

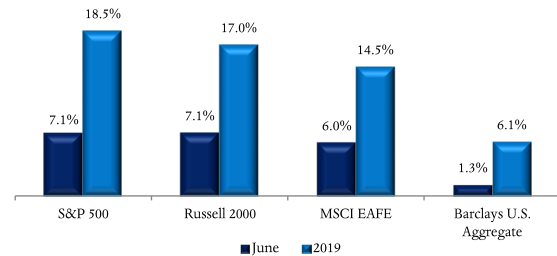


## MARKETS

Equity markets rebounded strongly last month reversing the economic and trade driven weakness seen in May. The S&P 500 index advanced +7.1%, its best June since 1955 (+18.5% ytd). Likewise, the Dow Jones Industrial Average (+7.3% in June; +15.4% ytd) recorded its largest first half advance in over two decades. Confronted by slowing economic data, risks to the trade outlook and below trend inflation, the Federal Reserve (the Fed) and the European Central Bank (ECB) signaled that further monetary stimulus was to be expected, catalyzing the rebound. Overseas equities also fared well in June, as seen by the +6.0% increase in the MSCI EAFE index (+14.5% ytd). Looking past local economic and political hurdles, European stocks held their own, rising +4.5% during the month (+17.2% ytd). In Asia, the Shanghai index added +3.7% (+21.0% ytd), while Tokyo stocks rose +3.5% (+7.5% ytd).

Credit, as well as risk-free sovereign debt, rallied during the month, a continuation of a strong first half of the year. The US 10-year Treasury yield declined from 2.13% to 2.01%, while European sovereign bond yields dropped markedly, in many cases increasingly in negative territory. At present, circa \$13 trillion of global bonds trade with a negative yield to maturity.

OPEC+Russia announced they will extend their crude oil production cuts of 1.2 million barrels per day by 9 months, a bit longer than expected, as robust non-OPEC production growth is expected to tip global balances back into oversupply next year. As a result, crude oil rallied with the WTI benchmark ending the month at \$58.47 per barrel, a +29% advance in 2019. Gold advanced on the back of dovish rate cut talk from the ECB and Fed as well as heavy foreign central bank buying. The yellow metal broke out to new intermediate-term highs, ending June at \$1,409.10 per ounce. Overall, com-



modity equities were strong, with the S&P Global Natural Resource index rising +9.7% for the month (+13.8% ytd).

## GEOPOLITICS

At the month-end G20 meeting, the US and China agreed to continue discussions revolving around trade and technology, averting an escalation in tariffs. In a sign of good faith, China volunteered to step-up purchases of US agricultural products, and the Trump administration softened its stance against the blacklisting of telecom giant Huawei. However, there were no other significant signs of progress in addressing the main negotiation points. While the lack of further escalation avoided a worst case scenario, existing tariffs remain in place and future uncertainty will likely continue to weigh on business sentiment.

President Trump also threatened to impose tariffs on Mexican goods in order to radically shake up immigration enforcement efforts along the southern US border. In response, Mexico deployed thousands of militarized police across the country. Under an agreement reached on June 7, the US gave Mexico until late July to reduce northbound migration, or face renewed pressure over tariffs and further enforcement measures.

In the UK, the race for Conservative Party leadership was in full force, with polls suggesting that Boris Johnson is a strong favorite to be the next prime minister. Notwithstanding Johnson's strong desire for the UK to

withdraw from the EU, the UK parliament is still likely to prevent a no-deal Brexit, barring an unexpected mandate stemming from a general election or referendum. At the moment, odds suggest only about 30% of UK voters want to leave the European Union without a deal, which has been elusive thus far.

#### UNITED STATES

The US economy is officially in its longest expansion, having grown 25% thus far, breaking the previous record of 120 months of growth from March 1991 to March 2001. The Atlanta Fed's GDPNow tracker points to a modest 1.5% gain for the economy in the second quarter, a notable deceleration. Faced with greater downside risks to the central bank's economic outlook, the fallout from the trade war and declining long-term inflation expectations, the Fed firmly signaled that interest rate cuts are warranted and imminent. Guided by Chairman Jerome Powell's comment that "an ounce of prevention is worth a pound of cure," the market now expects 0.5% worth of rate cuts by the end of 2019. This compares to forecasts for 0.5% higher interest rates last September, a rapid about face.

June employment showed a healthy 224,000 jobs were added, accompanied by 3.1% wage growth. The unemployment rate edged higher to 3.7% as the labor force participation rose.

#### EUROPE

Echoing the Fed, the ECB indicated that monetary policy would be loosened unless the economy improves. The central bank also hinted that it has the tools necessary if further QE is required, and that interest rates could fall even further into negative territory.

