MONTHLY MARKET REVIEW

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ROCKEFELLER
CAPITAL MANAGEMENT

POWER TO THE PEOPLE

The moneyed class' long joyride; ignore the surging youth vote at your peril

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Equities notched another month of gains, now three in a row, as bulls cheered the return of Goldilocks while the bears threw in the towel. Bullish sentiment was driven by continued anticipation for a "phase one" Sino-U.S. trade deal, and the belief that the slowdown in global manufacturing is now bottoming and poised to pick up. The three-month equity rally also coincided with the Fed's balance sheet having expanded from a five-year low of $3.76 trillion at the end of August to $4.05 trillion at the end of November. This $292 billion increase, which annualizes to more than a trillion dollars, is the fastest pace of liquidity injection in more than a decade. The risk-on mood was also reflected in the 10-year Treasury yield's surge from 1.69% on Halloween to as high as 1.94% by mid-November. However, the 10-year yield settled at 1.78% and flattened the yield curve by month end as the market priced in lower odds of a rate cut in the next few quarters.

The expectation of improving economic fundamentals helped lift crude oil prices, but the base metal complex was mixed. Safe havens like gold and Japanese yen unsurprisingly pulled back in such an environment. On the currency front, the U.S. Dollar Index (DXY) advanced against most currencies, especially those in Latin America where social unrest and violent protests have spread from Chile to Colombia. Brazil's central bank most recently intervened in the currency market to prop up the Brazilian real which declined to record lows.

While equities surged on the *expected* bottoming of cyclical data, economic fundamentals have remained lackluster. Weak earnings guidance from technology bellwethers Cisco, Dell, and Hewlett Packard Enterprise indicated that business confidence remained fragile in the face of continued policy uncertainty. The Street's 2019 S&P 500 Index EPS growth expectation has collapsed from 7% at the start of the year to essentially flat today, pointing to valuation expansion as the main driving force behind strong market appreciation (Thank you, Chairman Powell). With the market's volatility index (VIX) having fallen to the lowest levels in more than a year, it's clear that investor complacency is elevated. It will be interesting to see if traders will take some profits when the "phase one" trade deal is finally consummated – the so-called *buy the rumor, sell the news* ploy.

EQUITY MARKETS INDICES[1]	10/31/19 Price	11/29/19 Price	MTD Change	YTD Change
MSCI All Country World	534	547	2.3%	20.0%
S&P 500	3038	3141	3.4%	25.3%
MSCI EAFE	1955	1974	1.0%	14.8%
Russell 2000	1562	1625	4.0%	20.5%
NASDAQ	8292	8665	4.5%	30.6%
TOPIX	1667	1699	1.9%	13.7%
KOSPI	2083	2088	0.2%	2.3%
Emerging Markets	1042	1040	-0.2%	7.7%
Fixed Income				
2-Year US Treasury Note	1.53%	1.61%	9	-88
10-Year US Treasury Note	1.69%	1.78%	9	-91
BarCap US Agg Corp Sprd	1.10%	1.05%	-5	-48
BarCap US Corp HY Sprd	3.92%	3.70%	-22	-156
USD Performance				
Chinese Renminbi (CNY/$)	7.04	7.03	-0.1%	2.2%
Brazil Real (Real/$)	4.02	4.24	5.4%	9.2%
British Pound ($/GBP)	1.29	1.29	0.1%	-1.4%
Euro ($/EUR)	1.12	1.10	1.2%	4.1%
Japanese Yen (Yen/$)	108.03	109.49	1.4%	-0.2%
Korean Won (KRW/$)	1163.65	1181.45	1.5%	6.3%
US Dollar Index (DXY)	97.35	98.27	0.9%	2.2%
Commodities				
Gold	1513	1464	-3.2%	14.2%
Oil	54.2	55.2	1.8%	21.5%
Natural Gas, Henry Hub	2.63	2.28	-13.4%	-22.4%
Copper (cents/lb)	264	264	0.2%	0.4%
CRB Index	177	177	-0.1%	4.0%
Baltic Dry Index	1731	1528	-11.7%	20.2%

Source: Bloomberg.

The Trump-is-a-shoo-in belief is rooted in the notion that the economy will be stronger, and the Democratic party has drifted too far left. However, voter turnout data from recent elections portend a much tougher race ahead for the President.

NUMBER NINE DREAM

Thirty-*nine* years ago, in December 1980, on a nondescript wall in a secluded square across from the French Embassy in Prague, an unknown artist painted an image of John Lennon and some of his lyrics in commemoration of the music icon's tragic death. The police later had it erased but were unable to stop others from showing up at ungodly hours to scrawl Lennon-inspired graffiti and lyrics. In 1988, the wall became a symbol of resistance as young Czechs flocked to the site to vent their grievances in defiance of the ruling Communist party's last-ditch efforts to hold on to power. It led to a clash between students and the police on the nearby Charles Bridge. Following the fall of the Berlin Wall on November 9th, 1989, Czechoslovakians started the Velvet Revolution protests that eventually ended the Communist rule on December 10th, 1989.

