Six reasons to believe in economic growth in 2019

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Please see important information at the end of this program. Recorded 5/8/2019

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Hello this is Chris Hyzy, Chief Investment Officer

The weakness in equity markets around the world in the last few days is centered around two specific concerns which have prompted worries over the growth outlook for the balance of 2019:

1. The first concern is the potential that the much discounted trade deal between the US and China may not go through

2. The second concern is over rising geopolitical risk with Iran

Regarding the US and China trade deal - the US Administration over the weekend announced they would raise the current 10 percent tariff on 200 billion dollars worth of imported Chinese goods to 25 percent beginning Friday. This comes on the back that the US believes that China has potentially walked back from from a majority of the so-called agreed upon elements of the trade deal that both delegations have been negotiating for many months. This view began to circulate over the weekend once China sent edits to a draft trade package that supposedly reversed some major parts around domestic competition and technology transfer rights the US sought to include in any deal.

Market volatility escalated recently as concerns grew that the trade deal was now at a major impasse and without a deal uncertainty would rise thereby impacting confidence and ultimately economic growth. Some estimate that a no deal scenario with higher tariffs could impact earnings for the S&P 500 by some 2 percent if it only included 200 billion in Chinese goods and potentially 7 percent of tariffs were placed on all imports from a China.

With this latest uncertainty, short term investors and traders have removed risk from their exposures in more cyclical areas which have been the leaders of the V shape sharp rebound in equities since the lows in last December. Most vulnerable to a no deal - tariff hike- scenario includes assets across Asia and Europe and more cyclical areas such as semiconductors, some global Industrials and auto related industries in the US.

Our view is that ultimately a deal is reached as it is in both interests to strike a trade deal given the fact that both administrations desire a more solid growth outlook for each country specifically since growth is just now is beginning to pick up up toward trend in much of the world and most notably in China.

At the end of the day - it is likely a framework is agreed upon during the latest delegation talks this week and into. Ext with the potential for further and final negotiations around key elements prior to the summit in Osaka that President Trump and President Xi will attend in late June. We will watch this closely.

As far as Iran is concerned.

Iran, in response to recent sanctions by the US, has given Europe 60 days to find a way for Iran to sell oil and trade with the rest of the world or Iran will resume uranium enrichment. This has raised geopolitical uncertainty and risk a few levels which could last through the summer.

In the face of these two new developments we are still optimistic on economic growth in the next year and believe equities reach new highs prior to the end of the year for 6 primary reasons:

1. We are beginning a new early stage (fourth mini-wave post credit crisis) growth phase which should extend the current cycle well into 2020.

2. Fed is on hold for an extended period of time and appears willing to allow the economy to run above trend until inflation rises well above it's long run target of 2 percent.

3. China's economic growth is more stimulative than what most believe and is already beginning to take shape. This should help Europe (the largest trade partner with China) stabilize its economy and grow back closer to trend in the next year.

4. Overall financial conditions, which include; low rates, low inflation, narrow credit spreads, healthy consumer, stable U.S. Dollar are easier and help support business confidence and an improved backdrop in the Emerging Markets.

5. Investor sentiment is still very fragile. In aggregate, according to AMG, equity mutual fund flows have been negative (fixed income fund flows are significantly positive) through the first four months of 2019 despite the 16% plus gain in prices for the S&P 500. In addition, when examining the price return since year-end 2017 (approximately a 16 month period) the market is only up around 8.5 percent given the negative volatility downdrafts experienced in 2018. We believe that given easier financial conditions, supportive equity buybacks, and the profit recession worry off the table that equity valuation can head higher as investors' comfort level improves with a clearer outlook.

6. The next solid catalyst to above trend economic growth and still stable inflation is productivity. We expect the collective efforts of automation, big data, artificial intelligence, cloud-based system infrastructure, and advanced software cycles to drive a new productivity cycle in the years ahead, which should support corporate margins and balance out potentially higher competing wages. We are beginning to see these effects emerge as evidenced by the much better than expected Q1 2019 productivity report recently announced (3.6% versus 2.2% expected). We expect this trend to continue into 2020, which could keep the Fed on hold for longer while growth rises.

We continue to prefer equities relative to fixed income and favor the U.S. and Emerging Markets over other regions. We continue to prefer large caps relative to small caps as well. Growth and value opportunities continue to emerge in Technology, Financials, and Industrials, while segments of Consumer Discretionary are benefitting from consumer confidence and specific thematic growth trends.

We expect yields to drift higher through year end and the curve to steepen slightly. Therefore, we continue to prefer shorter dated yields, investment grade credit, but still see value in intermediate and long term municipals for taxable investors.

Given the 6 major reasons, we believe that any equity market weakness represents an opportunity to add to allocations, particularly for investors that are either under-allocated or have missed the move back up from the lows in late December. For investors that are more opportunistic and have not drifted above their stated equity weights, we would use three separate periods between now and year end (particularly in between earnings seasons) to raise equity allocations.

After a short period of consolidation in the markets we expect to head toward a new summit and pierce the old highs.

Thank you

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