

Cloudy with a Chance of Tariffs and a Recession: 2020 Forecast

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WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Create Opportunities

Session Overview

- Macroeconomic indicators
- Market indicators
- Geopolitical risks
- Conclusions for transactions in 2020



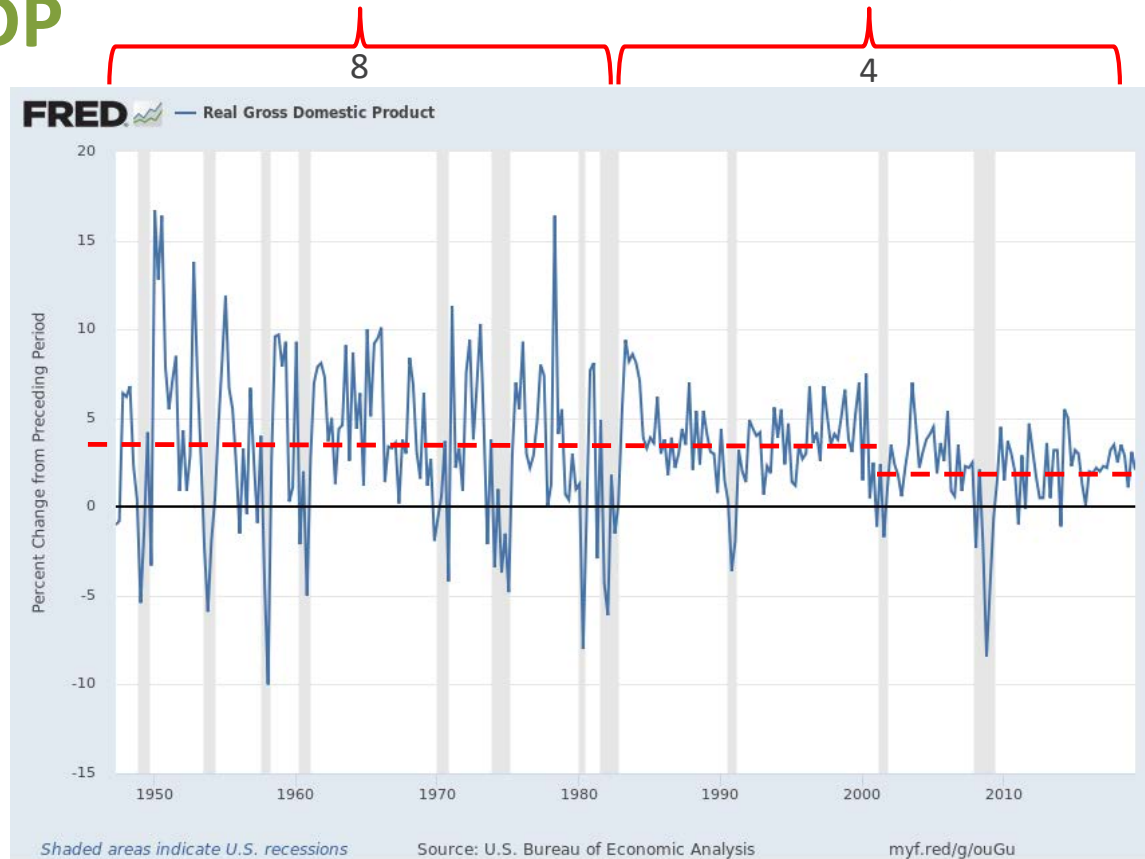
Macroeconomic Indicators

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Real GDP

Since 1983, recessions have become less frequent.

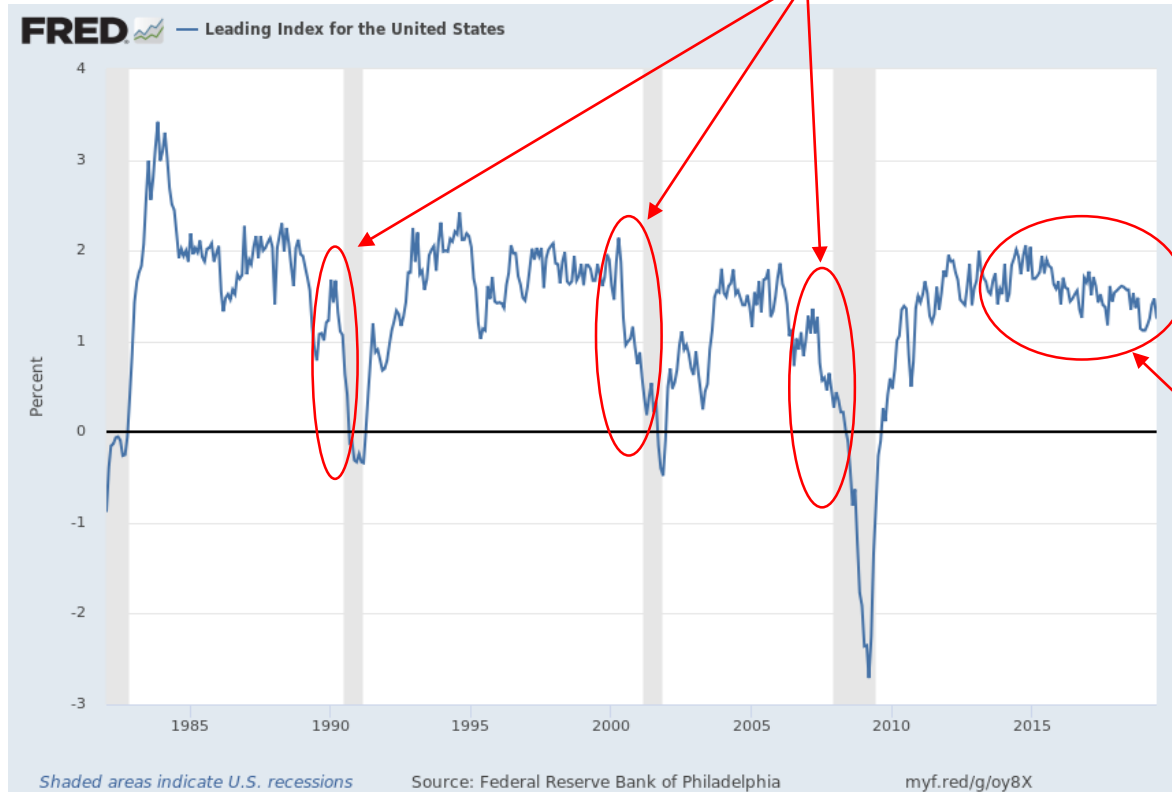


The average growth rate has slowed so now there is “less margin of error”, making it easier for the economy to slip into recession.



Leading Index

The Leading Index has fallen sharply in front of the last three recessions.

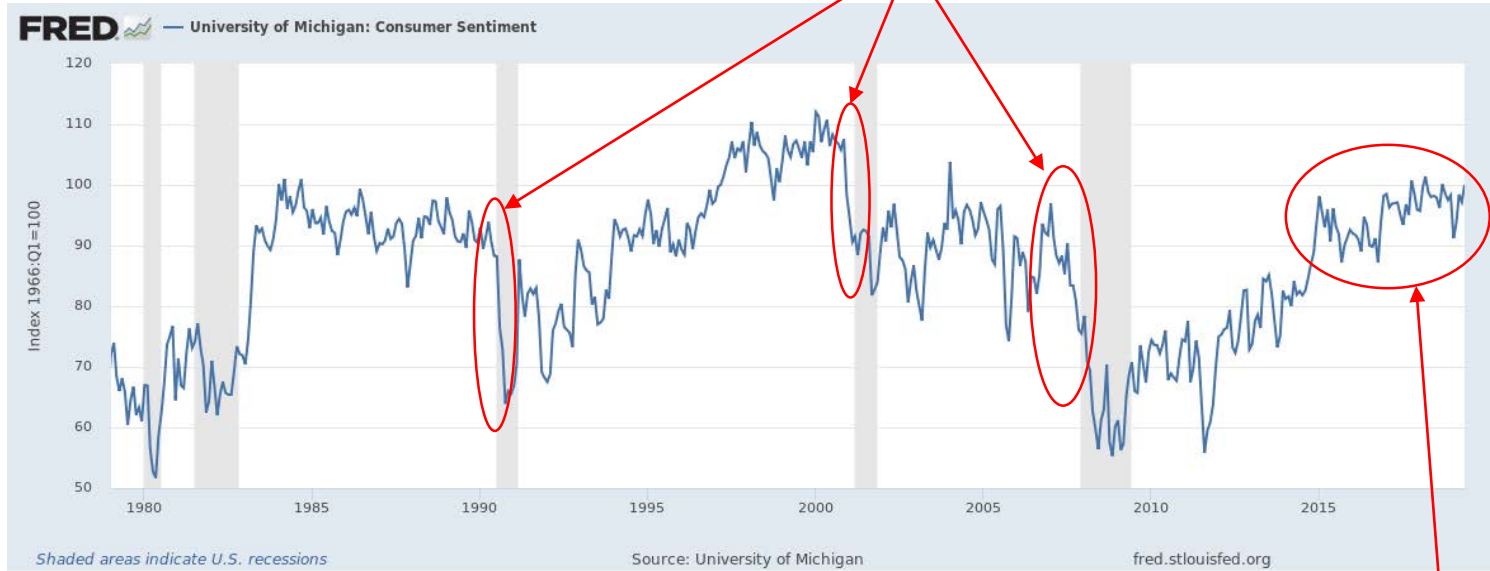


There has been no corresponding sharp drop-off.



Consumer Sentiment

Consumer Sentiment has fallen sharply in front of the last three recessions.

