October2019

MarketWatch

MARINE BANK
Trust & Investment Management

Conference Call Summary

Joe Terril, Terril & Company, Featured Speaker

We are still constructively positive on the economy, both in the United States and the world. However, we continue to closely monitor changes to business confidence based on issues like on-going trade wars and impeachment talk. In the past couple of months, we have been witnessing businesses postponing both spending and commitments, not permanently, but perhaps for two to three months while they watch to see what is going to happen with trade issues.

In the meantime, the consumer, around the world, is in great shape, particularly in the United States. Consumers can spend and are out doing so, making them, at the moment, the heroes of the economy. Viewed together, the positive of the consumer and the negative of business confidence, the economy continues to be okay. Consequently, for the moment, we are constructively positive on the world economy.

We are asked frequently about the likelihood of a recession. For the moment, we do not see that happening. Some people believe a recession is inevitable. If central bankers all over the world continue to be incredibly easy on monetary reserves and easy on credit, we think it unlikely that we would see the economy reverse itself and go into recession. However, our opinion will change if we begin to see any indication that excess reserves created by central banks are creating an inflationary impact. This inflation could cause central bankers to tighten credit. Surprisingly to us, we currently see no evidence of the past incredible money printing creating any inflation. We are watching this issue diligently.

Regarding investment markets, we are mildly positive on stock prices and negative on bond prices. Interest rates are so low that most bond prices are at 500-year highs. There is no value there. In our opinion, there are 10 elements of risk for every one of potential reward. We expect the 10-year Treasury bond in the United States, which was as low as 1.4% at the end of August and is now trading at 1.75%, to be closer to 2.5% or 2.75% within 12 months. We are not in the camp that believes interest rates in the U.S. are going to plunge to 0% or even turn negative.

Switching to the stock market, if the economy around the world is doing okay with no recession, most stocks are going to perform modestly. However, we are beginning to see a new trend in growth stock prices. The past approach of buy growth at any price may have finally played out. We expect that trend to continue. Basic industry companies, including paper companies, chemical companies and banks, are selling at discounts. In the past two or three years, they have not participated in the market rally. Therefore, based upon multiples of cash flow, dividend yields, etc., they are selling at modest prices. We are mildly positive on the stock market because the basic industry companies should carry the day for the overall averages. Companies such as airlines, energy, banks and consumer products are generating lots of cash, buying back stock and raising dividends. We feel that this is where future investment performance will be over the next couple of years.

Marine Bank's
Annette McClure
Executive Vice President
Trust & Investment Management
amcclure@ibankmarine.com
217.726.0661

John "Joe" Terril
President of Terril & Company, a St. Louis based, independent wealth management firm. Terril & Company has been overseeing retirement plans, IRAs and individual investment portfolios for over 37 years, an important keystone of Terril & Company's philosophy remains ensuring no conflicts of interest exist between the company and its clients.

ClientQuestions

Joe, how are bank earnings looking? Are lower interest rates hurting their profits? Do you intend to stay overweighted in banks?

Response: Bank earnings are looking good. Lower interest rates are slightly reducing net interest income. Even with this happening, profits are up 5%. If the interest rates were not as low as they are, profits might be up 7% or 8%. Banks are reporting higher profits due to several reasons. First, most banks are also involved in other businesses, like credit cards, investment banking, foreign exchange and investment management. This business is doing well which is helping revenues to stay flat or move slightly higher. The second issue that is positive for bank earnings is cost reduction. Banks are benefitting from electronic banking and technology that is reducing their costs. People want the convenience of banking at their fingertips, on their computers or mobile devices. This trend is just beginning, and as it develops, it will continue to benefit bank earnings.

