



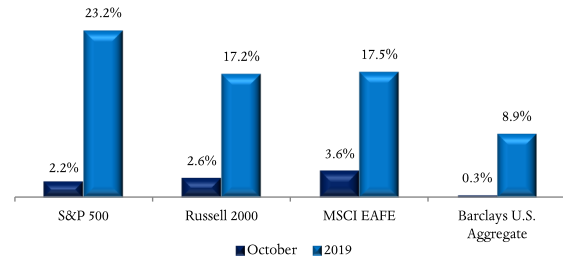
## MARKETS

Financial markets responded positively to signs of easing geopolitical tensions in October. The US and Chinese authorities moved closer to an initial deal on trade, while the UK made progress on the path towards a soft Brexit. Driven by softening economic data, global central banks reiterated their willingness to provide monetary liquidity, and the US Federal Reserve cut interest rates for the third time this year.

October was a good month for equity markets. The S&P 500 gained a further 2.2% (+23.2% ytd), reaching all-time highs. The Russell 2000 added +2.6% (+17.2% ytd), but remains approximately 8% below the high of September 2018. The rally featured cyclicals extending gains with defensives lagging. In Europe, the Stoxx 600 index rose +1.1% (+21.6%), with most markets, save the UK, rallying. Asian markets also showed gains, particularly in Japan where stocks rose +5.4% (+16.8% ytd). Returns were more muted in China, with Shanghai stocks rising +0.8% (+20.3% ytd). Playing catch-up, emerging markets outperformed developed ones, returning +4.2% (+10.7% ytd).

In fixed income, bond yields edged higher (US 10 year Treasury +2.6 basis points; German 10 year Bund +16.4 basis points), while curves steepened. Investors repriced dovish Federal Reserve expectations following softer data, and European inflation remained subdued. The Bloomberg Barclays US Aggregate index rose +0.3% in October (+8.9% ytd), while the US High Yield index added +0.2% for the month (+11.8% ytd).

Crude oil was little changed last month with WTI crude closing at \$54.18 per barrel. OPEC+ is set to consider deeper oil cuts at its December meeting, due to expected softer demand growth in 2020, amidst increased supply. Precious metals rose, clearly supported by low interest rates and a weaker dollar (seemingly ignoring



the rise in long bond yields and equities). Gold rose +2.8%, with silver the standout, adding +6.5%.

## GEOPOLITICS

US-China trade negotiations improved after the two sides agreed on the outline of a mini trade deal (which includes a significant increase in China's purchase of US agricultural products, a currency pact, China's further opening up of the financial sector, some tech transfer and IP protection items, and the suspension of the October 15 tariff increase by the US). The so-called "phase one" deal is likely to be signed in November. With regard to an eventual resolution of the trade war, it is interesting to note that US voter sentiment, across political parties, remains skeptical about the relative fairness of Chinese trade practices. In addition, both sides have ambitions to be the number one player in global technology. Barring support from China, the trade war pendulum could swing back towards escalation in the coming months if President Trump decides to ramp up anti-China rhetoric to boost support ahead of the presidential election in November of next year.

The risk of a no-deal Brexit diminished after a deal was agreed between the UK and the EU. Further, PM Boris Johnson won the first ever majority in Parliament for a withdrawal pact. However, MP's voted down the accelerated timetable to get the deal done by October 31, leading to an extension of Article 50, and an early election in the UK on December 12. Conservatives recently extended their lead over Labour, with the average of

the last 5 polls showing them 9.8% ahead. Further, Brexit Party and Liberal Democrats continue to lose ground in their estimated vote shares.

#### UNITED STATES

Recent US economic data continued to suggest an ongoing loss of momentum. The weakness remains most pronounced in the more trade-dependent manufacturing sector, with the Institute for Supply Management's manufacturing purchasing managers' index (PMI) latest reading of 48.3% indicating that the manufacturing side of the economy is contracting. Perhaps more concerning, there seems to be a gradual contagion of the slowdown into the broader economy leading the Consumer Confidence index lower by 0.4 points to 125.9. Retail sales dropped 0.3% in October as households reduced spending on building materials, online purchases and especially automobiles. Providing an overview of consumer health, the Markit Services PMI has steadily declined to 50.6%, down from the mid-50's earlier in the year. While the unemployment rate (3.6%) remains at a historically low level, the pace of job growth has slowed (on average, 160,000 jobs have been added each month this year, compared to 220,000 per month in 2018). Real GDP growth for the third quarter did, however, provide some optimism, growing at a greater than expected annualized rate of 1.9%. The upshot is that while the US economy is decelerating, it is not in recession. Further, the prospects of avoiding a downturn are improving thanks to thawing trade tensions and the possibility that tariffs may be rescinded, which should lead to improved corporate sentiment and a resumption of capex spending.