The European wage picture has been improving of late. Salaries that were growing 1-2% are now increasing 3-4% according to various business surveys, driven by minimum wage hikes (UK +4.9%; Spain +22.0%), and the end of austerity. For more skilled or niche labor, i.e. a software engineer, raises are seen at 8-10%. Meanwhile, overall inflation is subdued at approxi-

#### June 2019 Economic Statistics

|                           | Jun-19     | Dec-18     | Dec-17     |
|---------------------------|------------|------------|------------|
| Federal Funds Target Rate | 2.25-2.50% | 2.25-2.50% | 1.25-1.50% |
| Consumer Confidence Index | 121.5      | 128.1      | 122.1      |
| Manufacturing PMI Index   | 51.7%      | 54.1%      | 59.7%      |
| Unemployment Rate         | 3.7%       | 3.9%       | 4.1%       |
| JPY / USD                 | 107.88     | 109.56     | 112.67     |
| USD / EUR                 | 1.1368     | 1.1469     | 1.1996     |
| Gold / oz.                | \$1,409.10 | \$1,282.73 | \$1,302.45 |
| Oil (WTI) / bbl           | \$58.47    | \$45.41    | \$60.42    |

mately 1.2%, allowing for increased disposable income.

The Bank of England (BoE) has been less dovish than the Fed and ECB, given concerns around the limited spare capacity and on-trend inflation of 2.0%. However, June retail sales came in at the weakest level in a decade, indicating an uncertain outlook, especially with Brexit looming.

#### ASIA

In China, economic growth is expected to decelerate to 6.2% in 2019, the lowest in a quarter century, notably affected by slowing global trade. Further, such growth is predicated on stable commodity prices, supportive global financial conditions, and the ability of authorities to calibrate supportive monetary and fiscal policies to address external challenges and other headwinds. The loss of momentum for the world's second largest economy reflects battered sentiment stemming from the Trump administration's tariffs on Chinese exports and its efforts to contain the country's technology sector. While trade related data is soft, previously enacted stimulus has led to strong housing (home sales have risen 8.9% in 2019), and construction (starts have increased 10.5% since the beginning of the year). On the consumer front, retail sales bounced from a more than 16-year low earlier this year, showing +8.6% growth at the latest reading. Second quarter GDP should mark the bottom and improve thereafter. Drivers include increased governmental infrastructure commitment and additional rounds of fiscal stimulus over the coming quarters.

## OUTLOOK

According to the World Bank, global economic growth is forecast to ease to 2.6% in 2019 before inching up to 2.7% in 2020. Drivers include rising trade barriers, political uncertainty, and sharper-than-expected slowdowns in several major economies. Global trade, which is running at the weakest pace since the financial crisis a decade ago, is expected to recover somewhat next year. The Euro Area has been affected by a trifecta of weaker exports, investment and domestic demand, despite strong support from monetary policy. Thus EU economic growth is projected to hover around 1.4% over the 2020-21 period. US GDP growth is forecast to ease to 2.5% this year and decelerate to 1.7% in 2020. Emerging market growth is projected to revert to a four-year low of 4% in 2019 before recovering to 4.6% in 2020. As mentioned above, Chinese economic growth is dependent on numerous variables, indicating a much lower than usual predictability.

Manufacturing surveys have weakened around the world, with a notable decline in the US business surveys and continued weakness in China, Japan and Europe. Germany's export-oriented manufacturing sector, in particular, looks to be struggling. One risk is that this weakness in the manufacturing sector could lead to job cuts and falling consumer confidence. These are the key drivers of the shift towards further stimulus from the Fed and ECB, which we expect the market to keenly focus on going forward.

Bond prices have been on the rise on account of investor anticipation that the US Federal Reserve will reverse policy tightening and begin to cut interest rates. Likewise, the European Central Bank is expected to continue its easy money policy with the potential for further quantitative easing. These actions are supportive for risk assets given the aim of preventing the current economic slowdown from turning into a recession. In an indication central banks are perhaps "behind the curve," 10-year US Treasury yields have fallen consistently, having recently breached below 2.0%, down from 3.0% just nine months ago. Astoundingly, overseas bonds valued at over \$13 trillion, trade with negative yield to maturities. While current market pricing reflects expectations that central bank

stimulus will keep the economic expansion going, we continue to recommend a conservative posture with regard to fixed income investments. Specifically leaning towards short-term Treasuries and higher quality bonds, which can provide balance to portfolios. We remain wary that both government and private debt levels have risen substantially in both emerging and developing economies, and that the issuance of low-yielding bonds is being treated as a free lunch.

The number of loss-making companies listed on the US stock exchange is approaching a 30-year high. This figure has been boosted by recent initial public offerings which appear to require access to the capital markets to fund their growth. This cohort has beaten their benchmark by around 9% in the first half of 2019, even though historically they have underperformed by a similar amount. The outperformance can be explained by the fact that in a low interest rate environment, with moderate economic growth, investors are attracted to companies with strong organic revenue growth rates. However, it also indicates a level of speculation and attitude of triumphalism, which deserves to be noted. The upshot is that the bidding-up of such risky equities has, in-turn, led to a general neglect of strong cash flowing businesses. As such, even as indexes trade at their highs, there are numerous attractive equity investment opportunities. It is interesting to note that the outperformance of growth equities versus value oriented ones is at a historical extreme, both in terms of magnitude and duration. In addition, our favored large capitalization multinational oriented equities remain undervalued, relative to the broad market, which we view as attractive given their high quality business characteristics and above average dividend yields.

While we wait to see whether global growth reaccelerates or slows further, and whether equities pause for breath, it may be prudent for risk-averse investors to have exposure to select alternative and non-market correlated investments. This asset class has historically provided some cushion to portfolios during periods of rising market volatility, and also acts as a solid portfolio diversifier.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal