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OCTOBER 2019 INVESTMENT COMMENTARY

LET'S MAKE (IT LOOK LIKE) A DEAL

Over the last year, investors have become accustomed to markets rallying on hopeful trade deal news related to the ongoing U.S. – China trade war. On October 11th the Trump Administration announced that recent negotiations have resulted in a "Phase 1" deal, which forestalls an increase in U.S. imposed tariffs on Chinese goods being imported into the United States slated for October 15th. Broad markets rallied more than one percent in response to this announcement, but that rise faded toward the end of the trading day as a lack of details, no written agreement, and a statement that the deal will be formalized over the next two to three weeks came to light.

In response to this minimal, vague, "handshake" trade understanding, I have to believe that the smart money in the market expected such a hollow agreement that puts off President Trump's threatened increase in tariffs due to domestic political considerations. The current level of tariffs has been detrimental to economic growth and increases the amount of speculation that a recession could occur in 2020. It would have been politically precarious to allow tariffs on Chinese goods rise any higher than the current 25% level and risk a recession before the election. I do not expect the markets to treat this narrow and vague agreement, which does not lower tariffs as a relief valve of the current cautious sentiment, which has kept the broad U.S. equity markets from advancing much more than five percent since the beginning of 2018.

What has become clear to me is that market expectations regarding the direction of U.S – China trade negotiations are the primary drivers of near-term equity market direction. I have stated many times in the past that equity markets have a hard to discounting more than one or two macro risks at any one time. In the unlikely event that markets could stop worrying about U.S. – Chinese trade negotiations, the truth is that there are other equally worrisome issues that will come to the forefront and keep markets on edge.

The Chinese seem to be in the driver's seat as it is politically inconvenient for the incumbent U.S. administration to keep tightening the economic screws on China as we approach a presidential election year. Making matters worse, for the economy and markets is that without actually reversing tariffs, the economic damage and slowing economic growth here and abroad are likely to continue to worsen with each passing month. Tariffs on Chinese goods now sits at 25% on a substantial amount of these imports, but not all. The goods subject to tariffs are set to broaden even further in December. Additionally, tariffs have begun to be imposed on European goods, and there are threats to expand what is subject to tariffs coming from Europe. In reality, tariffs on European goods would not only slow an already very weak European economy; they would indirectly hit China because the European Union is China's single largest trading partner. It is very hard to see how a very lethargic global economy can materially turnaround in the face of this bellicose approach ahead

of next year's presidential election. The current level of U.S. tariffs on Chinese goods and the uncertainly that now overhangs U.S. – European Union trade relations sows a damaging level of economic cost and uncertainty into the complex system of global commerce.

Beyond tariffs, extreme uncertainty is the current state of affairs. This menacing uncertainty is defined not only by trade relations, but political uncertainty is paramount with the future of the European Union hanging in the balance of Brexit and a possible new middle eastern migration resulting from Turkey's incursion into northern Syria. U.S. political strife is hitting extreme levels as the process of impeachment of the President gains momentum and the Democratic primary field begins to come into focus.

Tactically, portfolio management during times of substantially high uncertainty must emphasize caution. Equity market strength will be used to harvest profits to be reallocated to more defensive investments. Opportunistic buying during periods of market weakness will occur, but will be tempered compared to less uncertain times. Equity security selection will be skewed toward companies whose earnings are not significantly levered to above-trend economic growth, but are instead economically resilient, driven by company-specific catalysts or a product of strong secular growth trends.

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