

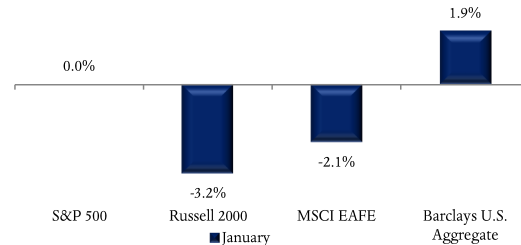


MARKETS

After a stellar 2019, risk markets began the new decade on a positive note, thanks to the signing of a “phase one” trade deal with China. However, the early gains were erased on concerns over the potential impact on global GDP from the spreading of a Chinese coronavirus. Markets also fended off a flare-up in tensions between the US and Iran, which fortunately de-escalated swiftly. For the month of January, the S&P 500 index declined -0.04%, while the smaller capitalization Russell 2000 index retreated -3.2%. Bucking the trend, the tech-heavy Nasdaq advanced +2.0%. Overseas equities also encountered volatility, with the MSCI EAFE index dropping -2.0% in January. In Europe, the Stoxx 600 index pulled back -1.1%. In Asia, Hong Kong stocks declined -6.7%, driven by coronavirus fears; similarly, emerging market equities tumbled -4.7%.

Given the risk-off sentiment, safe haven assets performed well in January. Specifically, the US dollar and Japanese yen both appreciated and government bonds rallied. US Treasuries and euro government bonds returned +2.4% and +2.5% respectively. The benchmark Bloomberg Barclays US Aggregate index appreciated +1.9% during the month.

Energy commodity markets began to discount a weaker global economy, over the next several quarters, driven by the coronavirus related demand shock. The expected lower demand for oil led to an -11.9% fall in the price of Brent crude (to 58.16/barrel, down from an intramonth high of \$71.75). Subsequently, OPEC+’s Joint Technical Committee failed to negotiate an additional output cut, intended to buttress the reduction in China’s consumption of oil by an estimated 650 thousand barrels of oil per day (MBbod) in the first quarter and 270 MBbod for the full year 2020.



GEOPOLITICS

On the global trade front, the US and China signed a “phase one” deal that brought a truce to a bruising trade war between the world’s two largest economies. The deal has led to a reduction of U.S. tariffs, from 15.0% to 7.5%, on about \$120 billion in Chinese goods, but kept in place tariffs on about \$360 billion of Chinese imports. In turn, China announced it would halve additional tariffs levied last year, against 1,717 US goods valued at \$75 billion. Further, China has committed to boost its imports from the US by around \$200 billion over the next two years; allow greater access to its markets for financial services companies; enforce intellectual property protections; and be more transparent in its currency management practices. The remaining tariffs are likely to stay in place for the foreseeable future, given the belief that a “phase two” deal is a long way off, depending on the outcome of the US Presidential election, coupled with the fact that trade negotiations are likely to focus on technological superiority going forward.

The Chinese Novel Coronavirus (2019-nCoV) epidemic, which originated in the country’s Hubei province last December, was declared a public health emergency of international concern by the World Health Organization. As we go to press the number of worldwide cases of the virus has risen to 40,573, with an associated death toll of 910. In comparison, the SARS outbreak of 2003 infected over 8,000 people, with 774 deaths. In the current instance, it appears that the vast majority of cases

have been contained inside China, the workshop of the world and its second-largest economy, which will bear close scrutiny in the coming months.

The UK officially exited the EU on January 31, 2020. The two sides will need to negotiate a new free trade agreement over the ensuing 11 months of transition. While the Brexit saga is nearly over, there may still be some stumbling blocks along the way.

UNITED STATES

The signing of a “phase one” trade deal between the US and China on January 15 was welcome news from an economic and sentiment perspective. Looking ahead, we believe that businesses will now feel empowered to resume investment plans that were postponed in 2019. However, the perceived uncertainties caused by the upcoming US presidential election in November, are likely to keep a certain cohort of businesses conservative in their capital allocation plans.

During the final quarter of 2019, the US economy grew at an annualized pace of 2.1%, indicating a solid footing. Manufacturing, which had been in the doldrums for five months, rebounded strongly from 47.8% to an expansionary 50.9% in January. Further, the services side of the economy remained resilient. This is indicative that the consumer, the bedrock of the US economy, is still in good shape, with confidence rising significantly in January. The main driver, total nonfarm payroll employment, rose by 225,000 in January, with the unemployment rate little changed at a near record low 3.6%. January’s figure compares favorably with an average monthly gain of 175,000 in 2019. Hourly earnings over the past 12 months have increased by 3.1%.

With the economy evolving broadly in-line with the Federal Reserve’s outlook of moderate economic growth and a strong labor market, the decision to keep the key interest rate unchanged at the January meeting was unsurprising. However, the central bank announced an extension of its multi-month support of the repo market, via liquidity injections, through April.

