

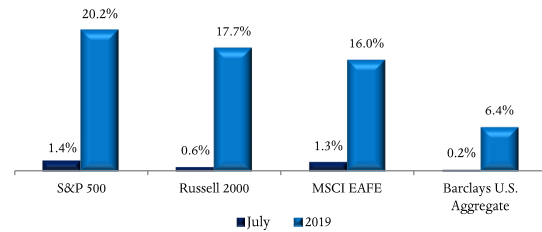


## MARKETS

US equities extended their 2019 run into July, spurred by the Federal Reserve's plan to lower interest rates for the first time in 11 years. The S&P 500 made several new all-time highs during the month, ending +1.4% higher (+20.2% ytd). The smaller capitalization Russell 2000 index added +0.6% (+17.7% ytd). Growth stocks once again outperformed value stocks, as did large compared to small companies. Overseas stocks generally underperformed their US counterparts as seen by the MSCI EAFE index's pull-back of -1.3% (+13.1% ytd). The Stoxx Europe 600 index rose +0.3% (+17.6% ytd) as the European Central Bank gave strong hints that a monetary easing package is on the way. In Asia, Chinese stocks pulled back -0.7% in July (+20.2% ytd), while Japanese equities rose +1.2% (+8.8% ytd). Emerging markets drew down -1.2% during the month (+9.5% ytd).

Global government bond indices posted modest gains, in what continues to be a declining interest rate environment amid trade tensions and fears over a slowing global economy. Enabled by low inflation, the Fed cut interest rates 25bps (to a range of 2.0-2.25%), the first reduction in over a decade. The central bank also ended quantitative tightening, which was running at an annualized rate of \$600 billion, two months ahead of schedule. Perhaps more importantly, however, an aggressive monetary-easing campaign was ruled out. The diversified Bloomberg Barclays Aggregate index rose +0.74% (+7.1% ytd). The US 10-year Treasury Note yield ticked up two basis points to 2.02%. Meanwhile, for the first time ever, Germany's entire yield curve (out to 30 years) traded with a negative yield (10-year Bund yielded -0.44%).

In currencies, the US dollar was the biggest winner in July, gaining 3.9% vs. the British pound and 2.3% vs. the



euro. Amidst lower rates, gold made new highs, ending at \$1,413/oz. On the energy front, WTI crude oil prices were steady, ending at \$58.58 per barrel. Demand fears, due to slowing economies, were counterbalanced by lower supplies and reduced inventories.

## GEOPOLITICS

In the UK, Boris Johnson was appointed prime minister after his victory in the Conservative party leadership contest, garnering two-thirds of the vote. PM Johnson's Brexit plan appears to be based on the idea that the threat of a no-deal exit will strengthen his hand in the coming negotiations with the EU. As such, he said he would not meet with the EU to discuss terms for Brexit unless the EU promised to abandon the Irish backstop, (which involves the UK retaining a very close relationship with the EU for an indefinite period, in return for a soft border). In turn, financial markets have become increasingly jittery about the potential for the UK to leave the European Union without a deal, with the Pound Sterling in meaningful retreat. However, it is important to note that the current configuration of parliament has regularly demonstrated that it is not willing to allow the UK to leave the EU without a deal. A no-deal exit therefore remains unlikely, unless a general election or referendum were to provide a mandate for it.

US-China trade negotiations remained active during July, but without much progress to report. In a surprise move, President Trump threatened to impose a 10% tariff rate on the yet-untaxed \$300 billion of imported

Chinese goods, starting on September 1. In turn, China retaliated by weakening its currency, a defensive measure possibly indicating preparedness for a protracted standoff.

### UNITED STATES

On the last day of July, in a much anticipated event, the Federal Reserve reduced interest rates by 0.25% (the first cut since 2008) and ended the sale of bonds on its balance sheet. However, Fed Chairman Jerome Powell's suggestion that the move in interest rates did not signal the start of a "lengthy cutting cycle" was not well received by market participants. Expectations for rate policy later in 2019 show a heightened level of anxiety about the US economy. Federal-funds futures are predicting a 75% chance of at least two more 25 basis point interest rate cuts following the Fed's three remaining meetings of the year.

We concur that a slowing of the economy, with moderate associated inflation (currently annualizing at 1.6%), does not warrant aggressive central bank action. The US economy just broke a record for the longest economic recovery (over 10 years) on record. Last month, the employment market grew by 164,000 jobs. This level of additions was in-line with the average of 2019 monthly job gains, and met expectations. The unemployment rate remains at a 50-year low level of 3.7%, with associated wages rising +3.2% year-over-year, and more people are looking for work. While second quarter GDP is estimated to have grown at a 2.1% annualize pace, ahead of expectations, the Atlanta Fed's "nowcast" calls for slower, but still-moderate, 1.9% growth in the third quarter (down from 2.2%). Manufacturing demands a watchful eye, with the July purchasing managers' index (PMI) data suggesting an ongoing deceleration, but still within an expansionary trend which has lasted 123 months thus far.

