Winslow, Evans & Crocker, Inc.℠

SEPTEMBER 2019 GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

GLOBAL ECONOMICS

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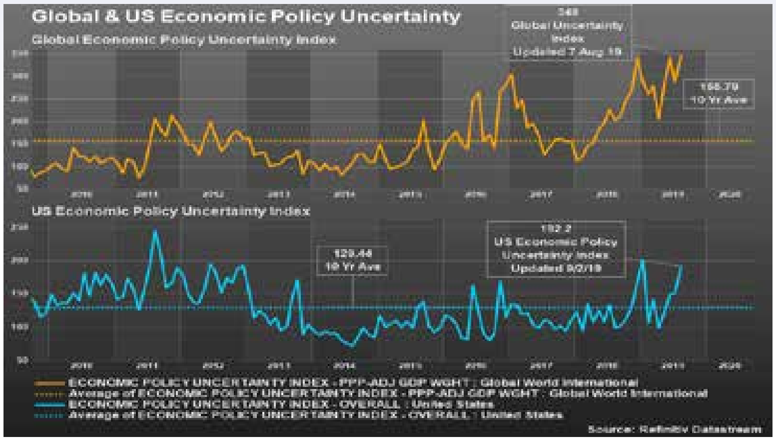
GLOBAL UNCERTAINTY AND THE GREAT LIQUIDITY FLOOD

When CNBC finds airtime to cover the Patriots' wide receiver Antonio Brown then you know that they, too, are a bit fatigued with the endlessly changing headlines about domestic and global economies and politics. The steady barrage of trade talks, tariffs and tweets set against a background of political intrigues such as Brexit, impeachment and the attack on the Saudi oil facilities is enough to make you want to re-open that bomb shelter you built in the 1950s! All of this angst generating news heightens investor uncertainty and market volatility. Chart #1 is a measure of global and domestic economic uncertainty that is illustrative of the recent acceleration of elevated anxieties. This, in turn, has led to greater turbulence in US equities markets as measured by the daily percentage changes, shown in Chart #2, and one of the highest surges in standard deviations since the Yuan devaluation of 2015.

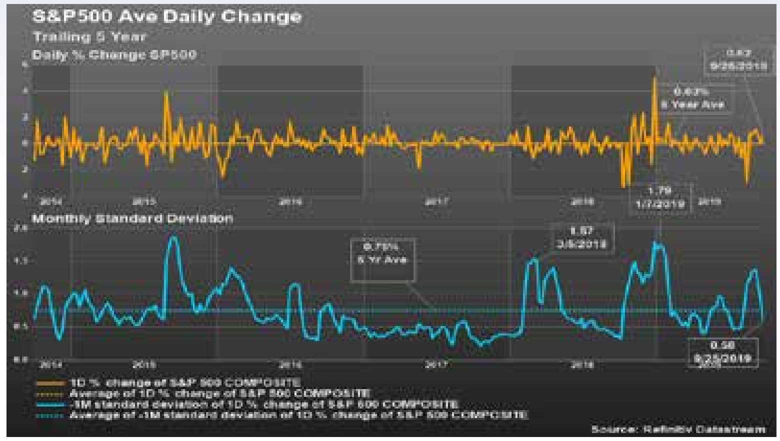
1



CHARTS 2-3

In order to determine an appropriate investment strategy while being inundated by this daily din we need to look for data that gives us an indication of the state and direction of the economy and, therefore, the market for risk assets. One indicator that has been a traditional bell weather of impending recessions is the inversion of the yield curve. It has turned negative in the past few months and has given rise to many bearish predictions for the economy. As we argued in last month's publication, the predictive value of an inverted yield curve is now greatly diminished. In Chart #3, you can see how financial stresses in the economy, the blue line, are currently declining while, during past cycles, they were increasing. These low financial stress indices are an indication that the credit market indicators such as high yield spreads or default spreads are seeing no threatening business issues. One of the reasons that the yield curve has inverted is that the longer dated US Bond yields have been pulled down by the negative interest rates prevalent in other major economies.

