STRATEGAS insight

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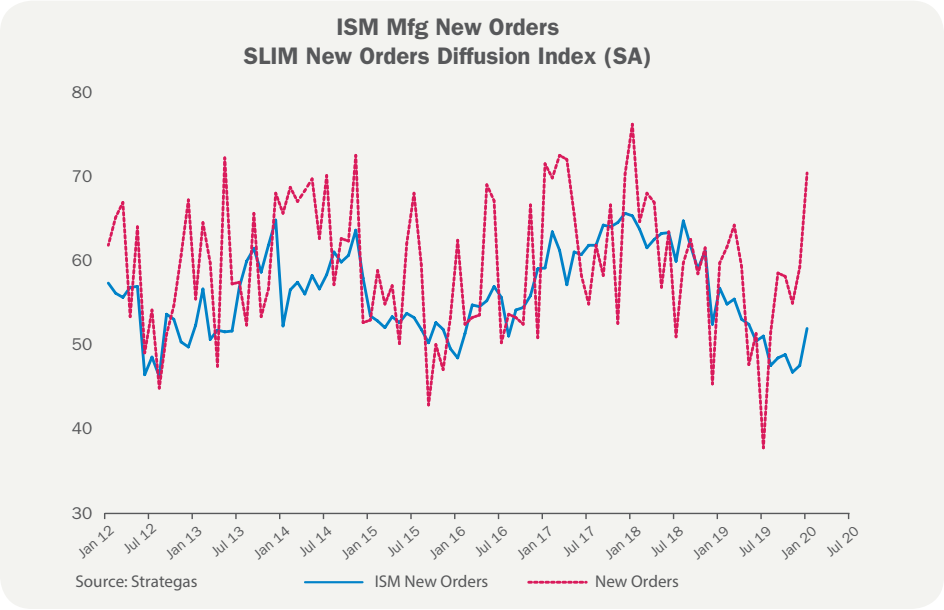
This Too Shall Pass

We remain impressed by the equity market's (and the economy's) resilience in the face of the growing list of potentially negative catalysts that it has faced over the past fifteen months. More recently, following another strong run-up to new all-time highs at year's end, the market was shocked by the deadly flare-up—and mercifully quick de-escalation—in tensions between the US and Iran. Better-than-expected fourth-quarter earnings and a surprisingly robust, positive response to the completion of the US's "phase one" trade deal with China helped propel the market's advance even further. The past month has brought two more headwinds (and we are careful to draw no comparison in severity between the two): the first—and far more concerning—is the outbreak and spread of the Wuhan coronavirus; and the second is the rapid, simply heretofore undiscounted, rise of Vermont Senator Bernie Sanders in both early state and national polling for the Democratic presidential nomination.

Without diminishing the real and tragic human impact of the coronavirus—the death toll in China is now, sadly, reported to have climbed above 1,000—for investors, the more worrisome element is the sharply negative economic impact caused by the reaction to the virus. Think of the increased number of surgical masks investors have seen on their commute or in the course of their travels over the last month. (We were surprised by their ubiquity on a recent flight from New York to Florida.) Have investors considered less public alternatives to dining out or taking in a show because of the virus? If they have not, do they know someone who has? Even if they have not (or do not), the behavior does not seem wholly unreasonable, does it? Looking around New York City and in our travels to other well-known urban centers, a change in behavior is evident. The Center for Disease Control (CDC) puts the number of confirmed cases of coronavirus in the US at just 13. Estimates from China have been as high as 40,000 infected. Beijing instituted a national travel ban following the Chinese New Year and has quarantined the entire city of Wuhan, the country's ninth most populous, with a population of more than 11 million. (By comparison, Dallas, with a population of roughly 1.3 million, is the ninth most populous US city.)

