NOVEMBER 2019

MARKET COMMENTARY

THE WORLD VERSUS THE UNITED STATES

EXECUTIVE SUMMARY

- ***TREASURY MARKET IS SIGNALING POTENTIAL WEAKNESS***
- ***THE U.S. HAS AVOIDED THE SHARP SLOWDOWN OTHER INTERNATIONAL ECONOMIES HAVE EXPERIENCED***

World economies outside of the United States have slowed dramatically. Will the U.S. stay in "modest" expansion or will the rest of the world drag us into a recession? This is the debate being waged in the bond market with every economic release.

The stakes are high. Yields on a significant amount of worldwide debt are near zero or even negative and our rates, while low by historic standards, remain an outlier. Plenty of bond market participants believe international growth has decelerated so dramatically that the U.S. can't avoid a recession and, therefore, the U.S. 10-year yield will migrate towards zero like many other developed countries.

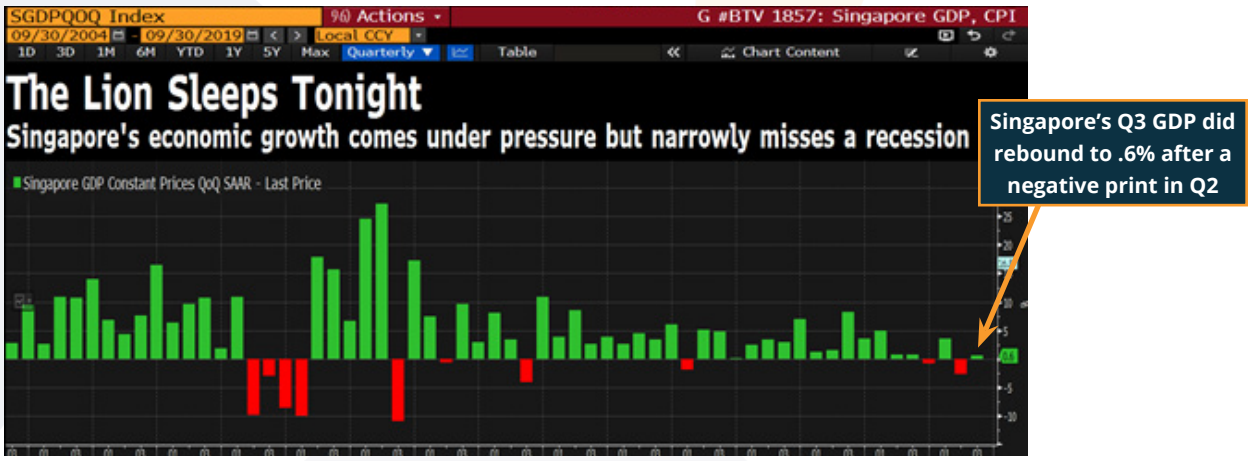
Source: Bloomberg, Star Capital Inc.

A key marker for international economic growth is South Korean exports – this has been worrisome.

Source: Bloomberg

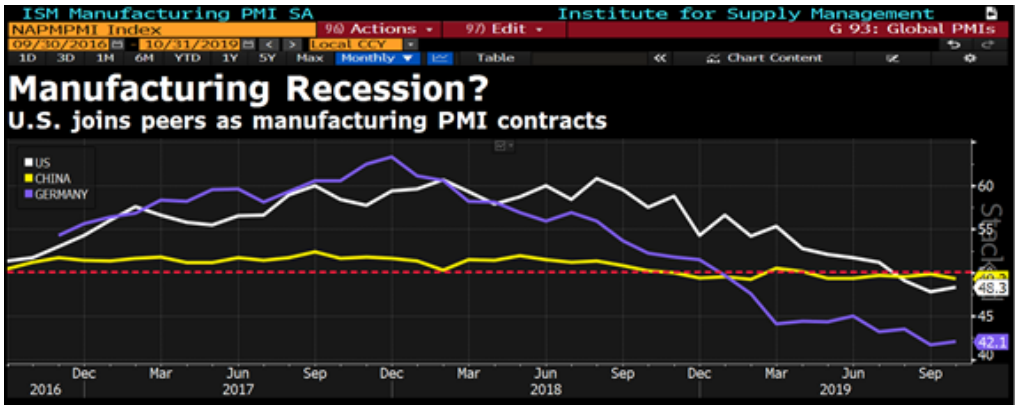
South Korean trade touches about 75% of the globe's GDP with Asia and Europe being most significantly weighted. Furthermore, about 20% of the country's exports are semiconductors. Semiconductors are considered the beginning part of the world's supply chain as they can be found in a broad range of consumer and industrial products. Investors view any slowdown in semi exports as a potential signal of reduced end-market demand and potential inventory builds.

