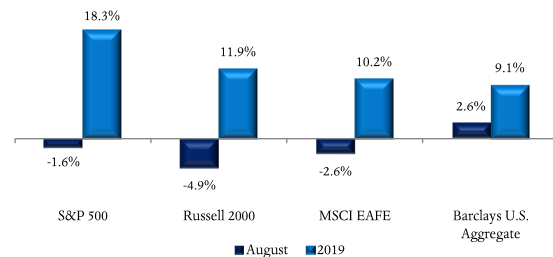




MARKETS

August was a volatile month for financial markets, initially triggered by US President Trump's surprise announcement of the intention to impose a 10% tariff on the remainder of untaxed Chinese imports (circa \$300 billion). Trade tensions were subsequently further elevated when China announced retaliatory tariffs on \$75 billion of US imports, including agricultural goods, crude oil and cars. This, in-turn, led to a US threat of a further 5% increase on existing and planned tariffs. Overall, heightened trade tensions and their economic consequences triggered profit taking in global equities during the month. The S&P 500 benchmark dropped -1.6% (+18.3% ytd), while the smaller capitalization Russell 2000 index retreated -4.9% (+11.9% ytd). Overseas stocks also pulled back, as seen by the MSCI EAFE's -2.6% return (+10.2% ytd). In Europe, the Stoxx 600 index retreated -1.3% (+16.0%). Asian equities also fell in Shanghai -1.5% (+18.4% ytd) and Tokyo -3.7% (+4.7% ytd). The MSCI Emerging Market index dropped -4.8% (+4.2% ytd), led by woes in Argentina which experienced a devaluation of the peso by 26%, versus the dollar, coupled with a 40% decline in local equities, after the national primary elections showed the current government could lose power in October.

In August's risk-averse environment, global bond yields continued to decrease, bringing the market value of negative yielding debt to over \$16 trillion. Fixed income segments with positive real yields rallied. Notably, 30-year US Treasury yields dropped below 2.0% for the first time. The Bloomberg Barclays US Aggregate Index advanced +2.6% (+9.1% ytd) while high yield bonds added +0.4% (+11.2% ytd). Physical commodity values declined -2.3% in aggregate in August (+1.9% ytd), while associated equities fell -6.5% (+3.9% ytd). Gold, however, continued to shine, ending the month at \$1,519/oz up +7.5% (+18.5% ytd).



GEOPOLITICS

In Hong Kong there have been virtually non-stop weekend demonstrations since June, with more than 2 million people marching against a controversial proposed extradition bill. In August there was a notable escalation in activity, with clashes between protesters and police, and chaos at the city's airport, necessitating its closure for several days. The movement does not have clear leaders and many people meet anonymously online to organize action. Activists have made five requests: the withdrawal of the extradition bill (allowing suspects in Hong Kong to be sent to China for trial) which appears to have been granted, retraction of the "Riot" designation (those guilty of rioting could face up to 10 years in jail), amnesty against those arrested (approaching 1,000 people), an independent inquiry into the police's handling of the protests, and "greater democracy" in Hong Kong.

In the UK, the Brexit saga continues, featuring a battle between PM Boris Johnson (who advocates for Brexit no matter what) and the UK Parliament (which opposes a no-deal exit). With the third, October 31, deadline looming, PM Johnson attempted to suspend Parliament for five weeks, starting as early as September 9, to prevent an extension of the Brexit deadline or block a no-deal exit. However, Parliament mobilized quickly, passing legislation that calls for the Prime Minister to seek a three-month Brexit extension (until end-January 2020) unless an EU-UK deal is struck by October 19, or Parlia-

ment explicitly votes to leave the EU without a deal. PM Johnson, in turn, immediately introduced a call for general elections, on October 15, just weeks before the Brexit deadline. This too was soundly defeated by Parliament, the PM's third defeat in a row. The Labour Party, headed by Jeremy Corbin, stated they would agree to elections, once Parliament has prevented a no-deal Brexit, so that may still come to pass.

UNITED STATES

Post the Federal Reserve's 25 basis point rate cut of July, August headlines were once again dominated by trade tensions but also the increased possibility of an economic downturn. In a sign that the US economy is not immune to global trade tensions, the ISM manufacturing PMI declined to 49.1% in August, into contractionary territory (below 50%), ending a 35-month expansionary period where the PMI averaged 56.5%. In a sign of contagion, the Services Business Activity index fell to a three-month low, while Consumer Sentiment weakened to the lowest level of 2019. Consumer psychology has seemingly begun to be affected by the extensive media commentary on the increased risk of a recession, following the inversion of the US yield curve, whereby the 2 year US Treasury yield rose above that of the 10 year US Treasury yield, which first occurred in mid-August. However, domestic demand has so far remained relatively resilient, with retail sales increasing 0.7% in July, showing that so far the strength of the labor market and rising wages continue to outweigh trade and recession concerns. Therefore, it appears to us that the US economy is slowing, not stalling.

With regard to US monetary policy, Fed Chair Jerome Powell's Jackson Hole speech was dovish, as expected, and paves the way for the Fed to make another (25 basis point) rate cut in September. Thereafter, financial markets are ascribing fairly even odds of one more rate cut at either the October or December meetings.