Considering the widespread footprint of the outbreak in China, the scale of the government's response, and the compound effect of both voluntary and mandated quarantine, it is not unreasonable to assume that China's gross domestic product (GDP) growth will fall dramatically in the first quarter. The knock-on effects, particularly to US manufacturing, could be notable. In short, absent a dramatic turn of events for the better, we anticipate some weakness in global economic data for the first quarter accompanied by increased market volatility. Although we have no scientific evidence to support our view (and with no intention of sounding callous), we still expect the ultimate impact of coronavirus will be transitory, given similarities to the dislocations caused by previous outbreaks (SARs, MERs). If this proves correct, economic activity could come back just as quickly as it deteriorated, presenting a v-shaped recovery through midyear. The question is: How bad will it get before it gets better? Keep an eye on global profit growth. Stronger data in 4Q2019 suggest a willingness by corporate operators to engage capital. If this continues

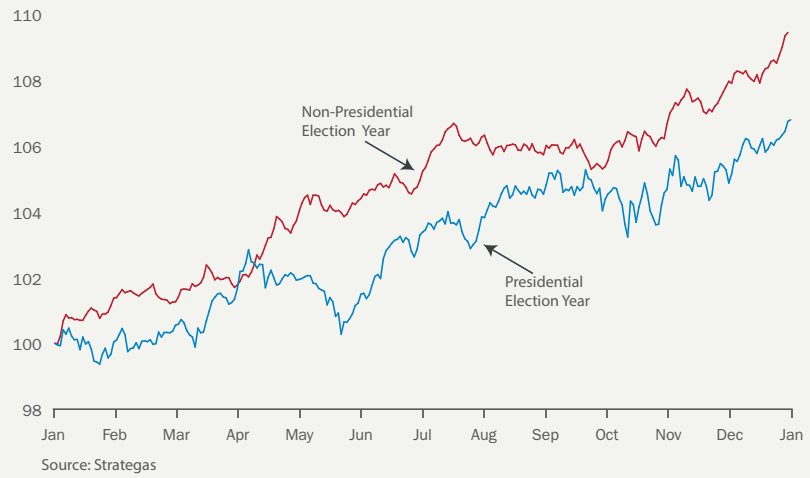


through 1Q2020, it will provide a welcomed offset to both the effects of the virus and the drag from Boeing. We will keep a close eye on Strategas's Leading Indicator of Manufacturing (SLIM) and other national activity gauges, like the Purchasing Managers Index (PMI), for signs of weakness.

Despite prospects within the margin of error for various Democratic presidential candidates in head-to-head match-ups with President Trump in the general election this fall, the market's appetite for far-left progressive policies does not appear hearty. Case in point: Recall the sharp ascent in national polling last summer of Massachusetts Senator Elizabeth Warren and the concomitant decline of the Health Care sector shares. The natural preprimary sequence of fundraising and debates has culled the ranks of nineteen aspirant candidates to a more substantive five or six. But, the lack of a decided frontrunner resulted in a certain laziness and lack of familiarity among investors on the implications of the emerging Democratic policy platform. Nothing sharpens the mind like being forced, and with the state nominating contests now underway, investors' attention has been piqued. Right on cue, in the week before the first-in-the-nation Iowa caucus, Vermont Senator Bernie Sanders was enjoying a strong showing in both early state and national polling. The market had not seen that coming. Although making no personal judgment, we think it is fair to say that the policies championed by a self-described "independent Democratic socialist" do not fit hand-in-glove with the generally capitalist economic leanings—however socially progressive individually—of professional investors. Sanders's ascendency posed an unpriced risk to the market. We believe it still does. The undeniably strong early state showing from former South Bend, Indiana mayor Pete Buttigieg and the improving prospects of former New York City Mayor Mike Bloomberg's well-financed and geographically unconventional campaign (both viewed as relative moderates) have softened the blow for investors. But both of these may bolster Senator Sanders's prospects by keeping the race fragmented.