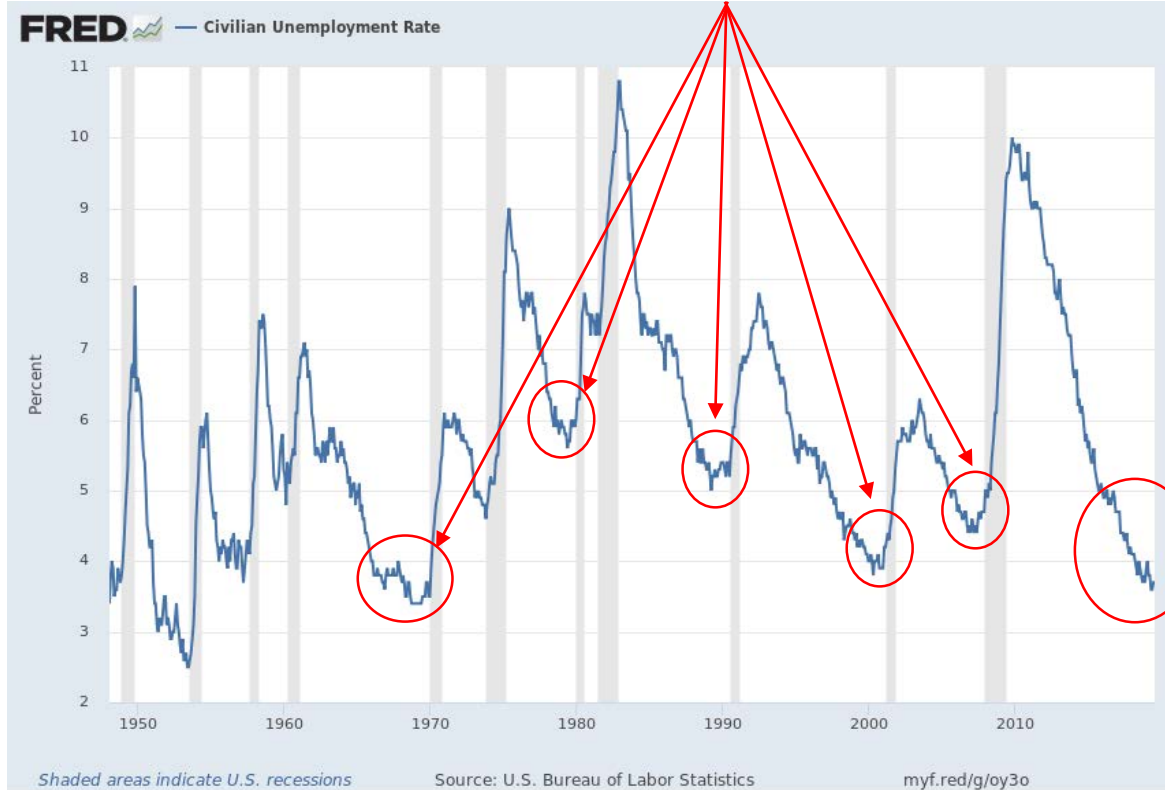


There has been no corresponding drop.



Unemployment Rate

While unemployment is traditionally a “lagging” indicator, it will still often show periods of flat-to-rising unemployment before the onset of a recession.



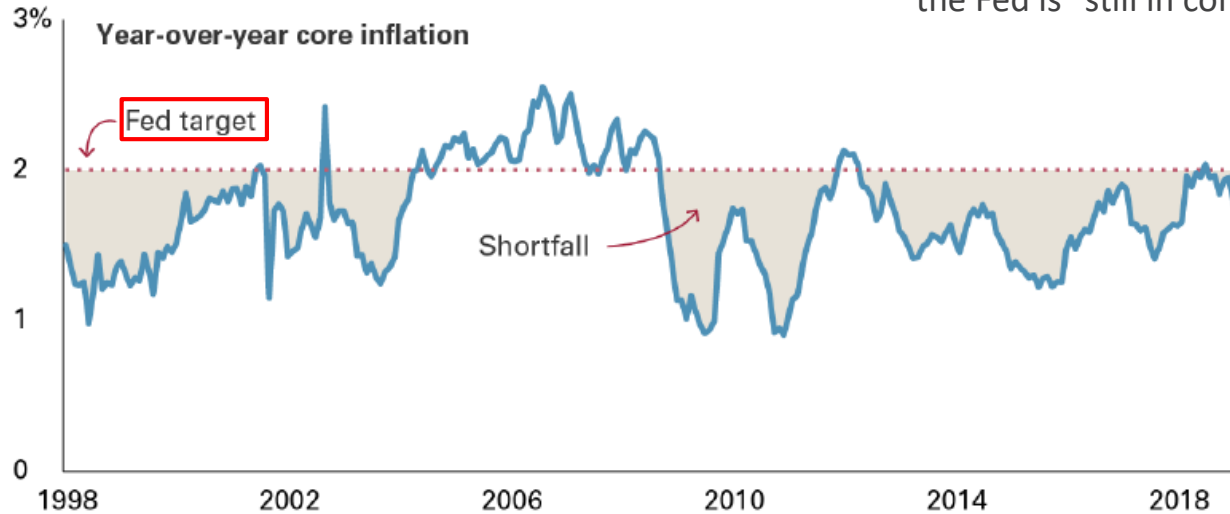
Unemployment is still dropping.



Core Inflation

Core Inflation remains in check.

This is important because it shows the Fed is “still in control”.