Another proxy for global economic health is Singapore's GDP growth. Singapore has the highest trade weighting relative to GDP in the world. While not as negative as South Korea's data, recent trends have been bouncing between growth and contraction.



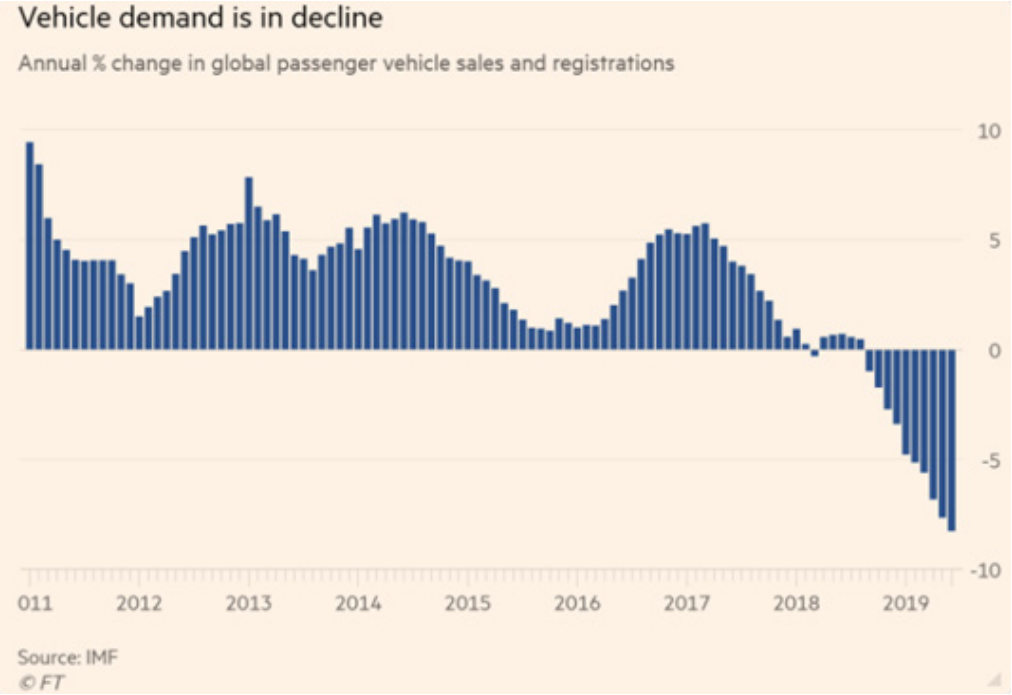
Source: Bloomberg

China and Germany entered manufacturing contraction earlier this year. Only the U.S. joined the contracting PMIs (Producer Manufacturing Index) late summer.



Source: Bloomberg

While the Chinese slowdown and "trade war" ramifications have had an impact, we believe one of the main culprits to the manufacturing slowdown is automobile sales.



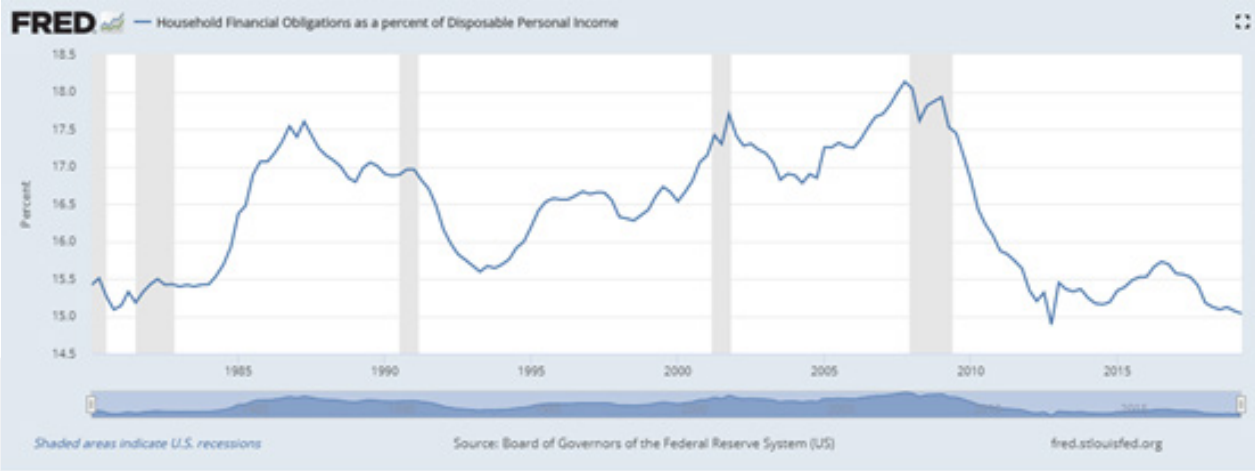
Source: Financial Times

Automobile manufacturing is an important segment of China's economy given they produce 25% of global vehicles. The auto industry is important to other countries as well. Germany, U.S., and Japan employ 12 million, 8 million and 5 million respectively in this industry. Overall, forty seven percent of Germany's economy is manufacturing dependent and therefore vulnerable to auto sales and the manufacturing environment.

