US debt interest rates remain subdued despite an explosion in the deficit and a credit worthiness downgrade of US government debt in 2011. Oil prices are down from $120 a barrel in 2011. The stock market has risen 400% since its low in March of 2009 and we are currently in the longest-running economic expansion in modern US history of over 10 years.

We had 280 clients at our Annual Client evening in early September. It was another wonderful evening of great food from Carle's, beautiful flowers from Carmar Gardens, beautiful music from Dave Miller and nice "swag" from Vasil's. However, we ventured into a serious talk to everyone in attendance over a topic that seems hard to even fathom, negative interest rates for borrowed money! Simply put, negative interest rates means that an institution from which you would borrow money, like a bank, will actually pay you to borrow the money. However, if you had money in savings or a checking account or a Certificate of Deposit in this institution, you would have to pay the institution to hold the funds for you. Currently in the world, there is $17 ***TRILLION*** of government borrowed money that is paying a negative rate of return every year. Every single Euro borrowed by the German government and government of Denmark has a negative yearly rate of return. Switzerland just had a bond go negative that won't be paid for 50 years. Investors are willing to give their money to the Swiss government for 50 years knowing that they will get less money back in fifty years! I know, this sounds absolutely incomprehensible that someone would do this. This is also completely ignoring the effects of what even mild inflation will do to the purchasing power of this money over 50 years with a guaranteed negative rate of return.

Why would someone invest in a guaranteed negative return? Some organizations have no other choice. Pension funds, endowments and Foundations have what are called Policies that have been written to give guidance to the Trustees and Investment Managers, like us, as to how the Funds should be invested. It is not at all uncommon to see a Policy that might say, "40% of the Funds must be invested in government backed securities". Policies are like the stone tablets that Moses brought down from the mountain. They ***must*** be followed. If the SEC finds that the policies that have been approved for internal management at our firm have not been followed, there are serious repercussions. Therefore, Trustees and Investment Managers must follow policies that have been approved for the management of Funds even if it guarantees losing money. This only applies to organizations like Pension Plans, Endowments or Foundations. Individuals do not usually have such firmly worded written policies. There are goals and risk tolerances that are agreed upon with an Investment Manager that an individual might be working with, like our relationship with you, but there would not be an edict that we ***must*** own bonds with negative rates of return in your portfolio.

Secondly, investors might surmise that the Trade War between the US and China is affecting the world's economy in dire proportions and that the stock markets around the world will eventually reflect this slowing economic activity and sell off. The bond holders would rightfully anticipate that a 1% per year loss on a government bond from Germany is better than a 40% drop in the German stock market.

Finally, if governments keep cutting rates trying to boost their economies and to fight the possibility of the greatly feared deflation, then investors who own bonds with a 1% negative rate of return per year will be better off than the new investors in bonds who might have a minus 2% or minus 3% rate of return per year!

So the obvious question, "Will the United States eventually drop to negative interest rates like the rest of the world?" As we indicated earlier, Germany, Denmark, and Switzerland are already negative. Japan, France, Spain, Netherlands, Belgium, Sweden, Austria and even Italy all have some of their government bonds yielding negative yearly returns. To be blunt, most of the capitalist societies of the world are negative except for the US and Canada. This is truly uncharted territory. Denmark currently has one bank that is offering a home mortgage for 10 years at -0.5% interest per year. Yes, you have read that correctly. The bank will pay you to borrow money for a 10 year mortgage. Another Danish bank is rolling out a 20 year mortgage at 0% interest per year, free money. Of course, you have to be able to pay the principle amount each pay period and we have no idea what kind of fees the bank is charging for these mortgages. Will closing costs and

"The world consumes 101 million barrels of crude oil every day with the United States consuming 21 million barrels a day."
Source: Department of Energy

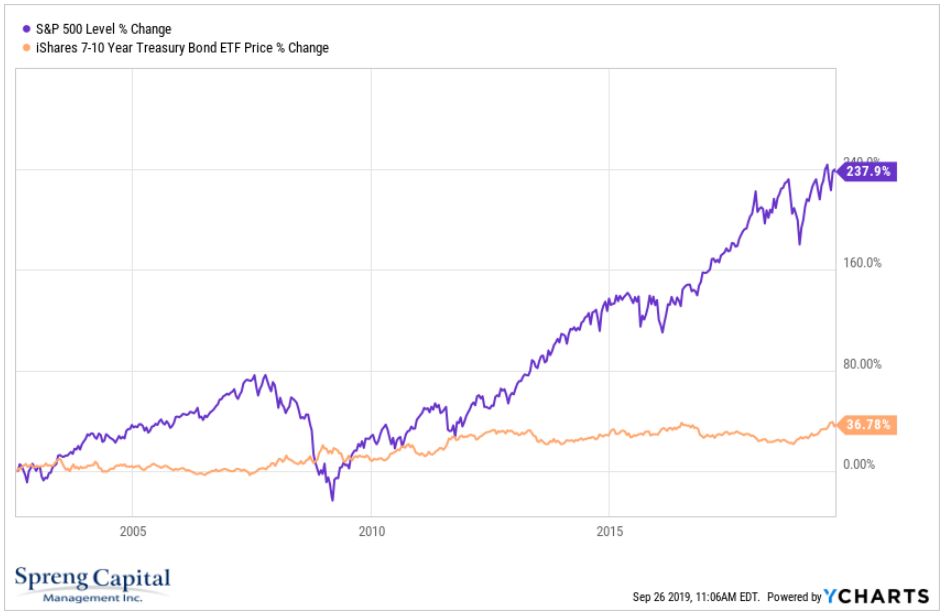
"The lowest unemployment rate in the nation as of the end of August was 2.1% in Vermont"
Source: Department of Labor