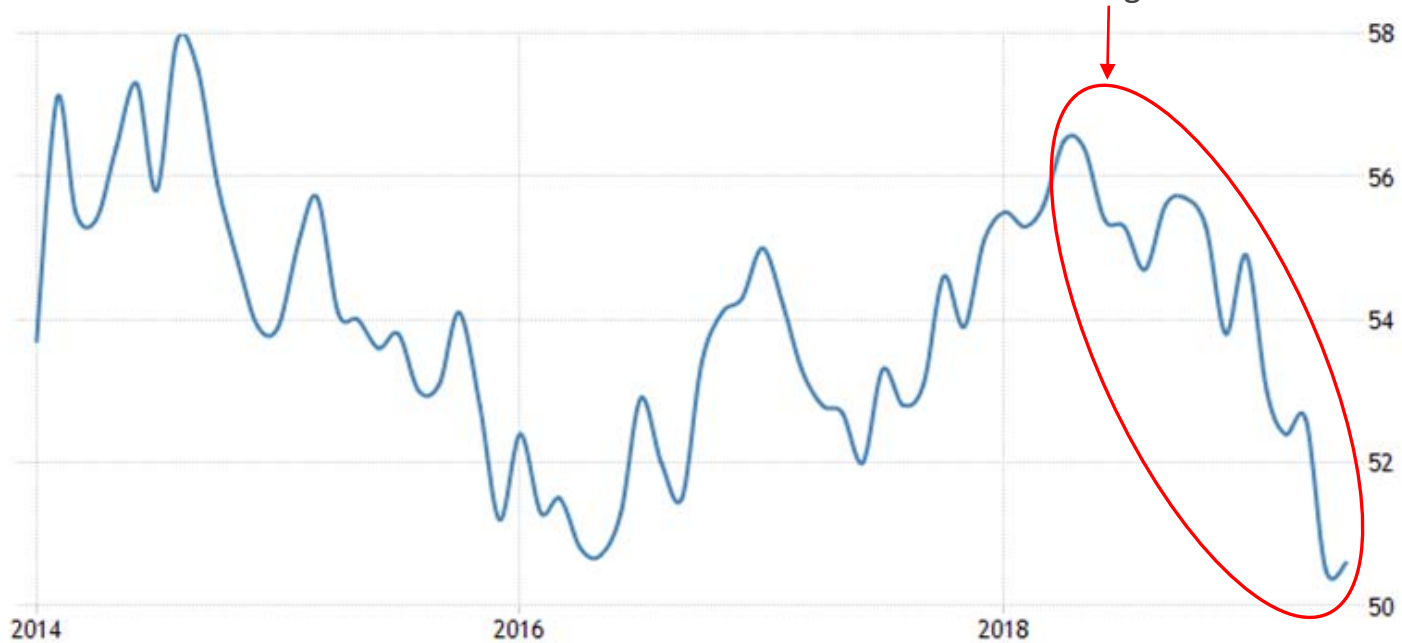


Notes: Core inflation is measured by the Core Personal Consumption Expenditures Price Index (which excludes food and energy). Data cover January 1998 through March 2019.

Sources: Vanguard calculations, based on data from the U.S. Bureau of Economic Analysis, the U.S. Federal Reserve, and Thomson Reuters Datastream.

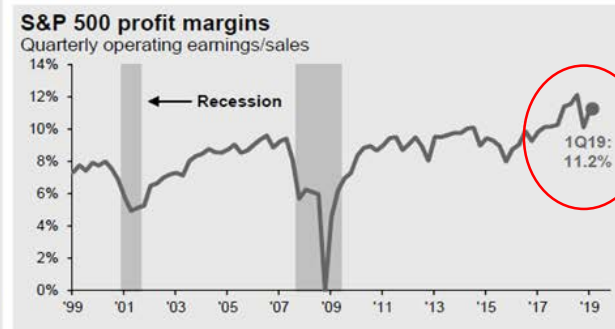
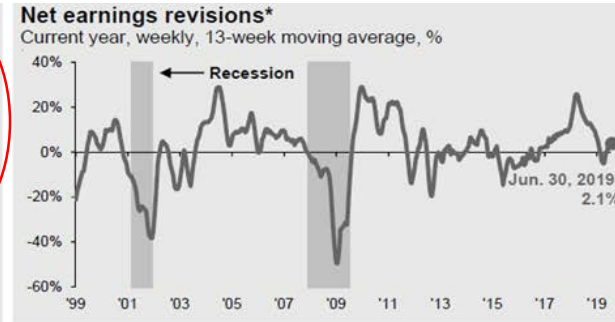
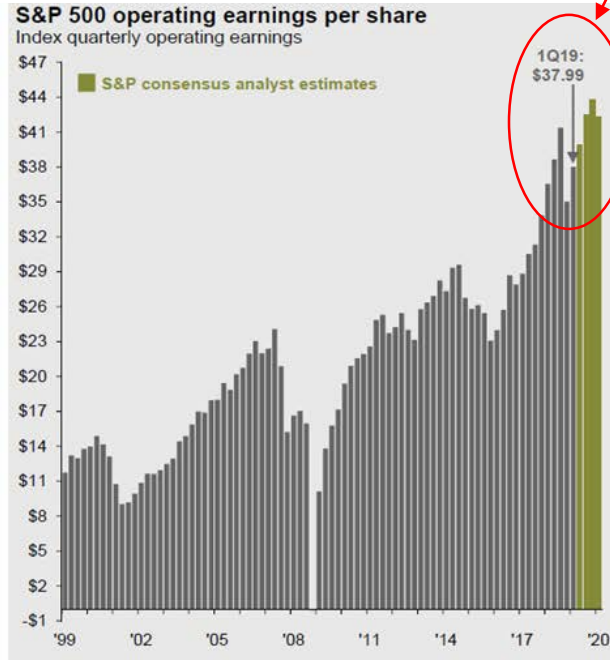
U.S. Purchasing Managers Index

U.S. Manufacturing PMI



Corporate Profits

Consensus EPS estimates remain strong.

