

## ECONOMIC OUTLOOK

---

### *Summary*

While the Novel Coronavirus (2019-nCoV) has had a devastating impact in mainland China, the severity of the global economic impact remains uncertain. This is partially due to the fact that the 2019-nCoV is spreading exponentially faster than the 2003 SARS virus, although with a much lower fatality rate (2% vs 10%), but also because it is currently 98.9% contained to mainland China. This is important globally because China is the world's second largest economy and accounts for roughly 16% of global GDP. Current estimates by the local government point to a 1% deduction from Chinese GDP in 1Q20. If accurate, this could push real GDP growth in China below 5%, the lowest level in roughly 30 years. As local businesses shut down and residents remain indoors, global demand for crude oil has declined and commodity shipping rates have plunged.

The economic impact to the U.S. is also still being determined. Although there have only been a handful of confirmed cases (11 at the time of writing) and no deaths reported, nearly every company in the S&P 500 does business in China and other emerging economies.

Companies such as Starbucks, Apple, McDonald's and Google, among others, have suspended or limited their operations in China. For many companies, such as Starbucks, China is the largest market outside of the U.S. and the store closures will affect their bottom lines. This is not just limited to the retail side having reduced revenues, but also from disruptions for companies with supply-chains that run through China.

With the "Phase One" deal between the U.S. and China, and the signing off of the U.S.-Mexico-Canada Agreement (USMCA), economically the year appeared to be off to a positive start. Trade tensions were one of the major economic headwinds from 2019. Additionally, unemployment remains near record lows and retail sales were fairly robust during the holiday season. However, before we can truly get some wind in our economic sails again, we will need to wait and see just how long it is before the virus is eradicated and the global economy can resume business as usual.

### *Positives*

4Q19 initial GDP QoQ was 2.1% vs 2.0% expected

---

Consumer confidence rose to 131.6 vs 128.0 expected

---

Retail sales ex-auto's increased 0.70% vs 0.50% expected

---

### *Negatives*

New home sales and pending home sales significantly underperformed estimates

---

Durable goods orders were below expectations when stripping out one-time defense orders

---

Core PCE missed estimate by 0.30% (1.30% vs 1.60%) as inflation continues to miss target

---

## EQUITY OUTLOOK

---

### *Summary*

Equity markets paused to start the year with the S&P 500 essentially flat for the month of January following four consecutive positive months to close 2019 in rally mode. Earnings season, which is currently in full swing, has largely been overshadowed by the outbreak of the Coronavirus. The virus, which is thought to have originated in the Wuhan province of China, threatens to stifle global growth and upset supply chains. To date, it's still largely unknown what the full impact of the Coronavirus might be as it continues to spread and more confirmed cases are reported outside of China. The total number of fatalities has eclipsed the death toll from the 2002-2003 SARS epidemic, but the current fatality rate of approximately 2% is lower than SARS.

The S&P 500 finished lower by 0.04% but the underlying composition was more meaningful. Information technology stocks were up 4.0%, as a sector led by Apple and Microsoft and were only bested by utilities which saw a 6.7% rise as interest rates declined significantly during the month. The worst two performing sectors in January were basic materials (-6.2%) and energy (-11.1%) as concern for global demand accelerates.

The potential for a China slowdown and a reduction in the appetite for risk assets was particularly troublesome for international markets. The developed international EAFE Index and MSCI Emerging Markets Index were both up firmly in December but fell 2.1% and 4.7% respectively in January.

Earnings season has largely been a non-factor with most companies reporting solid results but being somewhat more conservative with forward guidance. We remain constructive on the outlook for equity markets given the current economic backdrop and will continue to monitor developments.

### *Positives*

Resilient U.S. consumer and labor markets

---

TINA – There Is No Alternative (to equities)

---

Fed remains on hold

---

### *Negatives*

Coronavirus impact and ripple effects

---

Equity valuations are somewhat stretched

---

### *Unknowns*

Signs of trade progress but a very long way to go

---

## FIXED INCOME OUTLOOK

---

### *Summary*

Following the exceptionally strong returns for bond investors last year, few expected the asset class to deliver much more than their coupon rate this year. As a group, professional investors and strategists certainly were not expecting January's bull-flattener, where yields declined across the curve led by longer maturity bonds. Due mostly to the coronavirus, which is what happened as investors became increasingly concerned the virus would significantly impair the Chinese economy. As the world's second largest economy, a slowdown in China would be felt by the U.S. and the rest of the world, and the Fed would likely need to cut rates further to offset this economic impact.

The 2-year note ended January 26 basis points lower at 1.31% while the 10-year declined by 41 bps to end at 1.51%. Having increased to 35 bps on economic optimism, the 2 year to 10 year spread was once again down to 20 bps, raising alarm bells that a slowdown in economic activity is imminent. Relative to its starting yield, it has been reported that January's decline in the 10-year Treasury note yield was the fifth largest monthly decline in the last 90 years. Bonds with maturities from one year to five years now yield less than the lower band of the overnight rate set by the Fed. This inversion is the market's signal a rate cut is more likely than not. At the end of December, the futures market was pricing for one Fed rate cut late in 2020. By the end of January, the market was expecting a cut by June and a 62% chance of two or more rate cuts this year. Consistent with elevated economic risks, corporate bond returns trailed duration-matched Treasury note returns as credit spreads increased by about 10 bps in aggregate.

We are carefully monitoring the coronavirus for not only its human toll but its impact on government, corporate and economic activities. As of now, the range of outcomes leaves us to maintain a full-duration policy with the acknowledgement that interest rates could move back up as sharply as they fell with the quick development of a vaccine or means to contain the virus from spreading further. If the impact on commerce and the economy are as dire as some are warning, the move lower in rates will be validated with easing by the Fed and the possibility of even lower rates.

### *Positives*

Federal Reserve's rate policy can only go lower in the next few years

---

Economic uncertainty created by widespread pandemic fears

---

Global demand for high-quality income assets could rise

---

### *Negatives*

All U.S. Treasury bond yields inside of 10-years lower than inflation target

---

Capital expenditures could accelerate with removal of tariff uncertainties

---

### *Unknowns*

Ability of China to contain the spread of the coronavirus

---

Markets reaction as Democratic candidate emerges from early caucuses/primaries

---