by Russell Redenbaugh & James Juliano

Monday, September 9, 2019

GROWTH RESET

Last week there were two extremely pro-growth shifts in the most important policies on the margin - monetary and trade. Financial market "Footprints of Policy" reacted unanimously in the pro-growth direction, and we believe it marks a new line in the sand for risk-on assets.

On the trade policy front, good news began September 4th when the Office of the U.S. Trade Representative and Chinese state media confirmed that deputy-level meetings in mid-September would lead to ministerial-level talks in coming weeks. Today, Treasury Secretary Mnuchin confirmed the U.S. and China have a "conceptual" agreement on enforcement concerns, emphasizing positive progress already made in trade talks, which are set to resume at high levels in the coming weeks. Mnuchin said, "I think the enforcement area we at least have a conceptual, an agreement on."

As we have said since early 2018, we are not yet in a trade war with China. While uncertainty about a final trade outcome has weighed on U.S. stock markets, especially U.S. small-cap equities that are suppliers and lenders to many companies levered to trade, we are far from an actual global trade war. Real trade wars, like during the Smoot-Hawley tariff era, are accompanied by collapses in economic activity and equity values.

Ahead of Congress signing the actual Smoot-Hawley bill the DJIA declined 37%. After the bill was signed on March 17, 1930 the DJIA fell another 77%. U.S. stocks are currently between 5%-15% below new, nominal highs set in July, 2019.

Difficult trade negations continue, and the actions from both sides remain negotiation tactics in our assessment. Data continue to confirm that China is bearing the brunt of a "no-deal." Global supply chains continue to shift away from China and the Chinese economy is feeling the effects. "Manufacturing is being hit really hard. Investment is down, hiring took a serious hit, a huge hit to new orders," said Leland Miller, CEO of China Beige Book, which measures China's economic strength culled from mainland survey responses.

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Last week's positive developments show that both sides are talking. While no one can predict the exact timing or details of any trade deal, it is undeniably positive that both sides are communicating. We continue to believe a China deal will eventually be reached, adding to the list of freer, fairer trade deals the administration has already completed. We agree with our friend Art Laffer who notes,

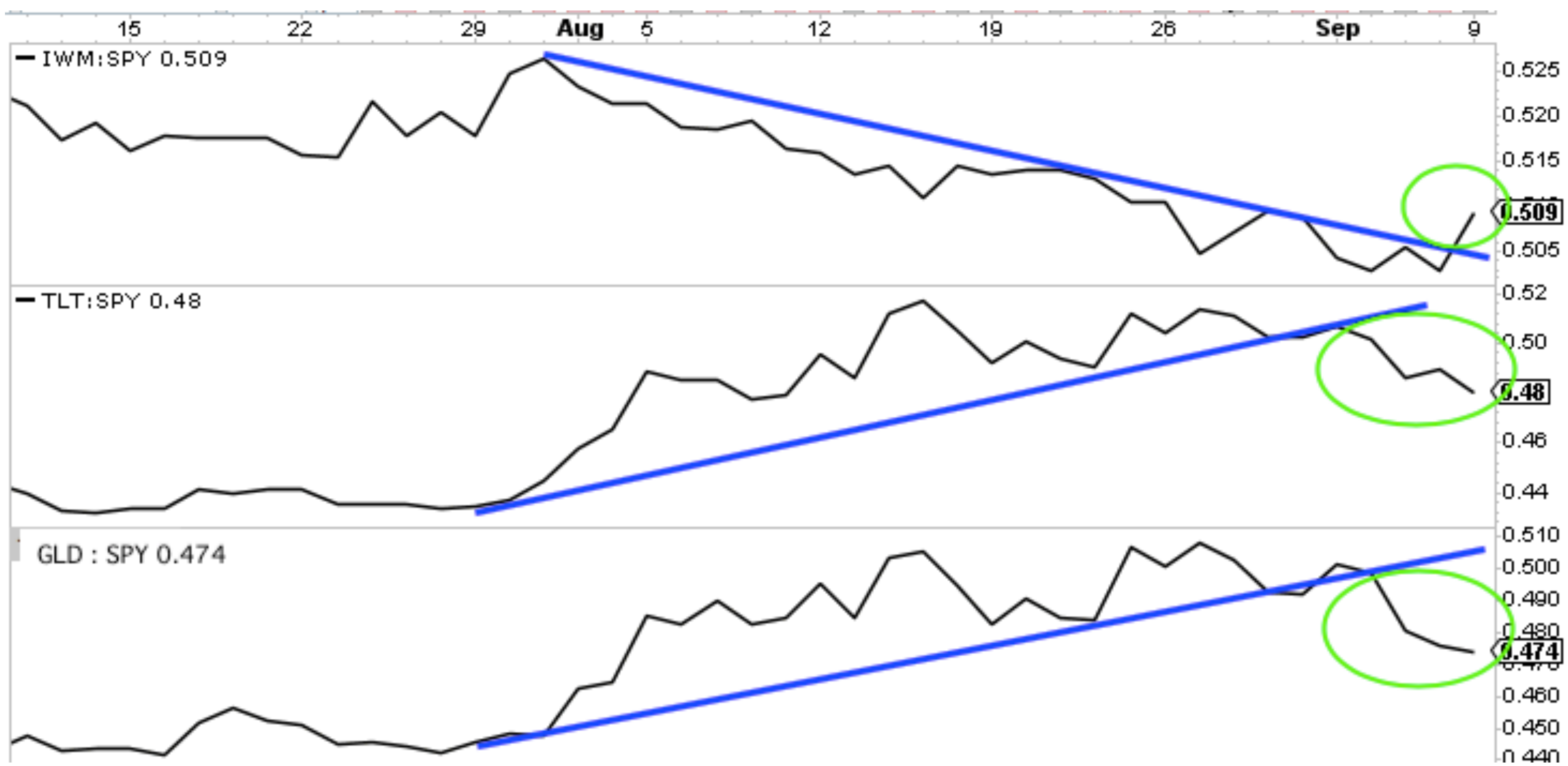
> "A China deal would be wonderful for the president, for the country, for politics. It will take a lot of the nastiness out. People like working and they like being rich. We need China very much, and they need us very much. I mean, it's a perfect match of comparative advantage between the two countries. And all we need to do is get the impediments out of the way -- the stealing of intellectual property and technology, all of this stuff. And I'm sure there are a couple of things we need to do to make it better for us and them, as well. A China deal it's a huge thing because it starts having a dynamic consequence with the rest of the world: Japan, South Korea, Europe, everywhere in the world will start doing deals. And it'll be like the Kennedy Round tariff negotiation was, and that was one of the most spectacular policy events ever, which rocketed the U.S. economy during the Kennedy era. This is the same type of thing with Trump."

On the monetary policy front, Fed officials last week made statements consistent with our belief that the Fed's actions are lagging behind what capital markets are saying. James Bullard, President of the St. Louis Fed and a voting member on the FOMC, said,

> "The U.S. Federal Reserve should cut interest rates by half a percentage point at its meeting in two weeks to get ahead of both financial market expectations for a rate cut and a global trade war. Global investors have sent bond yields plummeting in recent weeks to record lows, leaving the Fed's overnight policy rate seemingly out of line…We should take some signal [from bond markets that indicate] our rate is too high. I'm nervous that our policy rate is above every other rate. It is not a good place for the Fed to be."

On the heels of these positive trade and monetary developments, financial markets facilitated an immediate reallocation of capital. Risk-on asset classes attracted capital after months of underperformance. The three most notable assets we continue monitoring are U.S. small caps, gold and U.S. Treasury bonds. As shown in the chart below, all three assets have been signaling risk-off during August. Small caps were underperforming large caps while gold & Treasury Bonds (safe haven assets) were outperforming stocks. Those trends recently broke, signaling a shift to a risk-on investment environment.

Paired with the positive policy developments we observed last week, we believe this is the beginning of a durable move. We consider last week the beginning of a pro-growth shift that will send risk-on assets higher and safe haven assets lower, possibly in a significant manner. We are using last week's policy and "Footprints of Policy" shifts as a line in the sand for growth versus safe haven investments. The trends that broke last week should not reassert themselves if we are correct.