January 2020 Economic Statistics

| | Jan-20 | Dec-18 | Dec-17 |
|---------------------------|------------|------------|------------|
| Federal Funds Target Rate | 1.50-1.75% | 2.25-2.50% | 1.25-1.50% |
| Consumer Confidence Index | 131.6 | 128.1 | 122.1 |
| Manufacturing PMI Index | 50.9% | 54.1% | 59.7% |
| Unemployment Rate | 3.6% | 3.9% | 4.1% |
| JPY/USD | 108.38 | 109.56 | 112.67 |
| USD/EUR | 1.1093 | 1.1469 | 1.1996 |
| Gold/oz. | \$1,589.81 | \$1,282.73 | \$1,302.45 |
| Oil (WTI)/bbl | \$51.56 | \$45.41 | \$60.42 |

EUROPE

Growth in the eurozone remained positive, but tepid, at 0.1% in the final quarter of 2019, with forecasts calling for a reacceleration to 0.4% by the second half of the year. The European consumer remains supported by a healthy labor market as unemployment in the region fell 0.1% in December to 7.4%, representing a twelve-year low. In a further positive signal for the economy, a monthly survey of businesses by the European Commission found a better than expected improvement in sentiment in January, driven by a rebound in the outlook of German companies. The manufacturing side of the economy also showed a significant rebound. Should international trade improve on the back of the “phase one” trade deal, then the manufacturing hubs of Germany and Italy, which both have about a fifth of their employment in manufacturing, stand to benefit. However, it should be mentioned that the short term outlook is cloudy given the dependence of factories on parts sourced from China, given potential disruptions due to the coronavirus.

ECB President Christine Lagarde’s second meeting was subdued. Policy rates were left unchanged and a comprehensive review of monetary policy strategy was confirmed. The review will include an assessment of the monetary policy toolkit, including its effectiveness and potential side effects, how the ECB approaches price stability, and environmental sustainability. Nevertheless, market participants do not believe that the negative interest rate policy will be reversed. Importantly, Lagarde reiterated her call for additional fiscal stimulus, in particular by countries more easily able to bor-

row, campaigning that good fiscal support would provide a tailwind for the ECB's monetary policy.

UK economic data, which had notably deteriorated ahead of the December election, subsequently partially rebounded. Employment grew by 208,000 in the three months to November, showing resilience. The flash purchasing managers' index releases for January, the first major data points since the election, pointed to a sharp improvement in both manufacturing and services, with the composite rising from 49.3 to 52.4. This was sufficient for the Bank of England to keep interest rates unchanged at 0.75%, pointing to reduced risks from global growth as well as the sizeable domestic fiscal tailwind.

ASIA

January saw the outbreak of a coronavirus, originating in Wuhan, China. At the time of writing, the virus continues to spread, likely aided by the increased travel over the Lunar New Year celebrations. As we are still in the relatively early stages of the outbreak, and given the incubation period of up to 14 days (before symptoms present), it is hard to gauge exactly how the situation will develop and the subsequent economic impact. It is, however, certain to be a near-term drag on Chinese economic growth as well as that of its trading partners, as business and infrastructure networks shut down and more people remain at home. A concerted economic and monetary policy response from Chinese authorities has been enacted, with the aim of dampening the downturn and assisting a recovery in the coming quarters. The outbreak comes at a time when economic data suggests that the Chinese economy was growing at a 6.0% annual rate in the fourth quarter. Unfortunately, the recent trend will not be of much significance until the virus stops propagating and we can assess the far reaching implications.

OUTLOOK

Positive economic trends continued in the US, with green shoots appearing in Europe. China, which had led global growth, is likely to be the weak link in the coming quarters, given the effects of the coronavirus on the interconnectedness of the just-in-time worldwide supply chain. In

the meantime, major central banks are set to remain accommodative until they can quantify the repercussions for China and the rest of the world's economies.

As we go to press, US stocks are trading at all-time highs, supported by historically low interest rates and ample monetary liquidity. This success has led equity valuations towards the upper end of historical norms, with sentiment indicators showing that the S&P 500 index was at the third most overbought level in 30 years. Additionally, after the strong 2019 performance, which lacked earnings growth, the variance between price expansion / multiple expansion to earnings growth was the widest in the last several decades. While volatility may express itself, and prudence is always warranted, interest rates are expected to remain at low levels, and monetary conditions are unlikely to be tightened, at least in the short-term. In the meantime, our research indicates that there are still ample opportunities in the stock market, especially for stock pickers seeking out absolute and relative values both domestically and abroad.

Fixed income investors continue to bid for securities, with the 30 year US Treasury bond trading with a yield just above 2%, near a record low. Demand was driven by the recent coronavirus outbreak and an accommodative Federal Reserve. International buyers still view the US as their choice of safety for government bonds, especially given the negative yields in Europe and Japan. Further, a core measure of US inflation showed inflation pressures slowing to an annualized 1.3% in the fourth quarter, from 2.1%, in the latest reading. In all, the fixed income environment appears benign, but we reiterate our recommendation that investors remain conservatively postured at the short end of the yield curve given the potential volatility of long dated bonds.

The coronavirus outbreak and a brief flare-up in US-Iranian tensions in January serve as timely reminders that a well balanced portfolio construction allows investors to be proactive and opportunistic during periods of market stress. This is best achieved through a broad approach to portfolio diversification, including select alternative assets, which can behave in a non-market correlated fashion.

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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