Yanni & Associates Investment Advisors, LLC

THIRD QUARTER – 2019 CLIENT NEWSLETTER
REVIEW OF THE MARKETS:

Index:	3Q19	2019
S&P 500	1.70%	20.55%
S&P Mid-Cap	-0.09%	17.87%
S&P Small Cap	-0.20%	13.46%
Morgan Stanley's EAFE (International Stocks)	-1.07%	12.80%
Barclay's US Aggregate (Bonds)	2.27%	8.52%

ECONOMY & MARKETS:

In September, the Federal Reserve (the Fed) lowered the Federal Funds rate again by 0.25%. It will likely lower rates at least one if not more times in future meetings. As we anticipated and discussed in last quarter's newsletter, the Fed ceased its efforts in permitting any further roll-off of Treasury and mortgage-backed securities from its balance sheet. While against consensus estimates, the Fed is still projecting interest rates to rise in the near future years.

The longest expansion in U.S. history has continued with second quarter final GDP coming in at 2% (it's a noticeable slowdown from the previous 3.1% reported in the first quarter). While we are clearly in the latter stages of the economic cycle, we are not forecasting a recession in the upcoming months ahead. However, the probability has increased that one will occur in the next Presidential term. As this has also been one of the weakest expansions in history, some economists are projecting only a mild recession to follow. Overall, most inflation measures remain tame, but there has been upward pressure to wage growth in the last year. The latest unemployment report came in at 3.5%. Also, according to Factset, the forward Price-to-Earnings ratio for the S&P 500 is 16.5. However, the estimated earnings decline for the S&P 500 in the third quarter is -4.1%. Earnings growth is projected to be slightly positive for the fourth quarter and then 10.5% for full year 2020.

One of the latest concerns has been the inversion of the yield curve whereby the 10-year Treasury rate became lower than the 2-year rate (this has since reversed). While we have recently witnessed different points of inversion along the yield curve; this measurement is the most alarming. The inversion of the 10-year/2-year Treasury rates has preceded every recession since 1960! However, there were also two periods (1966 and 1998) where the yield curve inverted, but a recession did not occur in the months afterwards. Thus, while we still consider this inversion a major cautionary signal, it could also be indicating a false positive. Going back in history, the median span for a recession to occur after the 10-year/2-year inversion is approximately 17 months (after the election).

The on-again, off-again trade war will likely continue to be a major topic. Due to the significance of this issue, we have dedicated the next few pages of this newsletter to generally discuss international trade, trade wars, and other related topics.

YAIA FIRM UPDATE:

We have two Firm updates:

Komal Motwani has been promoted to **Investment Analyst**. Since joining the Firm in January, 2018, she has met many of our clients and has been an integral part of our success. Normally quiet in nature, she takes very thorough notes and has ensured intricate client circumstances have been handled properly. She has also helped our clients with numerous investment-related research projects.

Amber de Almeida was hired in August for a newly created position, **Office Administrator**. Thus, we have expanded our staff to four.
Amber formerly worked at another Investment Firm as a Client Service Specialist. Her educational background includes B.A. in English from Malone University and M.B.A. from Point Park University.

Over the last 18 months, we have assisted several clients on detailed and complex personal matters. To ensure the long-term success of the Firm, we decided to hire for a position that will complement Camille Simon (our Administrative Assistant) and also support Komal with lower-end investment and operational responsibilities. A few of these complex topics which we have encountered include:

- Sale of a business
- A dear close client passed away whereby part of the estate went into Trust while another part went to a non-U.S. citizen.
- Another client's brother passed away leaving her with outside accounts and real estate.
- Approximately 10 clients have transitioned to retirement or will do so in the upcoming 12 months (higher than average).
- Two more switched jobs
- One new beautiful baby!

GLOBAL TRADE

Importance of Trade

Global trade is a key driver activity, accounting for about 58% of the global economy (and 27% of the U.S. economy). Global trade allows countries to sell their recourses (labor, technology, natural recourses etc.) to international customers. Countries may be able to do two things:

A. Produce the same good and sell it internationally at a lower price (even after transportation costs).

B. Produce a good that another country may not be able to produce itself (for example, Cobalt is mainly produced in the Democratic Republic of the Congo (DRC) and Zambia).

⇨ Common examples of U.S. imports include many smartphones, computer and electronic products and some precious metals and gems (i.e. diamonds).

The World Trade Organization is the main body that oversees most countries that participate in global trade.

How does trade affect the U.S.?

Exports account for 12% of the U.S. economy and are a critical component of GDP. However, the United States imports more than it exports, creating a trade deficit.

➔ Exports help affiliated U.S. companies increase their profits.

➔ Imports can help domestic company buyers keep the cost of production low. However, imports can also mean lower profits for domestic company sellers that produce the same good.