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ALLOCATOR

Fixed Income

Bonds are an asset class that does well in a deflationary policy environment (Low Growth & Strong Currency)

We have long said the Treasury bond bubble will pop again as it did from May2013-Jan2014 when long term Treasury bonds fell 18%. With voters choosing Trump's pro-growth agenda to ignite growth, we believe the this is even more likely. Treasury bond prices are at risk to fall 30-50%, and we expect any moves higher in bond prices (lower in yields) to be short-lived. Since most other bonds price off of Treasury yields, fixed income in general is a risky asset class.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Investment Grade	LQD	9/9/2016	$119.00	$128.09	7.6%	
Aggregate Bond	AGG	9/9/2016	$109.00	$113.67	4.3%	
Municipal	MUB	9/9/2016	$111.00	$114.73	3.4%	
TIPS	TIP	9/9/2016	$114.00	$117.31	2.9%	
Extended Duration	EDV	9/9/2016	$128.00	$145.87	14.0%	
US Treasury 3-7 yr	IEI	9/9/2016	$124.00	$127.39	2.7%	
US Treasury 7-10 yr	IEF	9/9/2016	$109.00	$113.40	4.0%	
US Treasury 20+ yr	TLT	9/9/2016	$133.00	$145.79	9.6%	
International Total Bond	BNDX	9/9/2016	$54.40	$58.88	8.2%	
High Yield	HYG	4/12/2016	$77.00	$87.14	13.2%	Act more like equities than bonds, benefit from improving growth

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Commodities

A change in the price of gold is a change in the value of the currency. When gold rises, the currency's value falls and vice versa. Commodities are an asset class that does well when the currency is weak.

If growth is slowing while the currency weakens, there is stagflation. Own precious metals.

If growth is accelerating while the currency weakens, there is an inflationary expansion. Own agriculture, industrial and energy commodities.

Commodities suffered heavy losses in the strong US Dollar environment 2012-2015. In 2016 Dollar weakness was caused by election uncertainty and commodities rallied. That weak Dollar trend was reversed by Election2016. The demand for transactional and asset based Dollars will rise if Trump's pro-growth policies are implemented and fall if his policy agenda fails. Gold's recent decline back below $1,300/oz is a confirmation of better policy and rising growth rates. Capital is beginning to leave safe haven asset classes as policy uncertainty diminishes.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Gold	GLD	10/2/2017	$120.77	$141.92	17.5%	
Silver	SLV	10/2/2017	$15.67	$16.87	7.7%	
Energy	DBE	8/13/2014	$28.97	$13.67	-52.8%	
Oil	USO	7/30/2014	$37.00	$11.77	-68.2%	
Agriculture	DBA	9/13/2011	$32.50	$14.84	-54.3%	
Broad Comm. Index	GSG	8/5/2011	$33.00	$15.06	-54.4%	
Base Metals	DBB	6/17/2011	$23.00	$14.92	-35.1%	

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ALLOCATOR

Real Estate

Real Estate is an asset class that performs well when growth is accelerating. When rising growth is coupled with a strong currency, own real estate tied to business activity (like commercial REITS). When rising growth is coupled with a weak currency, own real estate tied to commodities (farmland).

Commercial RE will be helped by improving real economic growth. RE properties leveraged to businesses & economic growth are preferred under pro-growth US policies.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/ Loss	Policy Notes
Residential	REZ	12/21/2016	$61.00	$79.99	31.1%	Real estate assets have declined as higher interest rates expectations lower the perceived attractiveness of housing demand and real estate's dividend yield.
Building/Construction	ITB	12/21/2016	$28.00	$41.29	47.5%	
Mortgage REIT	REM	4/1/2016	$35.00	$40.95	17.0%	
REIT	VNQ	3/7/2016	$75.50	$93.45	23.8%	