Over the years, the Lennon Wall has evolved into a tourist destination and an open platform for graffiti art. However, it also attracted vulgar doodles and vandalism, which finally forced the owner of the wall to forbid unsupervised painting. It was a disappointment when I arrived there in early October only to find the wall covered with tarps for renovation. When the "new" Lennon Wall was unveiled on November 7th, it was transformed into an open-air gallery featuring the work of 30 professional artists. Gone was the tradition of unfettered graffiti and free expression. However, a smaller wall diagonally across from the Lennon Wall has become the new spot for graffiti.

If John Lennon were alive to see the fall of the Berlin Wall, he would have marveled at the date – the *9th* of November 1989. The number nine was special to him and inspired songs such as *Revolution 9* and *#9 Dream*. John has recounted that his childhood home was at 9 Newcastle Road, Wavertree, Liverpool – the street, the ward, and the city all have nine letters. John commuted on the No. 72 bus to the Liverpool Art College – 7 plus 2 equals *9*. His song writing partner Paul McCartney has nine letters in the last name. The Beatles' first performance at Liverpool's Cavern Club was on the *9th* of February 1961. Exactly *nine* months later, on the *9th* of November 1961, Brian Epstein saw the band perform for the first time. Brian was so impressed that he offered to manage the band and transformed the Beatles from four scruffy lads in leather jackets and jeans to heartthrobs in identical haircuts, suits and ties. On the *9th* of May 1962, Brian convinced EMI Records' George Martin to sign the then unheralded Beatles to a recording contract. *Nine* months later, *Please Please Me* became the band's first number one single. Then on the *9th* of February 1964, the Beatles made their historic appearance on the Ed Sullivan Show and firmly established themselves as the most popular band of the era.

During an interview in August 1980, John explained his fascination with the number nine by saying, "I was born on the *9th* of October, the *ninth* month. It's just a number that follows me around." Hmmm, I wonder if anyone pointed out to him that October is the tenth month of the year. Perhaps the number *nine* was not that special after all.

Four months after the interview, shortly before 11 pm on December 8th, John was tragically gunned down in front of his apartment complex on 72nd Street. He was rushed to Manhattan's Roosevelt Hospital and pronounced dead at 11:30 pm. Some noted that Manhattan and Roosevelt each has nine letters and at the time of John's death, it was already the *9th* of December in John's birthplace of Liverpool.

YOU SAY YOU WANT A REVOLUTION

While mourners flocked to the Dakota in the days following John's death, on the other side of the country in California, President-elect Ronald Reagan was busy assembling his team and laying the foundation for what was later dubbed the Reagan Revolution. The U.S. at the time was in a deep funk – it was humiliated on the world stage by the Iranian hostage taking, and its domestic economy was mired in double-digit inflation and rising unemployment. The Dow Jones Industrial Average Index was still below its 1973 peak, and the bearish mood was best captured in *BusinessWeek* magazine's infamous "*Death of Equities*" cover 16 months earlier.

The Reagan Revolution set in motion a near four-decade long policy evolution that was largely business and wealth-friendly. For starters, confidence in Reagan's pro-growth policies generated a U.S. dollar rally that helped Fed Chairman Volcker break the back of inflation and set in motion a multi-decade slide in interest rates. Reagan's seminal decision to fire 11,345 air-traffic controllers over their illegal strike in August 1981 dealt a serious blow to labor unions' bargaining power. Reagan also managed to lower the U.S. corporate tax rate from 46% to 34% by the time he left the office in 1989. For individuals, the highest marginal income tax was first brought down from a punishing 70% to 50% in 1982, and later slashed to 28% by 1988.

On the national security front, Reagan boosted defense spending from 6.4% of GDP in 1980 to as high as 7.7% in 1986. The combination of higher spending and tax cuts led to elevated budget deficits, which averaged 4% of GDP during Reagan's presidency and raised the gross federal debt from 31% to 50% from 1980 to 1988. However, the higher defense spending helped the U.S. win the Cold War *("Mr. Gorbachev, tear down this wall!")* and yielded a huge peace dividend in the form of new market openings as well as reduced military spending in subsequent years.

The pro-growth and business-friendly policy initiatives of the Reagan era were further expanded by his successors. President George H.W. Bush signed several free-trade agreements and started the NAFTA negotiations, which were completed by President Bill Clinton in 1994. In 2001, President George W. Bush granted China the permanent normal trading relations status and agreed to let it join the World Trade Organization. These moves enabled Corporate America to *"imagine there's no countries"* as they off-shored production to reduce costs while reaching billions of new consumers.

In the wake of the Great Financial Crisis, President Obama sought a more re-distributive policy and imposed more regulatory burden. However, the corporate income tax rate was unchanged, and the Federal Reserve's ultra-loose monetary policies created the most accommodative financial environment for businesses in decades. Low interest rates started a borrowing binge that pushed the U.S. non-financial corporations' debt-to-GDP ratio to a record 75% (vs. 51% in 1980) as companies levered up to fund share repurchases and dividend pay-outs. The Trump presidency kicked off another round of deregulation, and in December 2017, the corporate income tax rate was cut to an eight-decade low of 21%.

In sum, it's been a hell of a ride for Corporate America for nearly four decades. The corporate income tax rate went from 46% to 21%. Financing costs, as measured by investment grade corporate bond yield, have fallen from the teens to below 3%. Wages have not kept pace with inflation, and the transition from defined benefit to defined contribution pension plans resulted in further savings for employers. More opportunities were opened up thanks to globalization and deregulation. Earnings per share were steadily boosted by share repurchases and increased leverage. The annual volume of share repurchases has soared from $5 billion in 1980 to about $800 billion in 2018. Lastly, the market's price-to-earnings ratio has doubled during that period, going from below 10 times in 1980 to nearly 20 times today. It's no wonder the U.S. stock market and the moneyed class have done so well.

CLEANUP TIME – A BLUE SWEEP?

While Corporate America and the well-heeled thrived, their growing wealth did not trickle down to the lower rungs of society. The growing income and wealth inequality have led to rising populism on both ends of the political spectrum. On the right side, Trumpism has largely muted the moderate voice of country-club Republicans and made protectionism great again. On the left side, capitalism has become a dirty word to some, especially among the younger generations. A recent survey by YouGov/Victims of Communism Memorial Foundation found that 50% of Millennials (ages of 23 to 38) and 51% of Generation Z (ages 16 to 22) surveyed have either a somewhat or very unfavorable view of capitalism. 70% of Millennials and 64% of Generation Z respondents said they are likely to vote for a socialist candidate. 45% of Millennials and Generation Z believe that "all higher education should be free." It seems that, with no memory and little knowledge of the mismanagement and abuses by the Soviet Union and its satellite states, young Americans are embracing collectivism over individualism.

Ironically, while investors may dismiss this embrace of socialism as an inconsequential youthful indiscretion, the younger generations may wind up shocking the market next November by creating a blue electoral wave. At the present, the market consensus is that President Trump will be re-elected, and those who think otherwise have yet to adjust their portfolios. The Trump-is-a-shoo-in belief is rooted in the notion that the economy will be stronger, and the Democratic party has drifted too far left. However, voter turnout data from recent elections portend a much tougher race ahead for the President. According to the Census Bureau, voter turnout for the 2018 election was the highest in mid-term elections since the data collection started in 1978. Among young voters ages 18 to 29, the turnout shot up by nearly 80%, going from 20% in 2014 to 36%. In battleground states such as Arizona, Michigan, and Pennsylvania, youth turnout surged 164%, 114%, and 146%, respectively. Democrats also outperformed expectation in several key off-year elections in 2019, winning two of the three gubernatorial races in the deep red South. With President Trump's job approval rating among young people having been persistently depressed, a tsunami of young voters in November 2020 may just tip the balance in the Democrats' favor.

If Democrats wind up retaking the White House, the last line of defense for pro-business and market-friendly policies will be the Senate, where Republicans currently hold 53 seats and will likely gain a seat in Alabama. However, Democrats have a good chance at capturing Republican seats held in Arizona, Colorado and Maine, and the high turnout among young voters may also flip North Carolina as Senator Thom Tillis' margin of victory in 2014 was only 1.5%. A 50-50 party split will give the tiebreaker to the Vice President.

In the final analysis, although a Democratic sweep may appear to be a long shot at this point, investors should not dismiss the impact of potentially strong turnout among young voters driven by their disgust with a polarizing president. It will all come down to the ground game in battleground states. Just as the Reagan Revolution set in motion four decades of business and market friendly policies, a Democratic sweep could be a transformative event that sets the stage for a sharp reversal on multiple fronts – taxes, spending priorities, regulations, etc. Politically, the GOP will be mired in a nasty civil war among its various factions to redefine the soul of the party in the post-Trump era; the soul-searching will be even harder if Trump refuses to quietly sail off into the sunset. A deeply fractured Republican Party would be a negative for financial markets as its ability to impose checks and balances on the Democrats would be diminished.

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