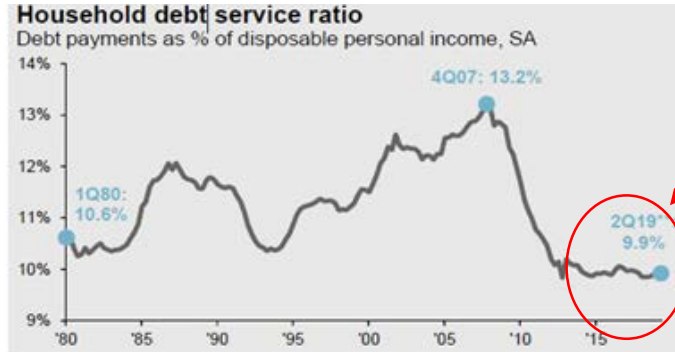
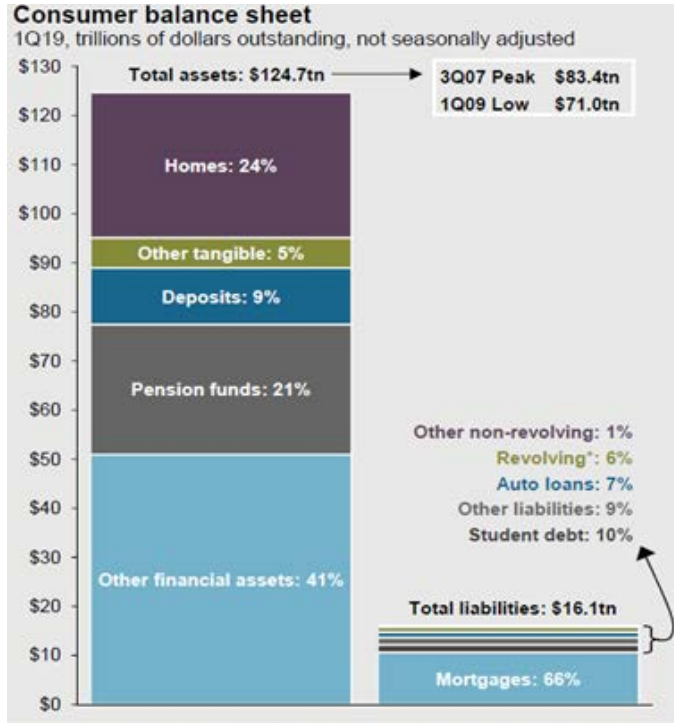


Profit margins remain solid.

Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.
EPS levels are based on operating earnings per share. Earnings estimates are Standard & Poor's consensus analyst expectations. Past performance is not indicative of future returns. *Net earnings revisions are calculated as the number of upward revisions minus the number of downward revisions as a percentage of total revisions. Total revisions include upward, downward and unchanged revisions.
Guide to the Markets – U.S. Data are as of June 30, 2019.

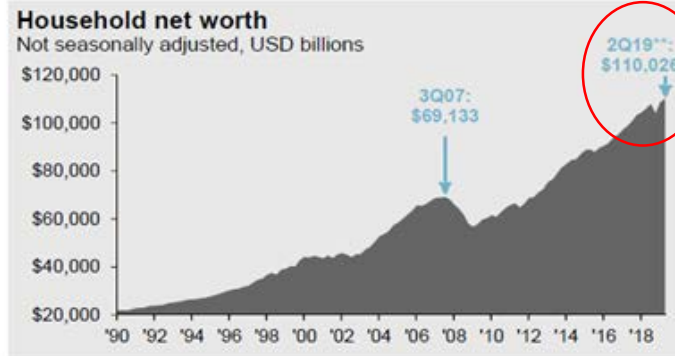


Consumer Balance Sheet



Debt Service is low.

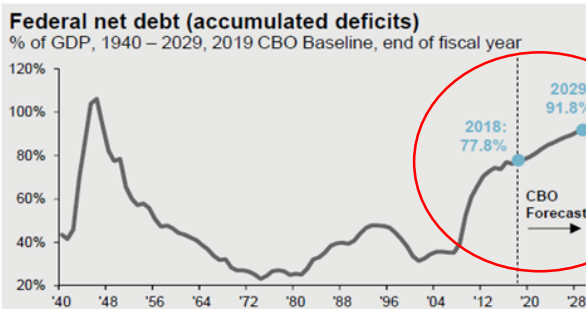
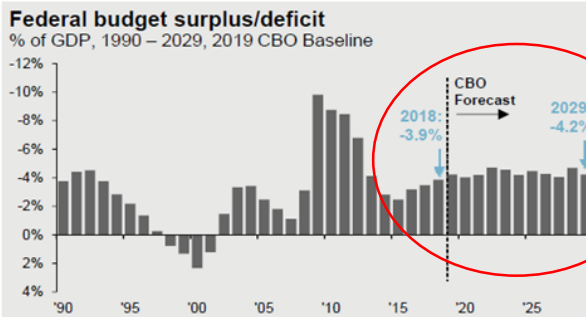
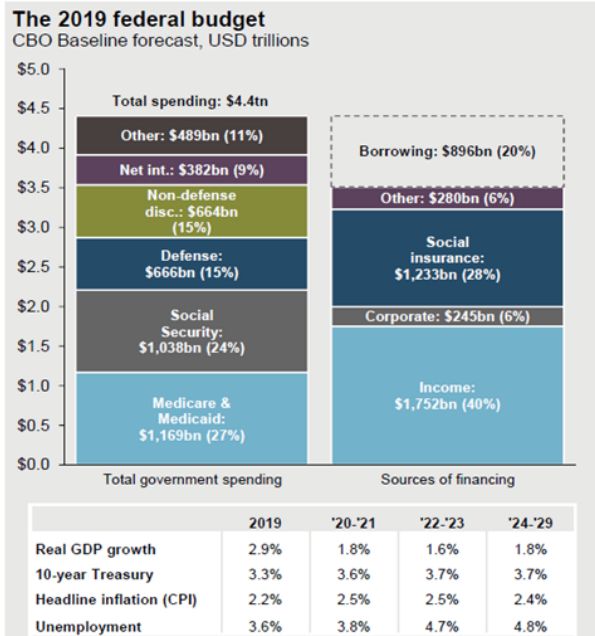
Net Worth is strong.