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ALLOCATOR

US Equity

We have been waiting for a 1980s/90s type of policy driven equity bull market for sixteen years. The 2014 midterm House/Senate/gubernatorial election shifts put us on the path as pro-growth candidates propelled the GOP to majorities. It was a repudiation of anti-growth economic policies and a big step toward a Reagan/Clinton type of equity bull market. Despite the voters' growth signal, Obama doubled down on his tax/spend/regulatory (EPA) agendas in 2015 causing stocks to be range bound and volatile. As 2016 began, policy uncertainty ahead of November's elections became the biggest threat to equities. The ebb and flow of the presidential political season moved markets in both directions as investors waited to learn which policy theme would prevail in November – growth vs. redistribution. Voters decisively made their choice in Election2016, and growth won. Trump's pro-growth policy agenda beat Hillary's anti-growth policy agenda in landslide fashion. Republicans retained control of the Senate, House and increased their control of governorships by three. The policy stage is now set for Trump and Congress to keep delivering pro-growth tax, regulatory and monetary policies. As they do, a bull market in U.S. equities will ignite to rival the 1980s/90s

US Equity - Cap Size

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Micro	IWC	7/11/2016	$72.00	$87.13	21.0%	Most tied to domestic policy / growth
Total Market	IWV	5/19/2016	$117.00	$174.38	49.0%	
Large	IWB	5/19/2016	$111.00	$165.35	49.0%	Large caps should underperform smaller caps as domestic economic growth accelerates
Small Cap	IJR	5/19/2016	$54.00	$76.56	41.8%	Most tied to domestic policy / growth
Mid Cap	IWR	4/6/2016	$38.57	$56.07	45.4%	More tied to domestic policy / growth

POLICY BASED INVESTING

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US Equity - Style

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Large Growth	IWF	7/11/2016	$101.00	$162.53	60.9%	Growth outperformed value in 2017 across all cap sizes. Trend will continue as tax cuts get implemented.
Small Growth	IWO	7/11/2016	$140.00	$194.83	39.2%	
Small Value	IWN	5/19/2016	$92.00	$115.97	26.1%	
Mid Growth	IWP	5/9/2016	$90.00	$145.26	61.4%	
Large Value	IWD	4/6/2016	$95.00	$127.18	33.9%	
Mid Value	IWS	4/6/2016	$68.00	$88.36	29.9%	

US Equity - Sector

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Staples	XLP	6/5/2017	$57.00	$61.44	7.8%	Defensive sector hurt by rising growth
Utilities	XLU	6/5/2017	$54.00	$62.81	16.3%	Defensive sector hurt by rising growth
Metals/Mining	XME	5/8/2017	$29.00	$25.45	-12.2%	Tied to commodity prices, hurt by strong Dollar
Energy	XLE	3/13/2017	$69.00	$59.03	-14.4%	Tied to commodity prices, hurt by strong Dollar
Healthcare	XLV	2/8/2017	$71.00	$91.27	28.5%	
Discretionary	XLY	11/14/2016	$79.00	$122.87	55.5%	Consumer strong w/ rising growth expectations
Financial	XLF	7/18/2016	$19.00	$27.44	44.4%	Helped by Trump deregulation (Dodd Frank) & rising interest rates
Materials	XLB	4/6/2016	$44.00	$57.24	30.1%	Global growth
Industrial	XLI	3/14/2016	$52.00	$77.20	48.5%	Global growth
Technology	XLK	3/7/2016	$41.00	$81.50	98.8%	Repatriation tax reform huge plus for tech companies