EUROPE

In Europe, investors focused on generally lackluster

August 2019 Economic Statistics

| | Aug-19 | Dec-18 | Dec-17 |
|---------------------------|------------|------------|------------|
| Federal Funds Target Rate | 2.00-2.25% | 2.25-2.50% | 1.25-1.50% |
| Consumer Confidence Index | 135.1 | 128.1 | 122.1 |
| Manufacturing PMI Index | 49.1% | 54.1% | 59.7% |
| Unemployment Rate | 3.7% | 3.9% | 4.1% |
| JPY / USD | 106.29 | 109.56 | 112.67 |
| USD / EUR | 1.0989 | 1.1469 | 1.1996 |
| Gold / oz. | \$1,519.85 | \$1,282.73 | \$1,302.45 |
| Oil (WTI) / bbl | \$55.10 | \$45.41 | \$60.42 |

economic data, especially in Germany, as well as increasing political uncertainty in various member countries. Second-quarter GDP data reaffirmed the EU's ongoing economic slowdown, showing growth of just 0.2% compared to the prior quarter. Importantly, it appears that Germany is now on the cusp of a recession, as its economy contracted by 0.1% in the second quarter, with the Bundesbank expecting the downturn in orders for cars and industrial equipment to continue into the third quarter. In line with the recent trend, there remained a historically marked divergence between the performance of the manufacturing and services economies. Whereas the latter expanded at a solid, and slightly faster pace, goods producers endured another period of falling output (the seventh in successive months). This dichotomy may provide the balance needed to avoid a regional recession.

Nevertheless, the economic malaise has fueled stimulus hopes. Germany's finance minister has left the door open for a fiscal stimulus package, should conditions warrant it, and the ECB all but promised to ease policy further. On top of the central bank's already announced new targeted longer-term refinance operations (TLTRO), the ECB is expected to further lower interest rates and could restart quantitative easing.

In Italy, Matteo Salvini pulled his League party out of its ruling alliance with the anti-establishment Five Star Movement (M5S), hoping to trigger an election that would return him to power as the unquestioned leader of a new government. However, this turned out to be a miscalculation as Prime Minister Giuseppe Conte was

given the mandate to form a previously unthinkable coalition government between M5S and the opposition Democratic Party, allowing him to stay on as Italian leader.

In the UK, the quest for Brexit, and uncertainty surrounding the various possible scenarios, continue to weigh on the economy. Second-quarter GDP shrank by 0.2% for the first time since 2012, inching closer to recession. There has also been associated pressure on the Pound Sterling, which ended August at a multi-year low. Both businesses (reduced capital and investment activity) and the consumer (weak outlook for retail sales) have been affected. If there is a snap election, policy uncertainty will remain high. In addition, recent polls suggest another hung parliament, which indicates an inability to act. There have been discussions of a three-way referendum where people vote to remain in the EU, or leave with the deal that Theresa May negotiated, or a no-deal Brexit.

ASIA

Investor eyes have been keenly focused on the economic and political climate in China. Thus far in 2019, policy makers have taken several measures to counterbalance the local effects of the trade war with the US. Notwithstanding the recent additional fiscal and monetary stimulus, the results have, thus far, been mixed. The most recent retail sales data, for example, have come in short of expectations. Also, China's manufacturing PMI for August dropped to slightly below 50, indicating that segment of the economy is in contraction.

In this context and without the prospect of a trade deal in the near term, the Chinese authorities were obliged to take additional stimulus measures in August. The People's Bank of China announced a lending rate reform to lower financing costs and allowed the renminbi to break the psychological 7.0 barrier, versus the US dollar, the lowest level in 11 years. The currency move triggered an official condemnation from the US, who labelled China a currency manipulator. On the trade negotiation front, the US and Chinese leaders (Liu He, Robert Lighthizer and Steven Mnuchin) have agreed to meet in early October.

OUTLOOK

Looking ahead, renewed monetary and fiscal stimulus is expected to support the global economy, but these measures won't be able to fully offset the negative effects of the trade war and hence the global economic slowdown is likely to continue, warranting a conservative stance.

Within equities, we continue to recommend a focus on quality companies with strong balance sheets, led by management with proven capital allocation skills. Of particular note, stock dividends presently offer a greater yield than the 30-year US Treasury bond, for first time since 2009, an event that only occurred once before in last 40-plus years. The current low level of interest rates is being taken advantage of by corporations globally, allowing them to lower their cost of financing at a time when margins are under pressure from lower top-line revenue growth and higher wage costs. The second-quarter earnings season showed that (non-GAAP) US earnings-per-share growth was just shy of 5%, on average, broadly in line with sales growth, with little margin expansion. We continue to forecast muted aggregate corporate earnings growth, this year and next, and thus believe that stock picking is poised to produce notable results during the coming "earnings recession" which is being exacerbated by the ongoing trade wars. In addition, the relative divergence between valuations of growth and value stocks is large, offering attractive opportunities for patient investors.

Despite historically low yields, we still see investment grade fixed income playing a necessary role in overall asset allocations, given their scope to rally further if sentiment deteriorates. However, we caution that higher rates could surprise market participants, and therefore continue to recommend caution by investing predominantly in shorter duration securities, especially given the extremely flat shape of the yield curve.

Select alternative strategies, especially those with low correlations to traditional asset classes, warrant close 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