Source: FactSet, FRB, J.P. Morgan Asset Management; (Top and bottom right) BEA.
Data include households and nonprofit organizations. SA – seasonally adjusted. *Revolving includes credit cards. Values may not sum to 100% due to rounding. **2Q19 figures for debt service ratio and household net worth are J.P. Morgan Asset Management estimates.
Guide to the Markets – U.S. Data are as of June 30, 2019.



Federal Budget



Deficit spending remain high, especially given the strong economy.

Federal Debt (net) is projected to exceed 90% of GDP within ten years.

Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department.
2019 Federal Budget is based on the Congressional Budget Office (CBO) May 2019 Baseline Budget Forecast. CBO Baseline is based on the Congressional Budget Office (CBO) May 2019 Update to Economic Outlook. Other spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Note: Years shown are fiscal years (Oct. 1 through Sep. 30). Economic projections as of January 2019.
Guide to the Markets – U.S. Data are as of June 30, 2019.



Positives / Negatives

Positives

- Economy still growing, albeit slowly
- Macroeconomic indicators not flashing red
- Inflation remains in check
- Healthy Corporate profitability
- Consumer balance sheets are healthy

Negatives

- Economic growth is slowing
- Aging business cycle
- Large federal deficits, growing federal debt

No obvious “red flags” in macroeconomic data.