In many ways, Buttigieg fits the mold, given the current preferences of the party. But the still real potential that Democrats could choose either a 70-something white, male, self-described socialist who never has been a member of the Democratic Party, or a 70-something white, male, self-made billionaire who has been a member of all the parties is not lost on the old guard. We have been amazed by the number of Sunday show appearances and op-ed pieces from Democratic Party power-brokers openly dismissing the national prospects of Sanders versus Trump. Conspiracy theorists even suggest House Speaker Nancy Pelosi delayed referral of impeachment articles to the Senate in an attempt to bolster the prospects of former Vice President Joe Biden. Being primarily viewed as moderate enough to defeat Trump in the general election, he would benefit from the progressives, Sanders and Warren, being tied to their desks in Washington in the run-up to the Iowa caucuses. In short, the disintegrating chances of former Vice President Joe Biden to claim the nomination, now confirmed by dismal showings in Iowa and New Hampshire, keep this an interesting and longer-than-helpful race for both Democrats and the market. Historical analysis shows the market can perform well regardless of which party occupies the White House. The important elements are confidence and clarity. In election years, the market generally has rallied, once the parties have nominated their candidates and the winner between them was increasingly clear. Sometimes this happens early (Clinton versus Dole in 1996) and sometimes late (Bush versus Gore 2000 and Trump versus Clinton 2016).

S&P 500 Avg. Performance: Presidential Election Years Vs. Non-Presidential Election Years 1933 – 2019



Source: Strategas

We remain optimistic, generally, for the US and global economies to evidence a late-cycle re-acceleration in activity. By our lights, this should favor more traditional value shares, small and mid cap companies, and international equities. This positioning may look wrong for a stretch over the next month or two as the market digests the two latest headwinds, but this too shall pass.

Strategas Recommended Asset Allocation

	Equities	Bonds
Overweight	Dev AC Core EM AC Core	TIPS IG Corporates
Neutral	US LC Value US LC Core US LC Growth US MC Value US MC Core US MC Growth US SC Core	Bank Loans Agencies ABS/CMBS US Dollar EMD Local EMD High Yield Convertibles
Underweight		US MBS U.S. Treasuries

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Founded in 2006 by Jason DeSena Trennert, Nicholas Bohnsack, and Don Rissmiller, the Firm was acquired by Baird Financial Group in 2018. Strategas operates independently as a wholly-owned subsidiary of Baird and offers institutional securities services through Strategas Securities, LLC, a broker-dealer, and investment management solutions, including this commentary, through Strategas Asset Management, LLC, a registered investment advisor.

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Index Overview & Key Definitions

Fed, The Fed or FED refers to the Federal Reserve System, the central bank of the United States. **Fed Funds Rate**, the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **Gross Domestic Product (GDP)** rate is a measurement of the output of goods and services produced by labor and property located in the United States. **Real Gross Domestic Product (GDP)** is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year. **Nominal Gross Domestic Product** is gross domestic product (GDP) evaluated at current market prices. The **S&P 500 Index** is an unmanaged index comprised of 500 widely held securities considered to be representative of the stock market in general. The **Russell 1000 Index** is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The **Russell 2000 Index** is an unmanaged index considered representative of small-cap stocks. The **PCE (Personal Consumption Expenditure) Index** of Prices is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data including U.S. Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures; essentially a measure of goods and services targeted towards individuals and consumed by individuals. The **Producer Price Index (PPI)** program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. **FAANG** is an acronym for the five of the market's most popular tech stocks, namely Facebook, Apple, Amazon, Netflix and Alphabet's Google. The **North American Free Trade Agreement (NAFTA)** is an agreement signed by Canada, Mexico, and the United States, creating a trilateral trade bloc in North America. The **Seasonally Adjusted Annual Rate (SAAR)** is a rate that is adjusted to take into account typical seasonal fluctuations in data and is expressed as an annual total. SAARs are used for data affected by seasonality, when it could be misleading to directly compare different times of the year. The **Atlanta Fed GDPNow** forecasting model provides a "nowcast" of the official estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis. GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available data for the current measured quarter.

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