But, the good news – 70% of the U.S. economy is consumer-centric with only 12% being directly tied to manufacturing. Thus, we are more insulated to manufacturing woes which may affect others.

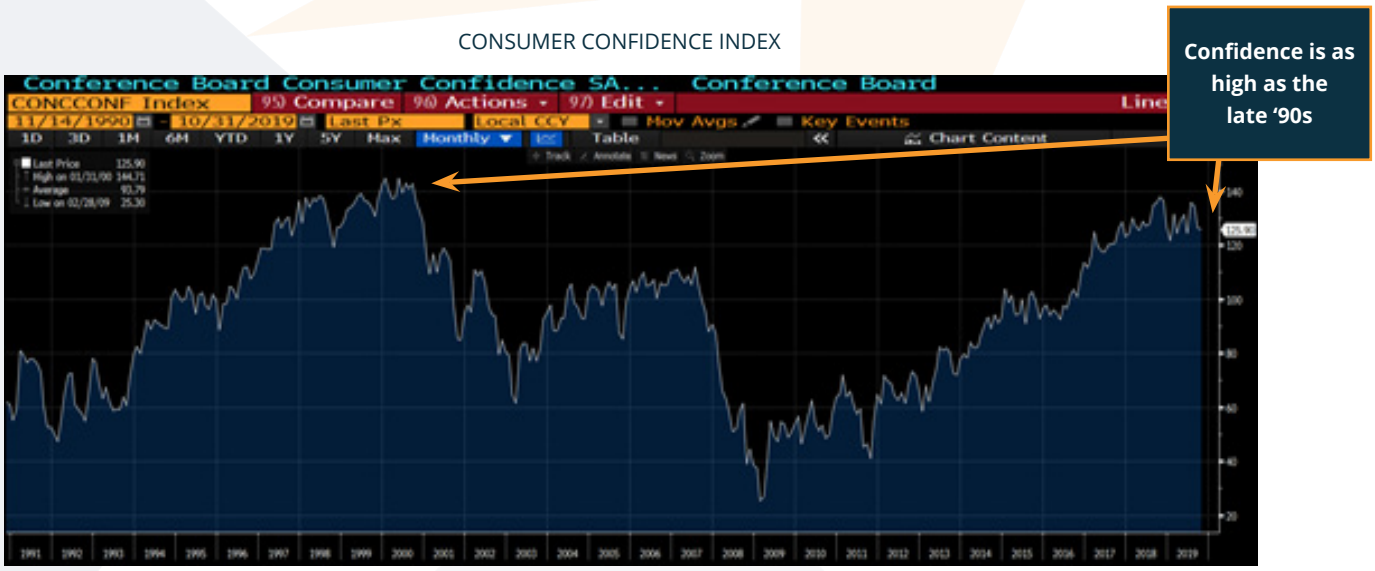
The U.S. consumer is in good shape – net worths and wages have been rising, debt servicing costs remain low, and sentiment is sustaining high levels.