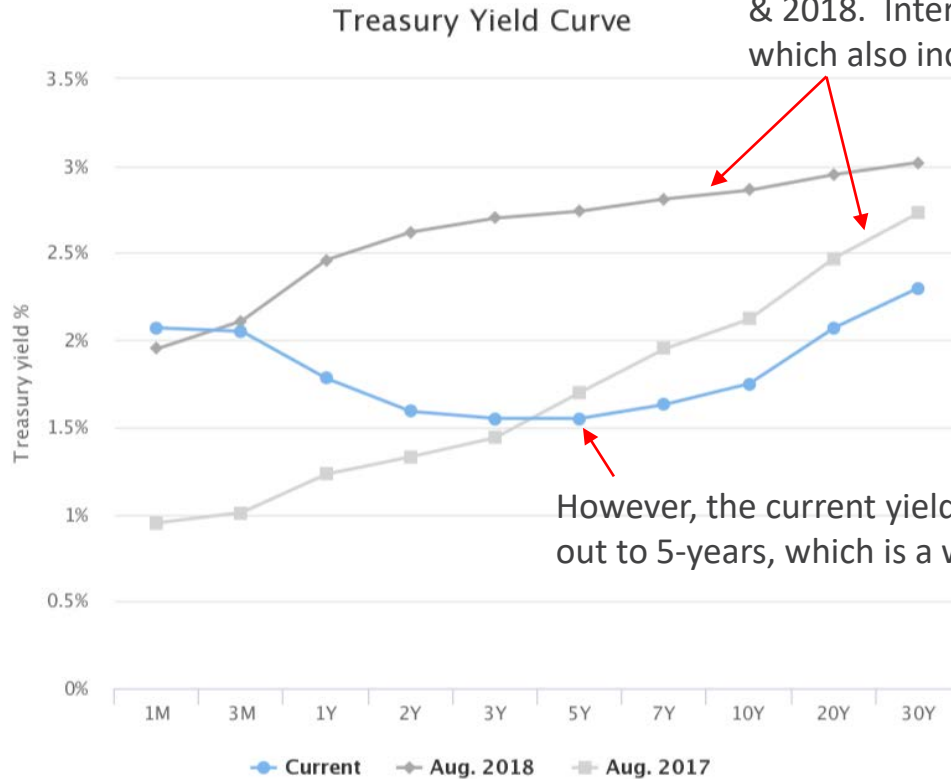
Market Indicators

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U.S. Treasury Curve

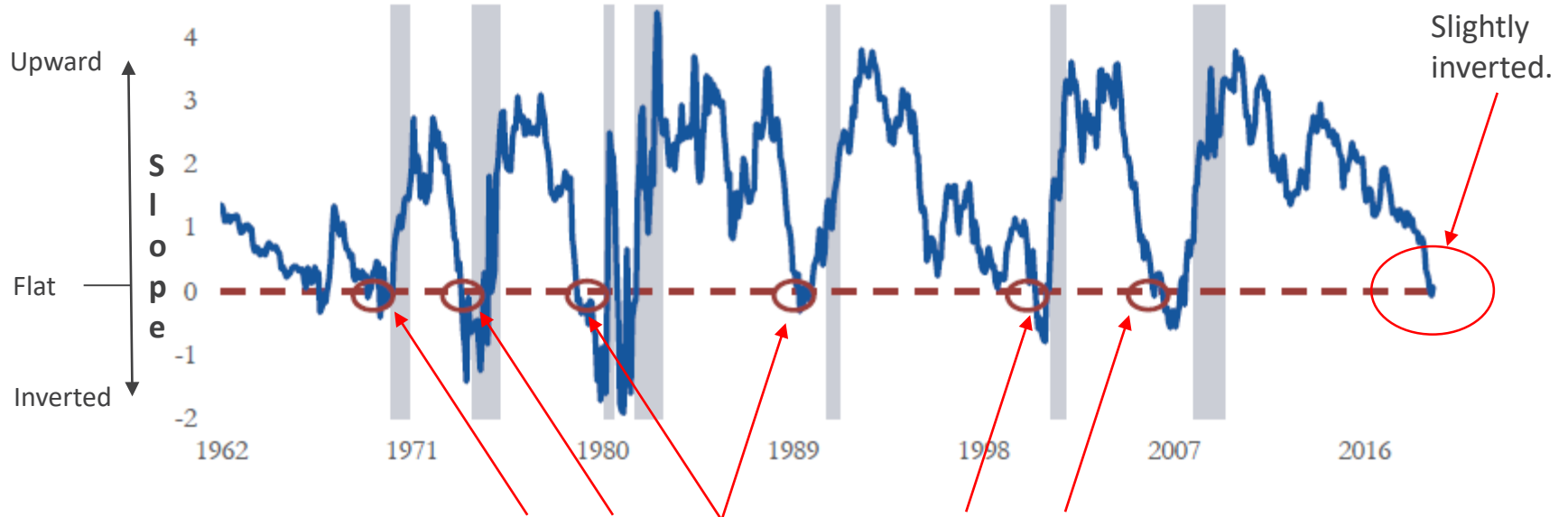
An upward sloping yield curve is a sign of a healthy economy, as shown in August 2017 & 2018. Interest rates were also rising, which also indicates a strong economy.



However, the current yield curve is inverted out to 5-years, which is a warning sign.

U.S. Treasury Curve Slope

10 Year-3 Month Yield



Inversion precedes recession in every case.

Fed Pause in “Monetary Normalization”

“Federal Reserve officials decided in late January to pause their steady campaign to raise interest rates as the global economic outlook became less certain and financial markets failed to appreciate the Fed’s willingness to shift if the economy weakened, according to the minutes of that meeting released on Wednesday.”

Source: NY Times 2/20/2019

“To ensure a smooth transition to the longer-run level of reserves consistent with efficient and effective policy implementation, the Committee intends to slow the pace of the decline in reserves over coming quarters provided that the economy and money market conditions evolve about as expected.”

Source: Federal Reserve website – March 2019 FOMC Communications

High Yield Debt Spreads

High yield spreads have risen sharply prior to the last two recessions.



Spreads have remained relatively low.



Negative Yields Are Pervasive

Negative Bond Yield Matrix													
Country	6-mo	1-year	2-year	3-year	4-year	5-year	6-year	7-year	8-year	9-year	10-year	15-year	30-year
Switzerland	-0.75	-0.64	-0.89	-0.91	-0.89	-0.87	-0.79	-0.76	-0.69	-0.63	-0.52	-0.29	-0.01
Germany	-0.58	-0.68	-0.74	-0.76	-0.74	-0.68	-0.64	-0.58	-0.46	-0.40	-0.31	-0.10	0.27
Netherlands	-0.59		-0.72	-0.70	-0.64	-0.61	-0.50	0.42	-0.32	-0.25	-0.15	-0.01	0.30
Japan	-0.13	-0.17	-0.26	-0.22	-0.23	-0.22	-0.22	-0.22	-0.21	-0.16	-0.12	0.07	0.36
Denmark	-0.06		-0.70	-0.70		-0.68			-0.45		-0.28		
Australia		-0.54	-0.65	-0.63	-0.57	-0.47	-0.39	-0.28	-0.22	-0.14	-0.03	0.31	0.70
Finland			-0.65	-0.63	-0.61	-0.54	-0.45		-0.19		-0.01		0.56
Sweden	0.40		-0.62			-0.55		-0.26			-0.01	0.18	
France	-0.59	-0.60	-0.68	-0.66	-0.62	-0.53	-0.41	-0.51	-0.21	-0.10	0.02	0.38	1.15
Belgium	-0.57	-0.58	-0.60	-0.66	-0.60	-0.54	-0.42	-0.25	-0.14	-0.06	0.09	0.40	
Slovakia		-0.33				-0.24	-0.50		0.00	0.18	0.26		
Ireland	-0.41	-0.53	-0.45		-0.46	-0.39	0.24	-0.14	0.45		0.22	0.58	1.16
Slovenia		-0.48	-0.30			-0.31		-0.14			0.25		
Spain	-0.41	-0.39	-0.40	-0.34	-0.27	-0.21	-0.06	0.08	0.20	0.29	0.43	0.80	1.47
Portugal	-0.38	-0.34	-0.37	-0.25	-0.17	-0.14	0.05	0.16	0.28	0.44	0.55	0.95	1.50
Malta	-0.25	-0.20		-0.10		0.02					0.74		
Bulgaria		-0.15		-0.01		0.05		0.37			0.58		
Italy	-0.16	-0.02	0.22	0.71	1.03	1.31	1.53	1.61	1.77	1.82	2.12	2.45	3.17
United States	2.19	2.03	1.81	1.75		1.78		1.89			2.03		2.52

Source: Pension Partners, @charliebilello; data as of June 17, 2019

Red indicates negative nominal yields. Green indicates positive nominal yields.