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Foreign Equity

Country	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
China	FXI	8/5/2019	$39.86	$40.61	1.88%	China's currency devaluation policy is a growth killer
Hong Kong	EWH	7/6/2016	$24.08	$23.87	-0.87%	
Mexico	EWW	10/1/2018	$51.23	$42.70	-16.65%	Freer and fairer trade agreements are pro-growth for all parties involved
Canada	EWC	10/1/2018	$28.78	$28.63	-0.52%	
Denmark	EDEN	7/2/2018	$63.89	$62.13	-2.75%	European polices not improvng despite anti-austerity movements across the Euro Zone. Capital is fleeing. A zero trariff trade deal with the U.S. would reverse course and be very pro-growth for European economies.
Switzerland	EWL	7/2/2018	$32.58	$38.07	16.85%	
Netherlands	EWN	7/2/2018	$30.51	$31.33	2.69%	
Sweden	EWD	7/2/2018	$30.51	$29.14	-4.49%	
Eurozone	EZU	7/2/2018	$41.01	$38.73	-5.56%	
Spain	EWP	7/2/2018	$30.35	$27.25	-10.21%	
Poland	EPOL	7/2/2018	$21.78	$20.69	-5.00%	
France	EWQ	7/2/2018	$30.52	$30.08	-1.44%	
Germany	EWG	7/2/2018	$29.98	$26.86	-10.41%	
Italy	EWI	7/2/2018	$28.89	$27.61	-4.43%	
Austria	EWO	7/2/2018	$22.65	$19.05	-15.89%	
Israel	EIS	2/26/2018	$52.41	$53.43	1.95%	
Vietnam	VNM	10/9/2017	$14.99	$15.81	5.47%	Demographic leverage to US economic growth policies
Indonesia	EIDO	7/24/2017	$26.78	$25.43	-5.04%	Demographic leverage to US economic growth policies
Ireland	EIRL	1/26/2017	$39.00	$40.81	4.64%	
Singapore	EWS	1/11/2017	$21.00	$23.34	11.14%	
World Ex US	VEU	11/15/2016	$43.50	$49.90	14.71%	Global growth reset higher after US Election2016
Norway	ENOR	8/20/2016	$20.00	$23.12	15.60%	
UK	EWU	8/4/2016	$30.50	$30.98	1.57%	Brexit was a vote for growth

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Japan	EWJ	7/15/2016	$47.00	$54.83	16.66%	
South Korea	EWY	7/13/2016	$52.00	$55.41	6.56%	
Hong Kong	EWH	7/6/2016	$19.00	$23.87	25.63%	
Frontier Mkts	FRN	7/5/2016	$10.50	$13.72	30.67%	Highly levered to Eurozone growth movement
Peru	EPU	6/29/2016	$30.50	$34.45	12.95%	
South Africa	EZA	6/29/2016	$51.00	$49.74	-2.47%	
India	EPI	6/27/2016	$19.00	$23.21	22.16%	Strong Dollar emerging market, tied to US growth
Taiwan	EWT	6/21/2016	$27.00	$35.77	32.48%	
Thailand	THD	5/20/2016	$64.00	$91.12	42.38%	
Belgium	EWK	3/16/2016	$16.50	$18.56	12.48%	
New Zealand	ENZL	3/5/2016	$36.00	$54.91	52.53%	
Philippines	EPHE	8/5/2015	$37.00	$34.40	-7.03%	
Qatar	QAT	12/1/2014	$24.00	$17.35	-27.73%	
Malysia	EWM	10/3/2014	$41.00	$27.98	-31.76%	
Australia	EWA	9/16/2014	$22.50	$22.23	-1.20%	
Greece	GREK	7/14/2014	$20.00	$9.31	-53.45%	
Portugal	PGAL	6/4/2014	$15.00	$10.05	-33.00%	
Columbia	ICOL	6/27/2013	$21.00	$12.62	-39.90%	
Turkey	TUR	6/1/2013	$58.00	$24.97	-56.95%	
UAE	UAE	5/20/2013	$23.00	$14.07	-38.83%	
Russia	RSX	8/7/2011	$30.00	$19.97	-33.43%	Weak Dollar emerging market
Brazil	EWZ	7/14/2011	$60.00	$42.13	-29.78%	Weak Dollar emerging market
Chile	ECH	3/1/2011	$61.00	$36.50	-40.16%	
Egypt	EGPT	2/23/2004	$64.00	$33.27	-48.02%	