2



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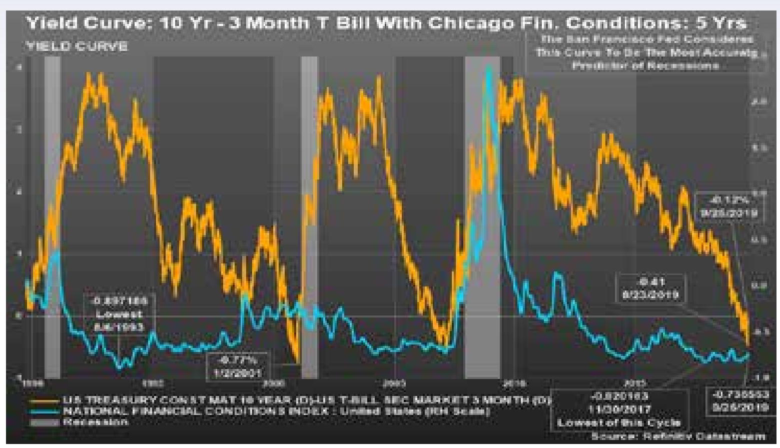
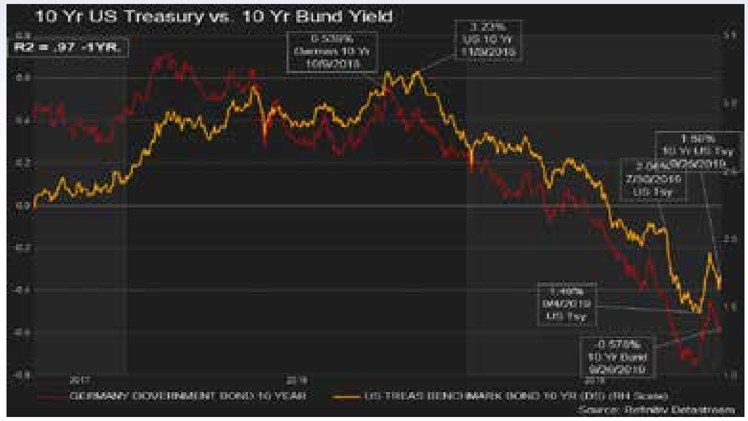


CHARTS 4-6

Chart #4 provides a good illustration. In it, you can see that there has been a near one-for-one correlation between the 10-year German Bund yield and the 10-year US Treasury yield over the past two years. The fall in the Bund yield has diverted investors into the US Treasury market thus lowering those yields. The fall in the Bund yield is caused by the fear of European investors of a further slowdown in their economies. Chart #5 clearly illustrates the divergence between German and US economic growth and business outlook. Although the European Central Bank has recently lowered rates and declared an open-ended approach to quantitative easing, Chart #6, Eurozone investors recognize that there are structural problems inhibiting economic growth that cannot be solved with just monetary policy but also must be addressed by the more intractable political classes.

4



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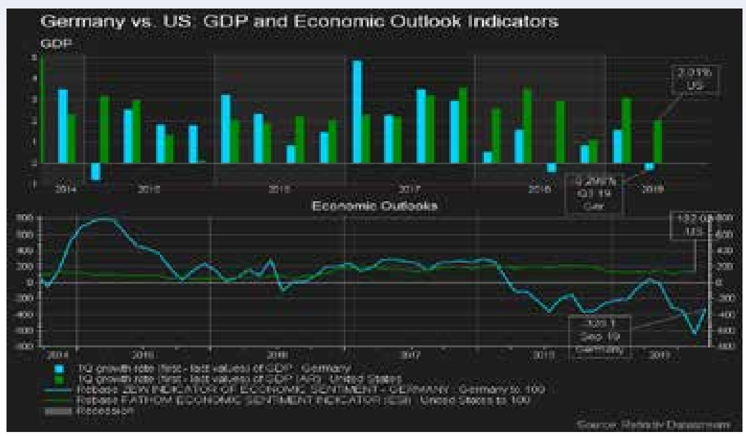

