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Latest Global Outlook
Suggested Investor Action Plan
Mid-May 2019

Warnings about Europe and Japan vs. positive U.S. outlook

We continue to suggest that It may be prudent to de-risk exposure to Europe (especially the U.K.) and Japan due to the deteriorating economic outlooks described in this report.

On the other hand, the U.S. economy while slowing a bit seems to be reinvigorated. The uncertainty over the Trump trade war is a negative globally, but not a crisis. For the U.S., the impact of the tariffs should be much less than the impact of the strengthening of the dollar in 2014-2016.

U.S. Bright Spot in Global Economy

5/17/2019 - Consumer sentiment rose to a 15-year high in early May as Americans grew more confident about the health of the economy and its outlook this year.

The Conference Board's estimate of leading economic indicators rose for the third straight month in April.

New-home construction starts rose a second month, up 5.7% in April following a revised 1.7% increase the month prior. Housing starts and new building permits both rose the most in three months, suggesting lower mortgage rates and the Fed's rate patience are helping to reinvigorate the housing industry.

The Philadelphia Fed's regional manufacturing activity index rose to a four-month high in May, nearly double the level in April.

The New York Fed reported that manufacturing activity jumped in the Empire State, reaching a six-month high in May. The region's key measures of new orders and shipments showed big gains, along with the survey's six-month outlook.

5/14/2019 -The small-business optimism index by the National Federation of Independent Business rose to a four-month high in April.

The 3 % GDP growth rate for first quarter 2019 occurred despite the negative impact of the government shutdown, market turmoil in late 2018 and slowing foreign economies. We also have very low inflation, which should prevent increases in interest rates. About 75% of S&P500 companies beat their earnings estimates.

While US growth is probably slowing to 2-2.5% considering the trade war, the upside potential is probably greater than the downside risk.

Eurozone: If anything more goes wrong, the Eurozone is on the brink of a recession.

5/17/2019 – Barron's – Europe Is Now a Bigger Trade Villain Than China: There is broad consensus in both Europe and the U.S. that the Chinese government threatens the open trading system. Yet while there is plenty of room to criticize its specific policies, China is no longer the biggest contributor to global imbalances. By some measures, it's not even in the top 10. Instead, Europe is now the single greatest source of instability for the rest of the world.

5/13/2019 - seekingalpha.com: After recovering in Q1, the Eurozone economy is expected to flat-line for the next two and a half years. The recent rise in Eurozone inflation is a headwind, since it is not accompanied by a sustained rise in GDP.

5/16/2019 – Deloitte Insights - The eurozone economy has been in an economic downturn since mid-2018, following the boom phase of the recovery that began in 2016. The European Central Bank now expects a growth rate of 1.1 percent for 2019, while the estimate of the European Commission is slightly higher at 1.2 percent.

The overall weakness of the eurozone is mainly driven by the industrial sectors—the very sectors that normally power economic growth in Europe. Industrial production has been on a downward

trend since 2018, especially in chemical and automotive sectors. In the automotive sector, the disruption of automobile production in Germany, due to new emission standards for diesel-powered vehicles, added to the overall weakening of the eurozone economy.

The Manufacturing Index (PMI) currently stands at 47.8, clearly in negative terrain after it experienced the steepest downturn in six years in March. In Germany, it fell even further to 44.5.

While the industrial sector is flirting with a recession, the services sectors show a degree of resilience, thanks to robust domestic demand. The big question therefore is whether the negative trend in the industrial sectors will spill over to the Eurozone domestic economy.

A hard Brexit remains one of the biggest external risks for the Eurozone economy, due to the strong and intensive economic relationships between the European Union and its third-largest trading partner.

The effects of Brexit on eurozone corporates are only one example of external economic headwinds, alongside tensions in the global trading system and slower growth in Asia and China. These external headwinds indicate that exports are unlikely to drive growth in eurozone in the near future. Quite unusual for the export-oriented eurozone, its economic performance will mainly hinge on its domestic demand.

5/15/2019 – Marketwatch - In addition to Brexit, the EU is plagued by an Italian recession and the recent France-Italy diplomatic crisis. Let's also not forget the immigration problem, Greek debt crisis and a growing dissent among member states on upholding EU laws and regulations. If this keeps up, some fear it could culminate in the collapse of the EU.

U.K – Most uncertainty related to Brexit

5/14/2019 – Marketwatch - despite the lowest jobless rate since 1974, there has been weak productivity growth, as growth in the labor force and number of hours worked has outstripped wider growth in the economy. Output per hour declined for the third straight quarterly decline.

5/12/2019 The Guardian UK - Bank of England forecasts issued last week showed the UK is heading for the longest run of falling investment in the post-war era, having already declined for four quarters in a row.

Japan

At its 24–25 April meeting, Bank of Japan downgraded its GDP growth forecasts for both FY 2019 and FY 2020 to 0.8% and 0.9%, respectively.

5/14/2019 The Financial Times - The index of economic conditions compiled by Japan's Cabinet Office fell 0.9 per cent. That prompted statisticians to cut their assessment of the economy from "weakening" to "worsening" — the lowest of five levels. The last time the Cabinet Office used the bottom grade to describe the economy was in January 2013.

Weakness was driven by a drop in industrial production and sluggish shipments of consumer durables and investment goods.

Barclays economist Kazuma Maeda said that the "mechanical" downgrade in the assessment did not necessarily imply that a downturn was likely. But he added: "That said, there is mounting concern about an economic recession."

China

China is still relatively unloved and cheap, providing room for Chinese equities to rally further.

5/13/2019 Marketwatch – In the US trade war China's policy makers are betting that they can absorb a blow to the nearly $400 billion of exports that the country, on net, sells to the U.S. each year.

"Between loose credit and loose fiscal policy, China did rebalance away from exports," said Brad Setser, senior fellow for international economics at the Council on Foreign Relations.

"Trump's escalation comes at an awkward time, but if push comes to shove, they're quite capable of supporting growth through more investment and credit," he said. He added that China has the capability of borrowing more, particularly if it's through the central government and not the more debt-saddled provincial governments.

"China has stepped up its stimulus measures aggressively since the start of the year, which suggests mature policy appreciation of the risks," added Lena Komileva, chief economist at G-Plus Economics, in a note to clients.

That's not to say China would escape unscathed from a full-fledged war. SocGen, for instance, says the drag from the trade war for China can be as high as 1.2% of its GDP. And that's without

modeling the greater impact on global confidence, as well as China's relations with key counterparts like the European Union and Japan.

The Economist 5/14/2019

In China, a revival in the industrial sector stabilized economic growth, defying our expectations that the slowdown in economic growth that began in the third quarter of 2018 would extend further. Coupled with the roll-out of fifth-generation (5G) technology in a number of Asian countries this year, the recent solid Chinese performance will support increased global trade in the second half of 2019.

Against this backdrop, recent belligerent declarations by President Trump, cast doubts over a US-China trade deal. Should a trade deal not be agreed (not our core scenario), investor sentiment would drop sharply, and global growth prospects deteriorate.

Trade War Drama: No Reason to Panic

5/18/2019 Barron's - Expect market swings as investors dissect tweets and economic data to gauge the next plot twist in the trade drama. Yet even then, there is reason not to hit the panic button. Both the U.S. and China are in a better economic position to withstand the latest tariffs. Changing trade patterns, meanwhile, could reduce the impact of the trade dispute on the global economy.

"If you were ever going to impose costs on the U.S. consumer, the time is when unemployment is at 50-year lows and inflation is a pancake," says Christopher Smart, head of Barings Investment Institute. "And it's clear that the Chinese government has tools that work [to deal with tariffs]—and even more fiscal firepower than the U.S."

In China, the trade dispute is feeding a wave of nationalism, with commentators comparing it to the nation's humiliation by foreign powers during the colonial era—a longtime sore spot with the Chinese. That could complicate negotiators' goals of pushing Beijing to make structural reforms, nailing down enforcement details, and working out thorny issues related to technology.

But the standoff over trade ranks low on the escalation scale, says Marc Chandler, a longtime currency analyst and chief market strategist at Bannockburn Global Forex. "It's like children in the sandbox, still hitting and spitting at each other, not killing each other," he says.

Action Plan Recommendations

I can discuss individually with specific recommendations based on goals, objectives and your risk tolerance.

Reduce allocations in Europe and Japan. Increase growth objective allocations to more U.S. equities. While growth is slowing, the U.S. has comparatively stronger economics than most global economies.

Consider more U.S. Small-Mid Caps, which overall are less dependent on European sales. With revenues more from within the U.S., they do not have the currency risk of a stronger dollar that reduces foreign earnings. Smaller companies have the potential for faster growth, and with so many more smaller companies than large, good research can potentially find hidden gems. Smaller companies' stocks are often more volatile with less trading volume, but over the long term have rewarded investors.

Instead of "dumb" index funds with no stock selection based on individual company outlooks, or similar ETF's (only make sense for traders, not investors), I suggest managers with long-term track records of outperformance compared to the category they invest in and compared to the risk taken (Alpha vs. Beta in investment terms) – not just raw returns.

For those who want to build an ark for some of their funds for more protection, I recommend a strategy that participates in part of equity gains without downside risk and not having to recover market losses to have future annual gains, backed by a strong insurance company[1]. Guaranteed[1] fixed annuities are also an option. However, we only recommend a few of these carefully selected options.

[1]Index annuities are insurance contracts that, depending on the contract, may offer a guaranteed annual interest rate and some participation growth, if any, of a stock market index. Such contracts have substantial variation in terms, costs of guarantees and features and may cap participation or returns in significant ways. Any guarantees offered are backed by the financial strength of the insurance company, not by an outside entity. Investors are cautioned to carefully review an index annuity for its features, costs, risks, and how the variables are calculated.