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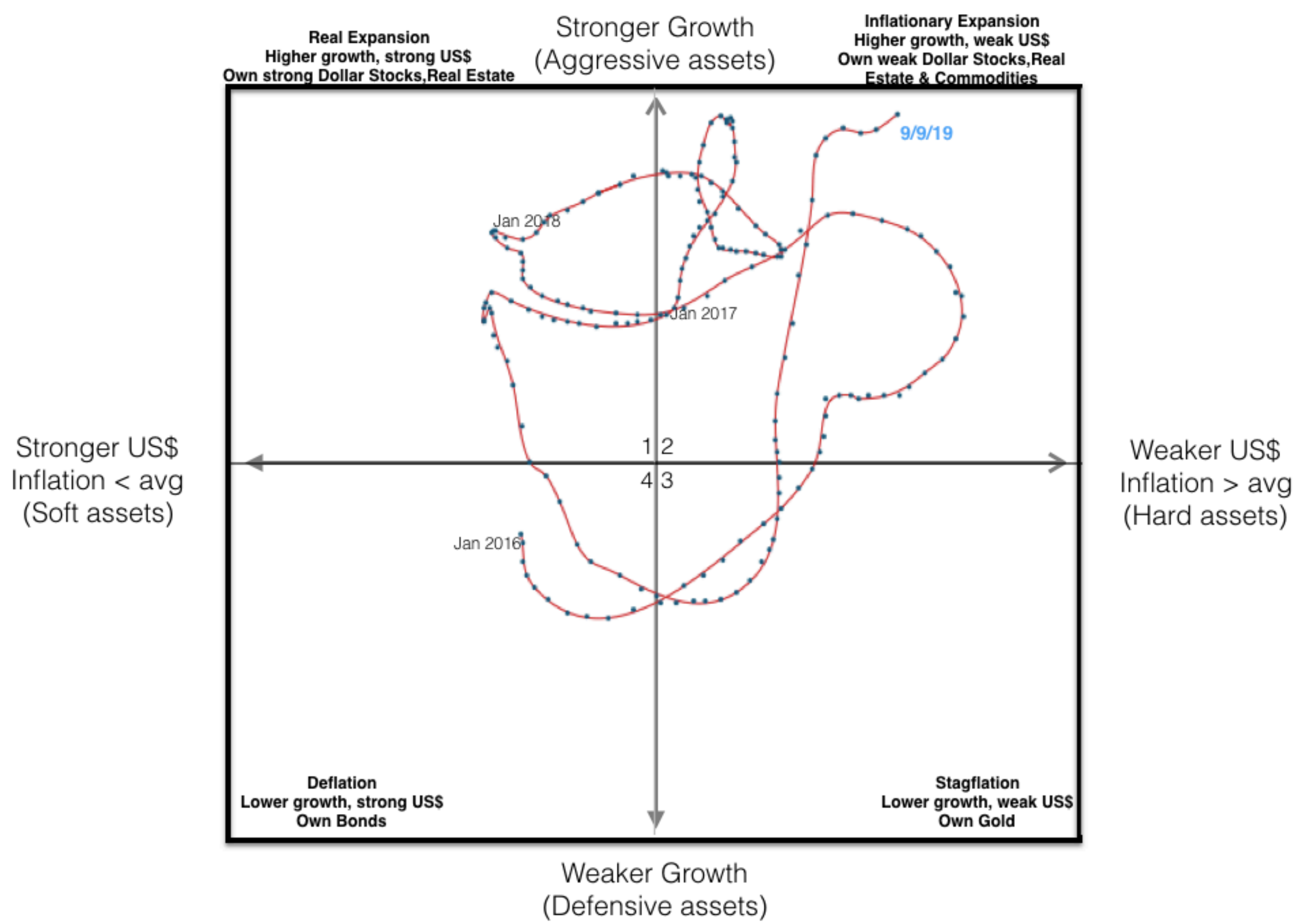
POLICY MAP

Growth increased versus last week (1.95 to 2.04): Despite pro-growth tax and regulatory policy improvements since 2016, growth has tipped into negative territory over fears of a 2008-style, deflationary monetary policy mistake.

Value of US$ was decreased versus last week (1.14 to 1.25): Dollar had been stable between gold $1,300-$1,375/oz, and strengthened to $1,230/oz. giving the Fed a strong Dollar signal to pause rate hikes until economic and market data calm down. Recent Dollar weakness above $1,400 is concerning but likely has some temporary geopolitical causes like Iran.



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BOND YIELD COMPONENT ANALYSIS

Nominal Yield: 1.55% (+3%) **Inflation Expectation Component: 1.54% (0%)** **Real Growth Component: 0.01% (800%)**

Real growth expectations embedded in the Treasury bond market have been dislocated from equity markets in 2019. Some of the collapse in real growth has been caused by global bond market dynamics with negative interest rates across the globe. But now the risk of a serious deterioration in U.S. policy is also weighing on growth. With trade policy still uncertain, the Fed disappointed with only a 25bp cut at their last meeting. A Q42018-type deflationary policy mistake is back on the table.