We will continue to stay overweighted in financials until the stocks rally another 25% from where they are now. Citigroup bought back 11% of its outstanding stock with its massive cash flow just in the last year, from October 2018 to October 2019. This buyback is at a pace of retiring 1% of the outstanding stock every month. By the end of 2020, Citigroup expects to have repurchased 30% of all outstanding stock. Citigroup will generate $20 billion this year, and the question becomes, how will they decide to return the cash to stockholders? They currently pay out about $4 billion in cash dividends. Of the remaining $16 billion, maybe Citigroup will spend $2 - $3 billion on technology, continuing to move towards dramatically lowering their costs. That still leaves them a tremendous amount of money to buy back stock and increase cash dividends. Citigroup is not alone in this situation. It is just an example of what is going on with a lot of industrial companies, the type that will be good investments over the next couple of years. The more stock they buy back, the more potential to increase cash dividends. We believe financial stocks are as much as 25% undervalued.

Would you please provide an update on the energy holdings?

Response: The energy holdings we own in our portfolios are energy infrastructure companies. They are not pumping and producing oil, finding natural gas or even refining the products. We hold the mid-stream companies that charge a fee for taking the product via pipelines to the various refineries or export terminals. They also store energy in tanks for a fee until the owner decides where they want the product delivered. We like these companies because they generate a lot of cash flow and, in our opinion, are selling at ridiculously low prices.

In 2015 and 2016, OPEC was battling a significant threat from ISIS in the Middle East. Because ISIS was funding its operations from oil, OPEC took the position of flooding the market with oil to drag the price down and hinder the ability of ISIS to make war against Middle East countries. That strategy worked. Since then, OPEC has reversed its course and stopped overproducing oil, and prices are back up to the mid-$50 range. However, when OPEC took that action and energy prices fell as much as they did, investment bankers and others became concerned about the balance sheets of mid-stream companies. They demanded they pay down debt and operate more conservatively, including using their cash flow to pay for their expansion plans. Over the last three years, that is exactly what happened — for example, going from 80% debt and 20% equity to 60% debt and 40% equity, a more conservative approach to operating the companies. At the same time, the demand for energy in the United States and around the world is continuing to grow, creating the need for more pipelines, storage tanks, etc. The industry has responded by building this infrastructure. Companies paid for expansion from current cash flow, not by borrowing. Retiring debt and paying for capital expenditures out of cash flow are positives.

Additionally, because demand around the world continues to grow for fossil fuels, cash flow is also growing. Therefore, the fundamentals of the pipelines/storage tank business are good. The demand for products is there and will continue to grow over the next two to three years.

Despite all the recent positives, the price of the stocks are down. We earn good dividends from the companies of 7% to 10%. At the same time, prices fall by 7% to 10%. Thus, we are not making money off the holdings. However, we continue to hold them in portfolios because we believe this will reverse and we will earn the dividends plus gains from higher prices. Many of the mid-stream companies are selling at $0.50 on $1.00 for what it would cost to build the assets. Cash flows for private companies in the mid-stream business are selling at 30% higher prices than the publicly traded companies. This dispersion should disappear in the future with the publicly traded companies moving up in price.

The midstream energy stocks are priced as if they are going to be going out of business in the next 5 or 6 years. This pricing is due to some investors believing energy renewables will take over. There is also concern liberal politicians will try to outlaw fossil fuels. We disagree. Replacing fossil fuels around the world will take 30 or 40 years. Much of the world's energy production outside the United States is in questionable areas, as we recently witnessed oil fields attacked in Saudi Arabia and a missile attack on an Iranian tanker. As a result, the willingness of the world to buy from the United States is a positive for the companies. We believe that the production and/or transportation of the fuels to the rest of the world is going to continue its growth. The companies are currently out of favor with investors. This creates a low price. This low price continues to be attractive to us.

MarketWatch

Monthly conference calls with time for your questions about the state of the markets are just one of the many personalized services offered by Marine Bank's Investment Management Team. This **Market**Watch update is a summary of our monthly call.

Our next monthly conference call will be:
November 20th 2019
at **10:30 a.m.**

To participate, dial
1.866.210.1669

When prompted, enter code **8558354#**

Email your questions to Annette in advance:
amcclure@ibankmarine.com

MARINE BANK
Trust & Investment Management

Investments are subject to risk, including possible loss of principal. Investments are not deposits of or guaranteed by Marine Bank, and are not insured by the FDIC.