MONTHLY MARKET REVIEW

November 1, 2019

ROCKEFELLER CAPITAL MANAGEMENT

POLITICS OF OUTRAGE

Rising dysfunction in Washington; new election in Great Britain

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Despite the growing political divisions in the U.S. and a rather mixed earnings reporting season that further reduced growth expectations, equities and sovereign bond yields rose in unison in October. The "risk-on" sentiment was fuelled by the expectation of an imminent "phase one" Sino-U.S. trade deal. Some progress on the Brexit front, which has minimized the risk of a hard-Brexit, also raised the hope that business investment on both sides of the English Channel would accelerate in the not-too-distant future. Coincidentally, the rally gained momentum after the Fed's surprise announcement on October 11th that it would start purchasing Treasury bills, with an initial pace set at $60 billion per month, into the second quarter of 2020 at least. While the Fed took pains to say that the asset purchase was technical in nature and *not* quantitative easing, the fact remains that its balance sheet is once again growing, and more liquidity is flowing into the financial system. The Fed also reduced the Fed funds rate for the third time this year, albeit its forward guidance has now turned more neutral.

The "risk-on" mood lifted commodity indices and pushed down haven currencies such as the greenback and the yen, but gold remained resilient. The fly in the ointment was the leveraged loan market, which continued to experience some weakness. The funding shortage in the overnight lending market that started in mid-September also persisted. No one seemed to have a good explanation as to why a supposedly end-of-quarter cash crunch wound up lingering into late October.

After eight years at the helm of the European Central Bank, Mario Draghi handed the reins to Christine Lagarde. Draghi will be remembered for his adroit handling of the European sovereign debt crisis and the controversial negative interest rate policy. Unfortunately, Lagarde is not left with much ammunition and will need to leverage the art of political persuasion to convince Germany to loosen her purse strings to rekindle growth. It's not an easy task with the normally austere German Government, especially when its unemployment rate is hovering around multi-decade lows. However, the urgency regarding climate change may just give them cover to roll out a "green" stimulus in the near future.

EQUITY MARKETS INDICES[1]	9/30/19 Price	10/31/19 Price	MTD Change	YTD Change
MSCI All Country World	521	534	2.6%	17.3%
S&P 500	2977	3038	2.0%	21.2%
MSCI EAFE	1889	1955	3.5%	13.7%
Russell 2000	1523	1562	2.6%	15.9%
NASDAQ	7999	8292	3.7%	25.0%
TOPIX	1588	1667	5.0%	11.6%
KOSPI	2063	2083	1.0%	2.1%
Emerging Markets	1001	1042	4.1%	7.9%
Fixed Income				
2-Year US Treasury Note	1.62%	1.53%	-10	-96
10-Year US Treasury Note	1.67%	1.69%	3	-99
BarCap US Agg Corp Sprd	1.15%	1.10%	-5	-43
BarCap US Corp HY Sprd	3.73%	3.92%	19	-134
USD Performance				
Chinese Renminbi (CNY/$)	7.15	7.04	-1.5%	2.3%
Brazil Real (Real/$)	4.16	4.02	-3.3%	3.5%
British Pound ($/GBP)	1.23	1.29	-5.0%	-1.4%
Euro ($/EUR)	1.09	1.12	-2.3%	2.8%
Japanese Yen (Yen/$)	108.08	108.03	0.0%	-1.5%
Korean Won (KRW/$)	1196.25	1163.65	-2.7%	4.7%
US Dollar Index (DXY)	99.38	97.35	-2.0%	1.2%
Commodities				
Gold	1472	1513	2.8%	18.0%
Oil	54.1	54.2	0.2%	19.3%
Natural Gas, Henry Hub	2.33	2.63	13.0%	-10.4%
Copper (cents/lb)	258	264	2.3%	0.3%
CRB Index	174	177	1.7%	4.2%
Baltic Dry Index	1823	1731	-5.0%	36.2%

Source: Bloomberg.

The recent wave of protests and riots that swept through Indonesia, Hong Kong, Chile, Ecuador, Bolivia, Spain, Lebanon, Iraq, etc. may wind up hitting our shores someday as public discourse in the U.S. has become increasingly tainted by tribal interests and identity politics.

A STRANGER'S LARGESSE

Born in Paris as the illegitimate child of a British nobleman in 1765, James Louis Macie led a nomadic life and never settled down. He travelled throughout Europe and pursued a wide range of interests from geology to chemistry. In 1801, after the death of his mother, James inherited a substantial fortune and changed his last name to Smithson, the surname of his biological father. He passed away in Genoa, Italy in 1829, and left his estate to his nephew with the stipulation that should his nephew die childless, the estate would then be donated to the United States to establish an institution in his name for the "increase and diffusion of knowledge among men."

James' nephew died in 1835 unmarried and childless. A controversy ensued among Anglophobes, Federalists, and States' rights advocates in the U.S. government on whether to accept the bequest from this foreign stranger who had never set foot in America. In 1836, President Andrew Jackson convinced Congress to authorize the acceptance of the bequest, and dispatched former Treasury Secretary Richard Rush to England to secure the funds. In August 1838, Rush returned with seven crates of gold coins and James' belongings.

Once the money was in the government's coffers, the effort to establish the institution got mired in bureaucratic morass. There was neither oversight nor accountability as the Treasury used the money to purchase bonds issued by Michigan and Arkansas, which promptly defaulted. Many politicians who embraced Andrew Jackson's brand of crass populism also viewed imported culture and higher learning with suspicion. Fortunately, the principled former president John Quincy Adams was still serving in the House and became a leading voice of conscience to honor James Smithson's bequest. Adams successfully persuaded Congress to restore the lost funds with interest. Finally, in 1846, Congress passed a bill to establish the Smithsonian Institution and a non-political board of regents to lead the institution. In 1855, 26 years after Smithson's death, the Smithsonian Institution Building was opened to the public.

In 1901, the Smithsonian's Board of Regents was informed that the cemetery where James Smithson was buried in Genoa was to be relocated in a few years. One of the board members, Alexander Graham Bell (of the telephone fame), and his wife Mabel went to Genoa with the intent of bringing Smithson's remains to the U.S. On January 20th, 1904, James Smithson finally reached the U.S. soil, albeit posthumously. Five days later, the U.S. Cavalry escorted the American and British flag draped coffin to Smithson's final resting place at the Smithsonian Institution Building.

Today, the Smithsonian holds 154 million items across its 19 museums, 21 libraries, 9 research centers, a zoo, various landmarks, and admits 30 million visitors annually without charge. The country clearly owes a debt of gratitude to James Smithson for his generosity and foresight. However, equally important was John Quincy Adams' effort to persuade his colleagues to do the right thing and honor the bequest. This demonstrates that a nation's character is often shaped by the values and moral compass of its leaders.

A STAIN ON HONOR

Some of President Donald Trump's ardent supporters often compare him to Ronald Reagan over the two men's outsider status, battles with the mainstream media and the establishment, pro-business agenda, big tax cuts, and conservative judicial appointments. Some also draw parallels between Reagan's anti-Soviet foreign policy and Trump's trade war against China. However, recent developments on the foreign policy front show that the Donald is no Ronald.

To the consternation of politicians on both sides of the aisle, President Trump pulled U.S. troops out of Syria without prior consultation with either our allies or Congress. The move gave Turkish President Recep Tayyip Erdoğan the greenlight to crush our staunchest ally in the region, the Syrian Kurds, who have carried out the brunt of the ground-level fighting against ISIS. Despite our military's subsequent killing of ISIS leader Abu Bakr al-Baghdadi, the chaos in the region could still lead to an ISIS resurgence as many detained ISIS fighters will likely be freed with their Kurdish captors being routed by the Turks. When asked about ISIS escapees posing a threat, President Trump said with a straight face that it was Europe's problem since "*that's where they want to go*."

One Republican senator called the abandonment of the Kurds a strike at America's honor and a "bloodstain in the annals of American history." 129 Republicans in the House voted for a resolution rebuking the Administration's betrayal. Trump's defenders countered that the establishment warmongers did not understand that the President was smartly extricating the U.S. from a regional quagmire. Yet the fact remains that the Administration has been expanding U.S. military presence in the region as another 2000 troops were dispatched to Saudi Arabia. The President crowed that the Saudis are paying "100 percent of the cost, including the cost of our soldiers."

It seems that instead of acting on principles, values and commitments as President Reagan did to make America a shining city on a hill that inspired all who desire freedom, President Trump has instilled a transaction-based foreign policy that prioritizes quid pro quo over shared values. While it may be expedient in the short run, it could undermine America's global leadership in the long run.