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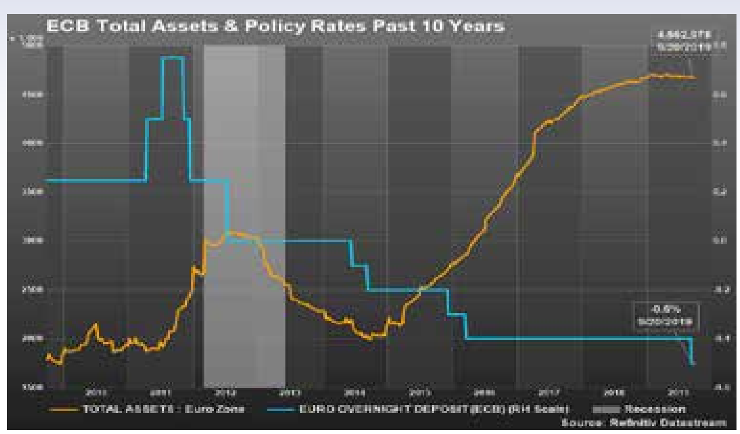
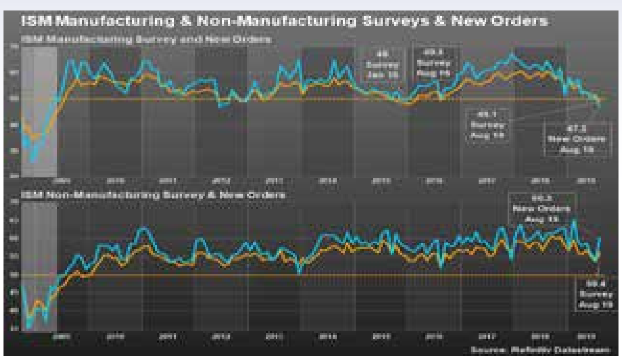


CHARTS 7-8

In the US there has been a clear slowdown in the manufacturing sector which has been offset by a very strong consumer. In Chart #7 the top panel is the ISM Manufacturing Index and New Orders Survey. The bottom panel is the ISM Non-Manufacturing Index and New Orders Survey. The manufacturing index, which is below 50, is reflecting the clear slowdown in that sector. Note, however, that for the past ten years the index followed a sine wave pattern with two prior dips below 50 without triggering a recession. The bottom panel represents the services sector and you'll note that both the index and new order surveys have been consistently above 50 for the past ten years and are now turning up. This is a clear indication that the services sector of the economy has held up very well. There are signs, however, that the manufacturing sector is adjusting to the trade and tariff uncertainties and may be getting better. In the bottom panel of Chart #8 we show the three-month moving average of the US Industrial Production index and it is clear that the ISM Manufacturing Survey has, historically, closely followed it. Recently the Industrial Production numbers have shot up which is a good indication that the ISM Manufacturing Survey will at some point follow. The recent decline in the August reading, although disappointing, was likely the result of the GM labor strike. That was followed by a disappointing ISM Non-Manufacturing reading which, however, remained above 50.

7



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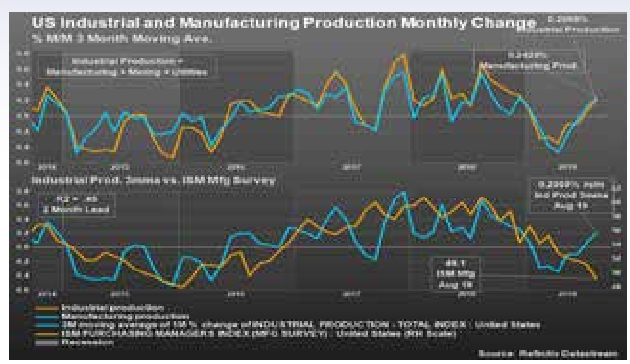

CHARTS 9-10

Another good indicator that the US economy is not entering a recession is the US Conference Board's recently released Leading Economic Indicator (LEI). Chart #9 shows the six-month percentage change for the LEI and its relationship to past recessions. As highlighted by the circled areas it is clear that this indicator must fall deeply into negative territory before the onset of a recession. Currently, the indicator is positive and trending back up!

It is clear that the US economy, although having slowed, is stronger and growing faster than other OECD economies. There is little doubt that trade, tariffs and political uncertainties are a drag on economic growth but the evidence so far is that we are not on the cusp of a recession.

The very easy monetary policies being pursued by the Eurozone and China coupled with the US Fed's rate reduction are very supportive for risk assets such as equities. The S&P500 remains relatively cheap when compared to the yield on the 10 year US Treasury Bond, Chart #10. The markets, however, will remain unusually volatile in the face of the above-mentioned global uncertainties but, absent a black swan event such as a military conflict or a complete collapse in global trade, we remain overweight equities and underweight duration.

Please consult with your investment advisor if you have questions about the contents of this newsletter.

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