appraisal fees rise? Common sense would indicate this will probably occur. What could this possibly mean in the United States banking industry if our interest rates should go to negative? Are savings accounts no longer offered? I think you can forget free checking accounts. Will a bank offer Certificates of Deposit anymore? Why would they? If the Federal Reserve is going to charge banks a fee for cash on hand in the bank overnight, instead of currently paying them a small amount for the Fed to borrow the bank's funds for overnight lending, why would a local bank want any excess funds in their bank at all? It would serve no purpose to have any savings accounts or CDs unless the bank could lend these funds to borrowers. But again, loan these funds out at what interest rate? If the Danish bank is paying the borrower 0.5% a year to borrow the funds, they have to be charging significant fees to be able to keep their doors open. Do we as investors want to own any financial services firms or banks in this environment? That's why President Trump chastising the Federal Reserve Board for not dropping interest rates to zero or even negative is probably not the most prudent Presidential course of action. We cannot stress this enough, we do not have negative interest rates in the United States at this moment. But we would be incredibly naïve to think that it is not possible at some point in the future. We live in a global economy and billions of dollars flow electronically over physical borders each and every day. If the Federal Reserve continues to lower interest rates to near zero or to zero %, it is not a leap of faith to think that it could swing to negative from there. How that would play out is anyone's guess. Does AT&T stock currently paying a 5.5% dividend per year double in price driving the dividend down to 2.75% a year? Why not, 2.75% is a lot better than 0% or -.05% a year!

Of course, the over-riding question always remains the same every day, every month, and every quarter, "Where do we go from here?" The US economy is healthy, as healthy as it has been for years. We walked through all of the reasons for that statement earlier, but there are darkening clouds on the horizon. Duke University runs a very good program of polling corporate CFOs, Chief Financial Officers. Duke has done this for years so they have a great deal of data from which to pull their research. Their latest survey revealed that over half of the large company CFOs expect the US economy to be in a recession by this time next year and over 2/3 expect a recession by the end of 2020. These are the men and women who control spending at our largest corporations in our economy. It is highly unlikely that they are pushing large expansions if they truly feel so strongly about recession prospects. A quirky barometer that we follow is the sale of RV units in the U.S. RVs are expensive and tend to be viewed as luxury items. Therefore, if consumers feel good about their financial prospects, they buy RVs. If they are feeling some trepidation about their financial security, they probably won't be buying. RV sales are down 20% in 2019 after being down 4.1% in 2018.

It is inevitable that the US economy will eventually go into a recession. Along with that will come higher unemployment, lower consumer spending, lower corporate profits and lower stock valuations. Recessions are as natural a part of a capitalist economic cycle as is the changing of the seasons. Recessions are actually needed to control excesses that have built up in an economy that has been experiencing growth. Unfortunately, the values of our portfolios will decline when the recession occurs because investors will convince themselves that the recession will never end and therefore, corporate profits will never rise again so they must sell their stocks to save their money. The fallacy is, economies always recover from recessions, corporate profits always recover and their accompanying stock values always recover.

Traditionally, investors sold stocks and bought corporate bonds or US Treasury bonds to protect themselves. Which brings us right back to our discussion of negative rates of return on government bonds. How logical is it to own another asset class, such as debt assets in the form of possibly negative return US Treasury bonds or currently negative German, Japanese, Danish or Swiss government bonds, accepting guaranteed losses with the purchase of these debt instruments? The following chart shows the US stock market, represented by the S&P 500 versus the 10 year US Treasury



"For every $1 spent for wages and salaries in the private sector, employers spend another 46 cents on benefits including paid leave, insurance, retirement plans and legally required benefits. Average compensation is $27.43 per hour plus an additional $12.49 an hour for benefits for a total cost to an employer of $39.92 per hour per employee." Source: Bureau of Labor Statistics

bond over the last 15 years. Quite a difference in performance! This is why investors choose stocks over government bonds and the inherent greater risk. There is greater return! Over the ***long-term***, and we cannot stress ***long-term*** enough, stocks have always out-performed debt assets. As investors we need to be emotionally and financially prepared for the eventual recession. We know that it is coming. We know that it will affect our investments. We are already making adjustments to your holdings where we feel that it is appropriate. We will continue to do so. In all probability, it is very likely that we will be early in our adjustments and our portfolios may under-perform the averages for a period of time. This is unfortunate but necessary. If you have any questions about this, please contact us. We have time. The economy is doing fine but it is slowing down. Now is the time to repair the roof and downspouts.

We had feedback from some clients that they had not received our email invitation to our Client Event in September. We always respond to, or try to, correct any error messages that come back to our email when we send out emails to all who are on our email list. Would you please, go into your email address book and add our main email to your address book so that your system knows that it is ok to accept emails from us. ***Please add jspreng@sprengcapital.com to your address book if it is not already there.*** We may be sending out email alerts in the future as market situations dictate and we want to make sure that you are receiving them.

If you don't remember anything else from this newsletter please remember this from Tracy Alloway a financial blogger. "Risk is not a fluctuating account value. Real risk is arriving at a point later in your life and discovering that you have not saved enough or taken enough risk with your investments to lead the lifestyle that you had hoped to lead." You don't want to take more risk than is necessary, but there is no reward without risk. Volatility always accompanies risk.

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."

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Spreng Capital Management Inc.

P.O. Box 47, 201 South Sandusky Avenue
Bucyrus, Ohio 44820-0047
P: 419.563.0084 F: 419.563.0234

www.sprengcapital.com

Jim Spreng: jspreng@sprengcapital.com
Leslie Lutz: lemory@sprengcapital.com
Tom Brown: tbrown@sprengcapital.com

Monday-Friday 8:30am-4:30pm
Closed 12:00pm-1:00pm