Congressional Republicans' dissent over the president's Syrian policy came at an inopportune time as Trump is faced with the need to marshal all resources to combat the growing political storms. The political calendar is quite daunting for the remainder of the year. Turkish President Erdoğan will arrive in the U.S. for a state visit on November 13th, which could make for an awkward situation given the House's censure of Turkey. The much-ballyhooed partial trade deal with China is still up in the air, and new tariffs are scheduled for mid-December. On the domestic front, a budget deal must be worked out with Speaker Pelosi to avert a government shutdown on November 21st. Given the House's impeachment inquiry, it remains to be seen if Trump and Pelosi, whom he called a "third rate politician," can put aside the bad blood to keep the government open. Between Thanksgiving and Christmas, President Trump is likely to be formally impeached by the House, with the trial in the Senate to take place in early 2020. While the House appears to be building a credible case, President Trump has framed the impeachment as the "Greatest Witch Hunt in American History." Since Senate Democrats are unlikely to sway 20 Republican senators to get to the 67-vote threshold and convict the President, Trump will most likely survive the impeachment unless new, unassailably clear evidence of treason, bribery, or other high crimes and misdemeanors are uncovered.

The impeachment proceedings will likely create some tense moments at Thanksgiving dinners across the country and further deepen the political tribalism where loyalty to a party or a boss trumps honor and duty. One way to deal with this visceral issue is to ask oneself "would I hold the same position if it were Obama rather than Trump" ? For investors, the more important question is when financial markets might be hurt by the political circus and brazen mis-governance. So far, there appears to be an eerie complacency as the impeachment is viewed as a mere distraction, and President Trump is still favored by many to be re-elected. However, with 46% of independent voters supporting the impeachment, according to the latest polling data on *fivethirtyeight.com*, we suspect President Trump could come out of this process somewhat diminished. The Iowa caucus is only 3 months away, and financial markets may soon start pricing in Senator Warren's rising odds of winning the Democratic nomination and the presidential election. Given her highly re-distributive and business-hostile policy prescriptions, investors could be in for a rude awakening.

LIGHT AT THE END OF THE BREXIT TUNNEL

Across the Pond, British politics appears to be just as dysfunctional, but at least their parliamentary debates are civil (they don't call non-supporters "human scum") and witty, and their accents sound quite sophisticated. Brexit has transformed British politics from a Left-vs.-Right battle to a Leave-vs.-Remain struggle. It's been 40 months since the Leave camp won the referendum by a margin of 52 to 48, yet the government has not been able to get Brexit done. The uncertainty over the terms of the U.K.'s withdrawal from the European Union (EU) has hurt the country's business investment and market performance.

On October 22nd, Prime Minister Boris Johnson made a breakthrough by getting the House of Commons to support his Brexit bill in principle. The Withdrawal Agreement will set in motion a post-Brexit transition period that lasts through 2020, with an extension period to the end of 2022 that must be agreed upon by the end of June 2020. During the transition period, the U.K. and the EU will work out agreements on trade, security and other issues. However, Johnson failed to get parliamentary support to complete Brexit by the October 31st deadline, and had to reluctantly get the EU to extend the Brexit deadline to the end of January 2020. He subsequently got the backing for a December snap election which will once again pit the Leavers against the Remainders. If Boris Johnson can win a sufficient majority to finally get Brexit done and then introduce various pro-growth policies, there could be substantial upside in the pound, and stocks with sizeable domestic U.K. exposure.

THE ERA OF POPULIST RAGE

The violent protests in Chile, a country known as a role model of economic development for Latin America, have forced it to cancel the upcoming APEC summit which was to be held in Santiago in mid-November. It all started with the announcement of fare changes to the nation's highly subsidized public transportation system -- a 3.75% hike at peak hours, fare decreases at off-peak hours, and *no change* to student fares. Yet groups of secondary-school students in Santiago started jumping turnstiles in early October to protest the fare increase, which then morphed into massive demonstrations, riots and looting across the country. As Chilean President Sebastián Piñera declared a state of emergency and replaced his entire cabinet to deal with the crisis, his neighboring Argentinian counterpart, Mauricio Macri, lost the presidency to the Peronist ticket of Alberto Fernández and former president Cristina Fernández de Kirchner. Argentinians were rejecting Macri's austerity and reform programs, but the irony was that much of their economic malaise can be blamed on Kirchner's eight-year reign that ended in December 2015. In an age of rising outrage fueled by divisive social media and widening inequality, people are losing patience and looking for scapegoats and quick fixes. The recent wave of protests and riots that swept through Indonesia, Hong Kong, Chile, Ecuador, Bolivia, Spain, Lebanon, Iraq, etc. may wind up hitting our shores someday as public discourse in the U.S. has become increasingly tainted by tribal interests and identity politics. American exceptionalism and leadership are not divinely endowed and can only be maintained by its people's collective integrity, dedication and courage.

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