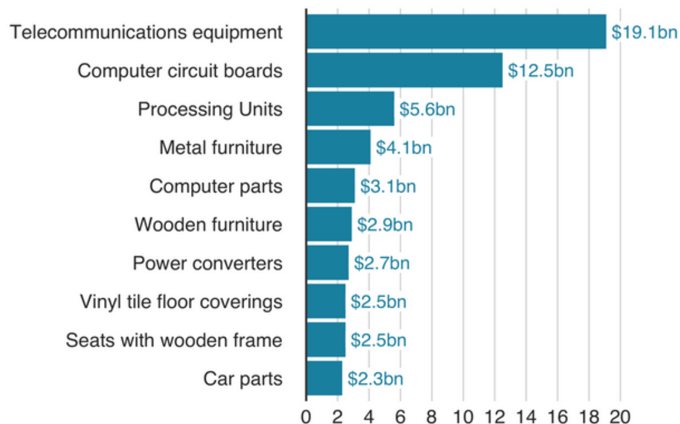
It's certainly understandable that a trade war with our largest trading partner (China) would be detrimental to the global economy. However, lost in the headlines is that the U.S. has signed or has pending deals with four of its other top seven trading partners (Japan, South Korea, Canada, & Mexico) which account for 60% of U.S. trade. Regardless of the U.S.'s recent trade accomplishments with other countries, an escalated trade war between two of the world's largest countries could disrupt the entire global supply chain.

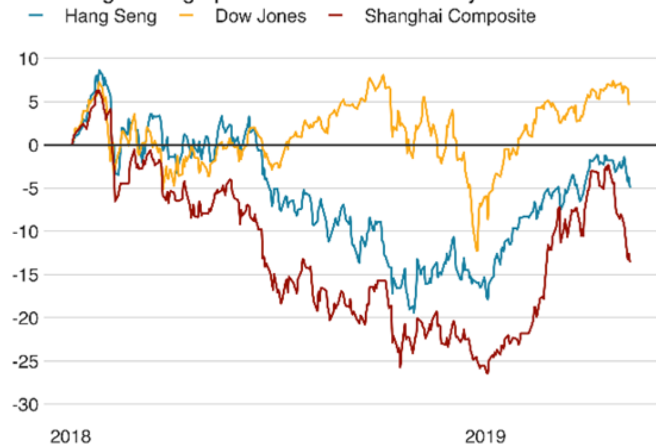
What are Tariffs?

A tariff is a specific tax levied on an imported good at the border. While our government does collect revenues through tariffs, they are also meant to protect domestic producers by enticing consumers and businesses to buy closely-priced American goods instead. *Going back 25 years when I interned with my Father's Investment Company (whose primary clients were unions and charities), this brought back a distinct memory. For my Father's annual corporate golf outing, he specifically only purchased domestic beer as he knew "the union guys" would want to support U.S. produced goods.*

In addition to tariffs, countries also use quotas, sanctions, and other means to protect domestic producers.

The recent U.S-China trade battle charts:





Trade Dumping

Dumping is the term used when foreign countries export goods at prices lower than their home-market prices or even lower their cost of production.

⇨ The objective of dumping is to increase foreign market share and to weaken foreign competitors' production efforts, possibly intentionally driving them out of business.

***Arguably, China may be dumping many products internationally including steel. <u>Some would argue further that its government (who owns stakes in many companies) will subsidize these producers for lost profits</u>.

⇨ Disadvantages are that dumping can be costly to maintain over time and this potentially could lead to issues with the home country's own fiscal affairs.

Currency Manipulation

Currency Wars: A currency war refers to a situation where nations deliberately depreciate the value of their domestic currencies in order to stimulate their economies.

➔ A weaker domestic currency makes its exports less expensive in global markets, and simultaneously makes imports more expensive.

Currency devaluation (and manipulation) is nothing new. Many countries intentionally devalue their currency to help boost their economies (increases tourism too). While China's recent devaluations have been in the spotlight, individual European countries such as Greece & Italy are no longer able to devalue their currency (members of the Eurozone, they all utilize the Euro). This drawback to Eurozone members has arguably inflated some of those troubled individual country's economic struggles.

China's currency devaluations could be problematic for the global economy; given it is the world's largest exporter and its second-largest economy.

Trade Complications

- With the emergence of technology, code-sharing requirements and the potential for computer piracy can complicate international relations.

- Retaliations for trade disputes can often result in countries placing tariffs on products beyond the original issue.

- If domestic businesses are unable to weather the impact of increased tariffs, many may be forced to make structural changes to their businesses or even shut down.

- Proving a country is dumping products is extremely complicated.

- Over the years, China has been accused of unfair trade practices (dumping), currency manipulation, producing favorable economic reports, and maintaining restrictions for foreign investors in its stock market.

- Ultimately, an all-out trade war with the U.S. and China will be a detriment on global growth and at worst, could cause a global recession.