It is also noteworthy that amid the threat of additional tariffs being placed on a range of US consumer goods, there has invariably been some pre-emptive inventory building, which may lead to lower demand in coming

### July 2019 Economic Statistics

	Jul-19	Dec-18	Dec-17
Federal Funds Target Rate	2.00-2.25%	2.25-2.50%	1.25-1.50%
Consumer Confidence Index	135.7	128.1	122.1
Manufacturing PMI Index	51.2%	54.1%	59.7%
Unemployment Rate	3.7%	3.9%	4.1%
JPY/USD	108.74	109.56	112.67
USD/EUR	1.1074	1.1469	1.1996
Gold/oz.	\$1,413.55	\$1,282.73	\$1,302.45
Oil (WTI)/bbl	\$58.58	\$45.41	\$60.42

quarters. In addition, US corporations' ability to spend more, thanks to favorable tax reform (and repatriation of monies from overseas), appears to be fading as seen by the slowdown in business capital investment spending.

### EUROPE

For investors, one of the most notable European leadership nominations stemming from Brussels was for International Monetary Fund head Christine Lagarde to take over from Mario Draghi as European Central Bank president at the beginning of November. Lagarde, one of the most dovish candidates, has been vocal in her support for Mr. Draghi's accommodative stance on monetary policy. Given the ECB's struggles to normalize interest rates during the economic recovery, it is likely that Europe's response to the next downturn will require greater coordination between central bankers and politicians to support economies. Lagarde's expertise in political negotiations likely came into play in this respect, sealing her nomination. In the meantime, reinforcing the expected continuity in policy, the ECB's Governing Council sent a strong signal to the market that a stimulus package is coming (just seven months after ending its previous QE program). This likely means interest rate cuts, deeper into negative territory (potentially using a tiered system in an effort to reduce the negative impact on the banking sector), as well as additional asset purchases.

Why are such extreme actions envisaged? There appears to be continued softening in EU economic data,

and inflation has yet to reach targeted levels (inflation appears to have steadied at 1.6% for the trailing 8 months, with just minor variability). German manufacturing data, typically resilient, continues its slide, and business sentiment surveys reached six-year lows. The EU's unemployment rate is currently 6.3% within a range of 18.1% (Greece) and 2.2% (Czech Republic), with Germany at 3.1%.

Offsetting some of the economic concerns are constructive talks between Italy and the European Commission around Rome's fiscal trajectory. Italy's additional budgetary belt-tightening were material enough to avoid an Excessive Deficit Procedure. Meanwhile, in the UK, against an unstable backdrop, cracks are appearing in the local consumer outlook, with retail sales contracting for a third consecutive month in July.

### ASIA

Investors continue to be keenly focused on the outlook for US-China trade relations, and its effects on local economies. Both sides are discussing topics such as forced technology transfer, intellectual property rights, services, non-tariff barriers and agriculture. Meanwhile, on the back of heightened tariffs, Chinese imports into the US were down -12.6% in June, while US exports to China were down -16.8%, highlighting the bilateral effects. Second-quarter Chinese GDP growth of 6.2% (a 27-year low) highlighted perception of the slowdown given the contraction in manufacturing activity. However, retail sales and industrial production data showed some tentative signs of stabilization.

Beijing's determination to keep their economy stable remains without a doubt, and the effects of the most recent monetary and fiscal stimulus are in the process of trickling down. Looking ahead, however, with China having amassed \$40 trillion in debt, it cannot be counted on for significant additional stimulus in the near term. Perhaps not coincidentally, other Asian central banks are signaling their own concern about the region's outlook for economic growth, as seen by a series of surprise interest rate cuts from Australia, New Zealand, Thailand, and India.

### OUTLOOK

Central bank policy looks set to be supportive for assets in the second half of the year, but this may be largely priced into the market. Investor sentiment is likely to be economically data driven, perhaps bringing an end to the recent period of "bad news is good news" for asset prices (because central banks will come to the rescue with monetary stimulus, and interest rates will stay low). In this case, downside risks to the economy warrant an element of investor caution.

Within equities, we prefer to focus on companies with durable franchises and strong balance sheets, which may be less exposed to slowing economic growth. These businesses feature inherent pricing power and flexibility to buy back their stock. The most obvious short-term risk for investors is overpaying for high growth businesses, which command premium multiples. But, at the same time, there are numerous value oriented equity opportunities apparent in global markets. From a top-down perspective, the S&P 500 index has recently fluctuated between 16-17x forward earnings, which seems reasonable, especially in light of the low interest rate environment. Looking ahead, we envision a stock-pickers market, with the eventual potential for capital flows into value oriented equities.

Historically low yields have been setting new records in Europe and Japan, while US rates have dropped across the curve. Global government debt amounting to \$15 trillion (25% of total outstanding sovereign bonds) are trading with negative yields. While it is still possible for bonds to play a role in portfolios, given their scope to rally further if sentiment deteriorates, we feel that the current trend is extended. We therefore continue to urge caution and would avoid exposure to long dated bonds.

Select alternative strategies, with low correlation to traditional asset classes, warrant consideration for investors looking to add ballast to their portfolios at this stage of the cycle.

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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