The trailing economic data points led the Federal Reserve to cut interest rates by 25 basis points, for a third time this year, to a target range of 1.50–1.75%, and indicate that any changes going forward will be data dependent. This action should improve lending conditions, especially for credit-linked consumer spending. By way of further easy monetary policy action, the Fed also announced a new asset purchase program whereby the central bank will purchase government-backed

October 2019 Economic Statistics

	Oct-19	Dec-18	Dec-17
Federal Funds Target Rate	1.50-1.75%	2.25-2.50%	1.25-1.50%
Consumer Confidence Index	125.9	128.1	122.1
Manufacturing PMI Index	48.3%	54.1%	59.7%
Unemployment Rate	3.6%	3.9%	4.1%
JPY / USD	108.02	109.56	112.67
USD / EUR	1.1150	1.1469	1.1996
Gold / oz.	\$1,513.16	\$1,282.73	\$1,302.45
Oil (WTI) / bbl	\$54.18	\$45.41	\$60.42

securities, expanding its balance sheet at a \$60 billion monthly pace through mid-2020. This effort is meant to keep money markets in check after a messy episode in which interest rates for repurchase agreements (short-term loans between banks and other financial institutions) spiked in September.

#### EUROPE

The global economic slowdown appears most evident in the eurozone, particularly in Germany, due to the region's relatively greater dependence on international trade. The fragility of local economies is illustrated by the October PMI's of 45.7% in manufacturing (deeply in contraction territory), offset by a slight rise in services to 51.2%, leading to a barely expansionary composite reading of 50.2%. This data signals forward GDP growth of only 0.8%, which is well below potential. Akin to the US, the employment component of the composite PMI now shows that employment is increasing at the slowest pace since December 2014. Consumer confidence also fell to -7.6 in October, the lowest reading since December of last year.

October's European Central Bank (ECB) meeting marked Mario Draghi's exit as President. We bid him farewell and applaud his guiding principle to "never give up" in trying to meet the central bank's mandate. Christine Lagarde, former head of the International Monetary Fund (IMF), will now take the reins of a monetary policy that is nearing its limits, with interest rates at -0.50% and open-ended quantitative easing of €20 billion per month (in place until the central bank's inflation targets are achieved, which is a problem given

that the ECB's forward looking projection is a mere 1.5%). Potential future central bank actions include an incremental rate cut (to -0.60%) and a larger pace of QE (to €30 billion). An additional goal for the ECB, led by politically-savvy Lagarde, may be to convince eurozone governments to loosen their fiscal purse strings to stimulate their economies.

## ASIA

China's manufacturing activity rose for the second straight month in October, with data indicating a broad-based pickup across the major PMI components with a headline reading of 51.7%, the highest since February 2017. New and export orders both increased to 53.6% and 51.1%, respectively, to the best levels since the beginning of the US-China tariff conflict. Overall, GDP growth in China softened to 6.0% for the third quarter, down from 6.2% previously. Looking ahead, economist forecasts call for GDP growth to stabilize in the 5.8% region over the next six months, with the US-China "phase one" deal cushioning near-term downside risks. Aiming to soften the economic descent, the People's Bank of China, last month, enacted a second 50 bps cut in the banking system's reserve requirement ratio (and telegraphed a third to come in Q1 2020) collectively releasing CNY 900 billion (approximately 1% of GDP) into the banking system. In turn, credit data for September revealed a significant pickup in total social financing and new bank loans.

The Bank of Japan left monetary policy on hold, and indicated that short and long-term interest rates are expected to remain at their present or 'lower levels' for as long as necessary to achieve price stability, as the country continues to grapple with deflationary forces.

## OUTLOOK

The global economic slowdown and ongoing geopolitical uncertainties, have been well publicized and remain at the top of investor concerns. Our analysis, however, indicates that the global economy may be close to a near-term bottom, due in part to the resumption of monetary liquidity from the US, European and Asian central banks (combined they are printing money at an annualized pace

of over \$1 trillion), coupled with historically low (or negative) interest rates. In addition, the thawing of trade relations between the US and China should alleviate some corporate planning anxieties and release pent-up capital expenditures and other investment spending. Further, fiscal stimulus from China, as well as potentially from Europe (especially Germany which has been conservatively managed) may offer additional economic support and confidence in boosting global economies.

Given the discounting mechanism embedded within equities, we do not see signs of broad based excess or a general stock market bubble. In fact, the S&P 500 index is only modestly above levels seen in January of 2018, indicating a market that has, until recently, been in consolidation for nearly two years, driven by generally flat earnings. Similarly, the smaller capitalization Russell 2000 index remains in a two-year trading range, but is still approximately 8% below the high of fourteen months ago. Overseas, the MSCI EAFE and Emerging Markets indexes have trading laterally, with healthy volatility, since May of 2015. Therefore, should economies avoid a hard landing or recession, associated equities are poised to rise, assisted by ample liquidity and the lack of competition from fixed income. In addition, value equities in general have underperformed their growth counterparts, to a historical degree, both in terms of magnitude and duration, offering select opportunities.

In fixed income, short-term government bonds, particularly in the US, can still serve to add ballast to portfolios in adverse market environments. However, the recent upward trend (10-year US Treasury Notes are approaching 2.0%, up from a low of 1.5% since the late summer) signals that interest rates may have bottomed, making long dated bonds a riskier proposition.

Given the historically low level of interest rates (with \$12 trillion of overseas bonds trading with a negative yield to maturity), select alternative strategies may be appropriate for investors seeking stability during volatile periods, as well as those striving for risk adjusted or non-market correlated returns.

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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