HOUSEHOLD FINANCIAL OBLIGATIONS AS A % OF DISPOSABLE INCOME



Source: https://fred.stlouisfed.org/series/FODSP

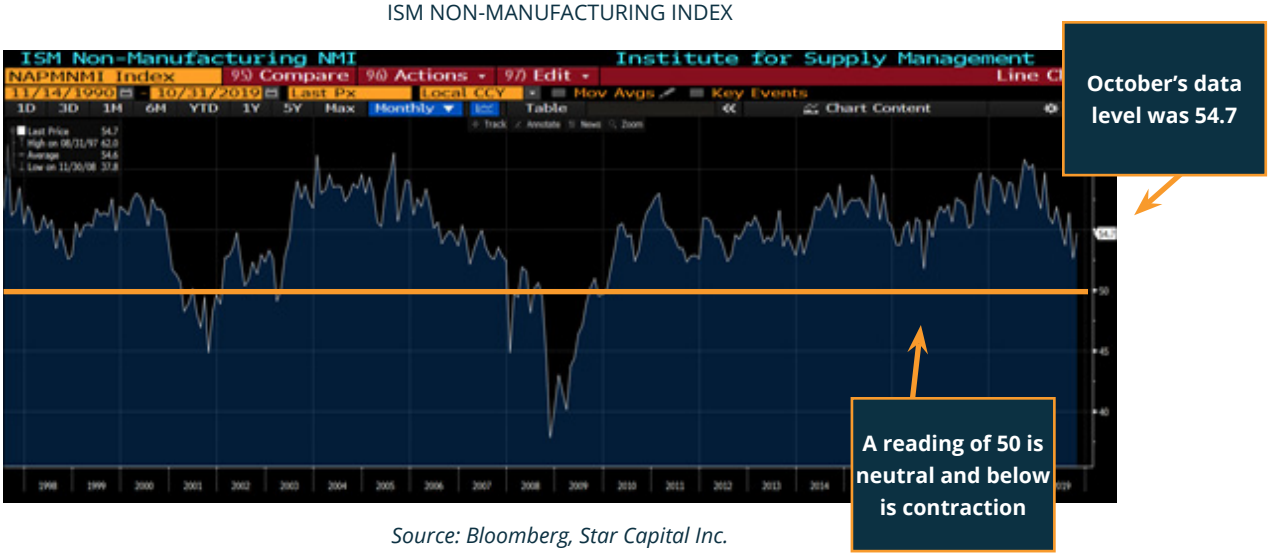
CONSUMER CONFIDENCE INDEX



Source: Bloomberg, Star Capital Inc.

Therefore, the non-manufacturing component of our economy has been soft lately but it is still expanding.

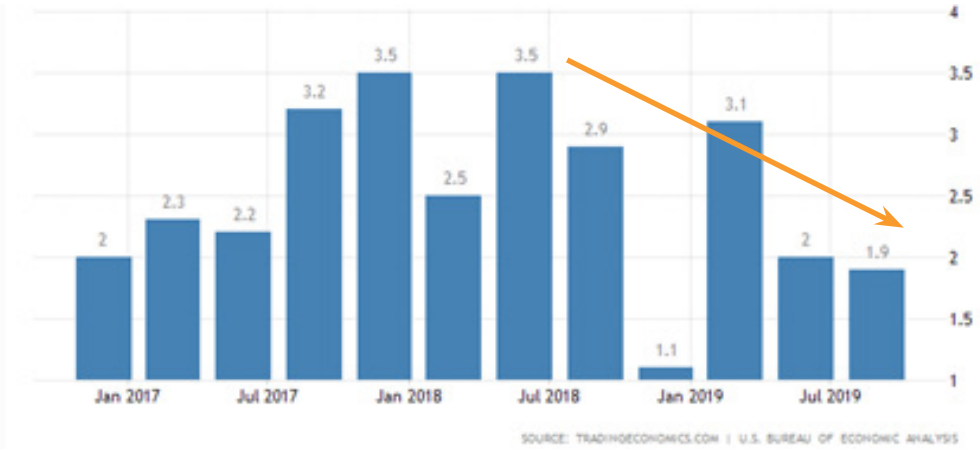
ISM NON-MANUFACTURING INDEX



Source: Bloomberg, Star Capital Inc.

Recent trends in our GDP have been positive but decelerating. This deceleration is why the Federal Reserve has taken an "insurance policy" out by lowering rates this year.

U.S. GDP GROWTH YEAR OVER YEAR



Source: https://tradingeconomics.com/united-states/gdp-growth

Does the manufacturing recession persist or broaden into the services sector? Will the global weakness spread onto U.S. shore? We don't have an answer with any conviction and will watch the data like others but someone will win the tug of war.

Where we do have an opinion is the nature of the next round of stimulus. Many central bankers are expressing opinions that monetary policy alone can not be counted on to combat slow growth or even recessions. The narrative has been shifting to "fiscal" incentives in coordination with monetary actions. Whether fiscal action is constructed around social programs, educational efforts, or infrastructure spending we will not know until more detail is offered. Unlike the actions weighted towards monetary stimulus post the great recession, the impact of coordinated programs may impact the economy differently this time.

The monetary actions dubbed "helicopter" money in the last cycle resulted in one of the slowest recoveries in history and inflated valuations on financial assets. On Wall Street, growth stocks received a substantial valuation premium due to the limited number of companies able to consistently grow.

Depending on the nature of fiscal actions, the benefits this time may create an improving tailwind for more main street companies. This scenario would likely extend the recent rotation from premium valued growth stocks to more value oriented companies. A resolution (or partial) in trade negotiations could also propel this rotation too as "late cycle" industries start to display earnings power.

Interesting times!

Please feel free to contact us with any thoughts or questions. We appreciate your trust and confidence.

THANK YOU

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PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS