Ermes Monaco

From: Ermes Monaco
Sent: March-15-19 2:16 PM
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Subject: VALUED CLIENT MAIL LIST: Early Spring 2019

HollisWealth

MonacoCapitalManagement

ARE WE THERE YET?

Source: Google Images

We can all likely remember taking a road trip to a destination never having travelled to before, knowing where we wanted to go and where it was on the map but yet seeming like we would never get there while on the way. The current global economic landscape is much like this as we speak; we've emerged from recession but not yet achieved robust growth. Aggravating the condition is the fact that this pace has persisted for several years now.

Historically the notion of a productive global economy has been based less on active coordination and cooperation amongst economic regions and more on the emergence and domination of one sovereign jurisdiction being the primary driver with which the other regions have supplied and traded with. For example, the British, Spanish and other empires played this function at one time or another. Since post second world war, the United States has been the "patriarch" in this role.

Source: Google Images

Politics vs Economics:

However, increasingly, political rather than economic priorities have pre-occupied the U.S. federal agenda, with re-emerging protectionist sentiments fuelling social pre-occupations such as immigration issues and geo-political conflicts which are less related to economically significant activity. The introduction of trade tariffs and abandonment of various global partnerships such as NAFTA, the Trans-Pacific and Paris Accords are examples of this.

<u>To be clear, these sorts of political movements don’t really drive the economic bus but certainly impact its speed</u>. The border immigration dilemma and North Korean nuclear threat have not really impacted financial market performance. We illustrated this in the Monaco Capital Management September 2018 pre-fall newsletter. However, political animosity has concurrently deteriorated the cooperative rapport that has typically been a benefit of economic partnerships. This has led to a suspension of collective efforts to foster growth, and is fostering a new “cold war” with NATO allies as well greater dialogue amongst political and economic adversaries such as Russia and North Korea.

Source: Fall 2018 Newsletter

Yellow (economic related):

- **Tax cut announcement**
- **Trade Tariff threat**
- **NAFTA re-negotiation**

Red (non-economic related):

- **North Korea threat**
- **Stormy Daniels scandal**
- **Immigration crisis – separation of children**

Internally, suspicions about the integrity of the current leaders of the U.S. federal administration have also created a media fuelled distraction from economic priorities and could potentially undermine the ultimate economic success of the federal government. The Mueller Special Counsel Investigation into political interference has now entered its second year and is, similarly, never seeming to wrap up. Additionally, federal government initiatives such as the tax cut, relaxing of environmental controls and tariffs have not improved domestic economic performance as the latest reported GDP measure for the 4th quarter of 2018 declined to 2.6% (www.tradingeconomics.com).

Will things improve or will they get worse? Yes.

There are sufficient positive economic indicators projecting a positive bias to toward continued growth and a deferral of imminent recession. **Yet, matters left unresolved can create sufficient economic drag as to actually trigger slowdowns, corrections and ultimately recessions. Some of the unresolved factors having a negative impact are:**

Downside

- **Trade tariffs:** These are actually increasing the cost of goods at the consumer level and resulting in a reduction of disposable income which would otherwise fuel growth (It acts as an indirect tax which is helping to pay for the tax cut).
- **Political investigations**: The multiple investigations of the federal administration are creating a lack of confidence in the current administration, a distraction from economic issues and a breakdown of bi-partisan co-operation.
- **Low GDP and labour income growth/corporate re-investment:** These factors are interactive as a politically inhospitable slow global environment is deterring companies from expanding and creating high value employment. This is inhibiting the consumer seeking employment which is typically most available at minimum wage.

Upside:

For all the bearish concerns, there are also positive factors which support continued growth. Some of these are:

- **Reduction of interest rate pressure:** With weak GDP and inflation numbers, the central banks are indicating a more dovish posture with an expectation of few or no further rate increases during 2019. This allows the cost of financing to remain tolerable and capital to revert back to the stock markets to support corporate growth.
- **Corporate earnings:** The most recent earnings quarter indicated mixed performances with many companies indicating sustained earnings but lower forecast projections as political tensions rather than fundamental economic

factors feed uncertainty. However, this can change quickly to more positive results should tensions ease allowing companies to further re-invest and expand with greater confidence.

- **Capital accumulation:** The current climate has restrained the pace of growth but is concurrently allowing price and debt levels to moderate or decline as cash reserves remain robust. This is creating favourable future market conditions as negative factors are systematically resolved.

In a nutshell, we're getting there, we're just not there yet.

The longer it takes to get there, the more bumps in road we'll encounter but the potential for a change in the U.S. political climate is now less than 2 years away which is creating a timeframe to a next destination to look for.

Therefore, we maintain our current views and takeaways for 2019:

- **The overall pace of growth will continue to be modest but positive.**
- **A continued impact of the tariffs will dampen corporate earnings.**
- **An eventual resolution of the China-US trade dispute will produce a dramatic recovery spike but not necessarily a new recovery trend.**
- **U.S. Trade tariffs may continue to be imposed despite trade agreements being achieved as occurred with the draft USMCA; this will continue to act as an indirect tax and a drag on GDP.**
- **Commodities may recover on strength as alternatives to the U.S. dollar as it enters a weakening cycle.**
- **Market performance will be sector specific.**
- **Volatility will moderate.**

What's the takeaway?

- **Continue to manage expectations, avoiding the temptation to perceive short term movements as longer term trends**
- **Continue to include:**
  - **A defensive component in portfolios including a variable cash reserve**
  - **Alternative sources of returns to capital appreciation, particularly during periods of weak market performance, such as income streams and tax efficiency**
  - **Investment hedges to help offset market volatility and minimize the impact of market weakness on portfolio value**
  - **The possibility of selectively purchasing quality assets opportunistically as the financial markets travel through their cycles**
- **Continue not to rely on most mainstream media reporting as a sole source of fulsome and completely objective information given its focus on attracting the reader rather than conveying "true and plain and full disclosure".**

- **Continue to keep a plan in mind in terms of ultimate financial objectives rather than a reliance that the markets will always go up.**

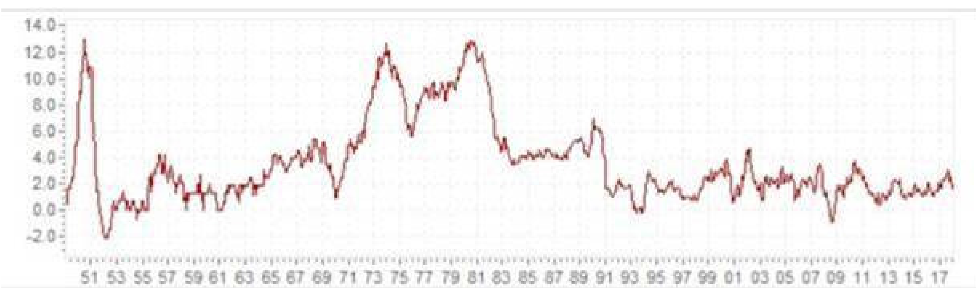
PLUS: CONSIDER PRE-EMPTIVELY ADDING STRATEGIC ASSETS SUPPORTING KEY SECTORS OF ECONOMIC ACTIVITY FOR DEMONSTRATED RECOVERY WITHIN 6-12 MONTHS.

KEY ECONOMIC INDICATORS and BUSINESS SECTORS

CANADIAN DOLLAR

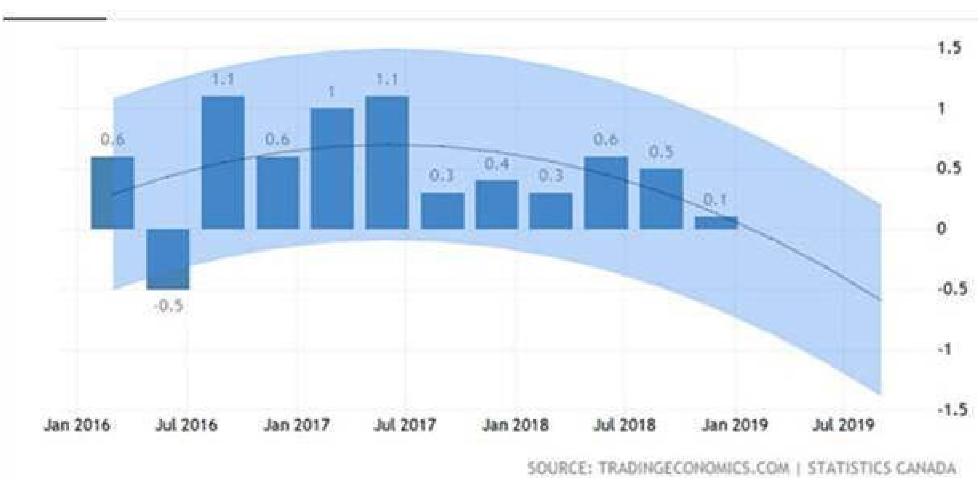
Last 5 Years **Source: Thomson Reuters**

CANADIAN INFLATION SINCE 1951

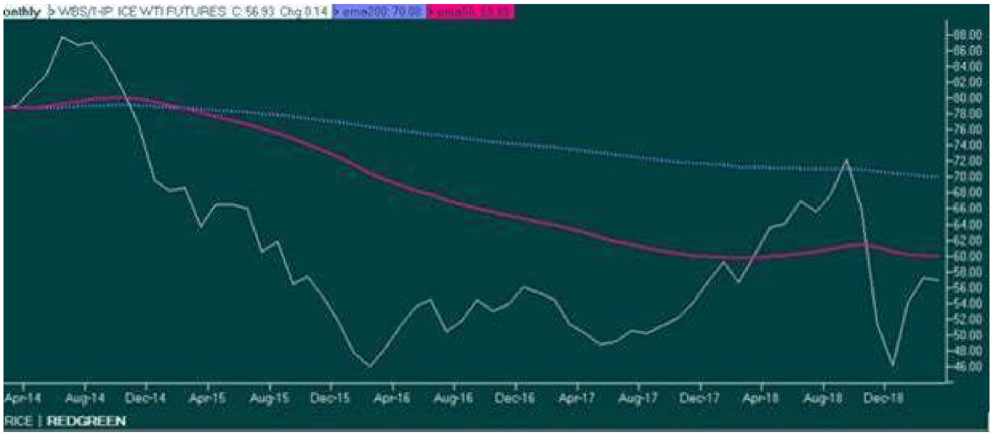


Source: Inflation.eu

CURRENT TREND IN CANADIAN GDP

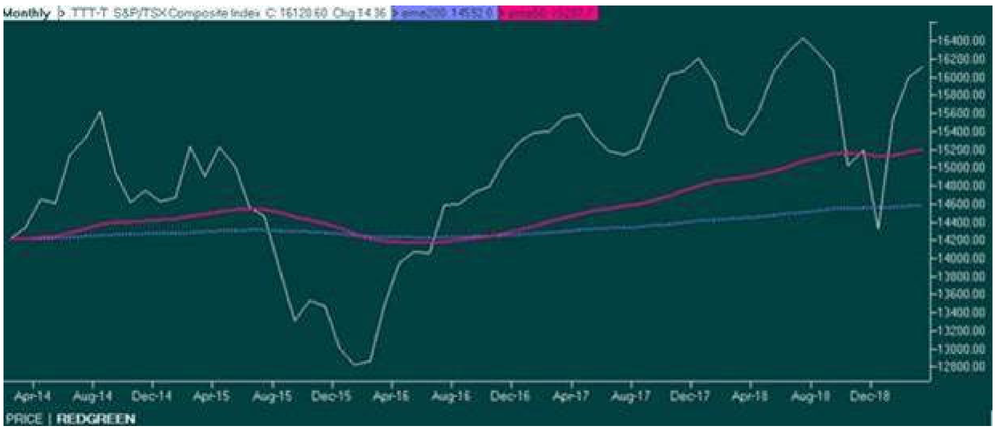


ENERGY WTI OIL PRICE BBL



Last 5 Years **Source: Thomson Reuters**

FINANCIAL MARKETS - TSX



Last 5 Years **Source: Thomson Reuters**

REAL ESTATE

Canadian vs U.S. Housing Index

Source: TradingEconomics

Regards

HollisWealth

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