The total value of global debt with a negative yield is \$12.9 trillion!

The majority of this is debt issued by sovereign governments but about \$1.5 trillion of the total is in corporate bonds.



S&P 500

Volatility has increased significantly



Positives / Negatives

Positives

Fed pause in “monetary normalization”
Credit spreads are tight

Negatives

US yield curve inversion
Stock market volatility elevated
Debt with negative yields is pervasive

Markets are signaling caution.



Geopolitical risks

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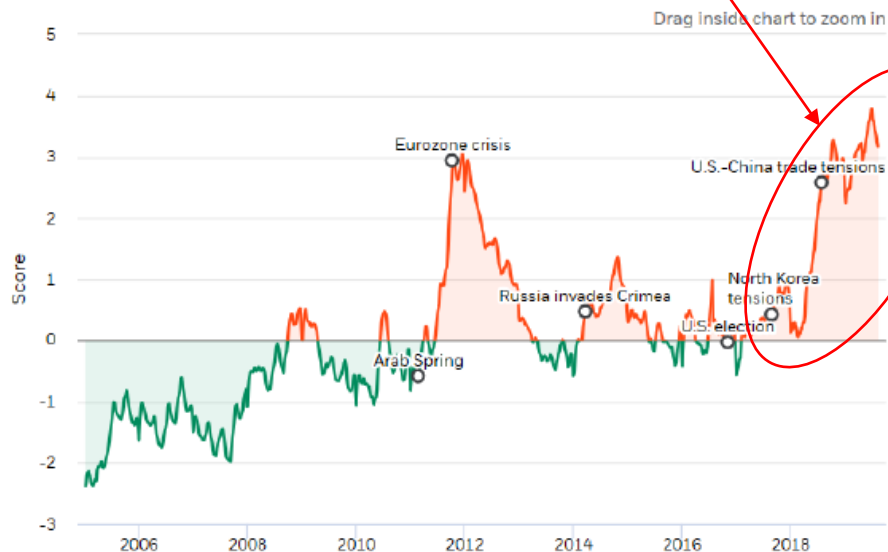
Geopolitical Risks

Top-10 risks, select to view

Gulf tensions	
Global trade tensions	
European fragmentation	
U.S. - China competition (new)	
South Asia tensions (new)	
Major cyberattack(s)	
North Korea conflict	
Russia - NATO conflict	
Major terror attack(s)	
LatAm policy	

Geopolitical risks appear to be elevated.

Global index



Source: BlackRock Investment Institute, with data from Refinitiv. Data as of August 9, 2019. Notes: We identify specific words related to geopolitical risk in general and to our top-10 risks. We then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases as well as on Twitter. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history from 2003 up to that point in time. A score of one means the BGRI level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average. We recently improved the methodology of our global BGRI, tying it closely to our other risks and updating the keywords. The chart may look different from previous updates as a result.



Where we are today

- Latest Tariff
 - Announced August 1
 - Effective September 1
 - ◇ Delayed until December 15
 - 10% on Consumer Products
 - ◇ Effectively all China Imports



Where we are today

Overall exemption request period	3-6 months
List 3 exemption request - Includes agriculture and durable goods	Ends September 30
Original list exemption request period	Ended in 2018
List 2 exemption request period	Ended in 2018

Where we started

**Solar Panels and
washing machines**
January 23, 2018

List 2
Finalized August 7, 2018
Effective August 23, 2018

List 1
Announced March 1, 2018
Effective July 6, 2018

List 3
Finalized September 17, 2018
Effective January 1, 2019

Why we started

Years of trade imbalance



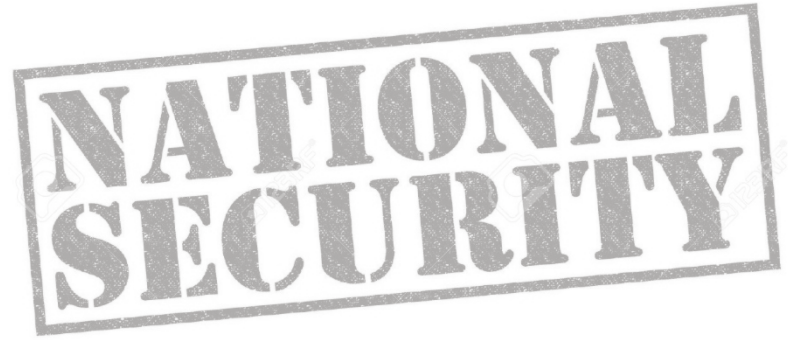
National Security



Why we started

- Trade imbalance
 - Trade agreements
 - Theft of intellectual property such as technology and US trade secrets
 - Product dumping





Why we started

- National Security
 - Decline of the steel and aluminum industries – move production to 80%

	Pre-tariff	Post-tariff
Steel production	78.2%	80.8%
Aluminum production	39%	63%

Recommended Process



Exemptions granted

Original tariff list	More exemptions granted to China products
List 2	Only 5 exemptions granted after
List 3	Still open

Reactions

- Trade partners angry
- Retaliation- China 2025
- Political good and bad



Like



Love



Haha



Wow



Sad



Angry

What was expected

- Price increases
- Delays in supply chain
- Quality issues

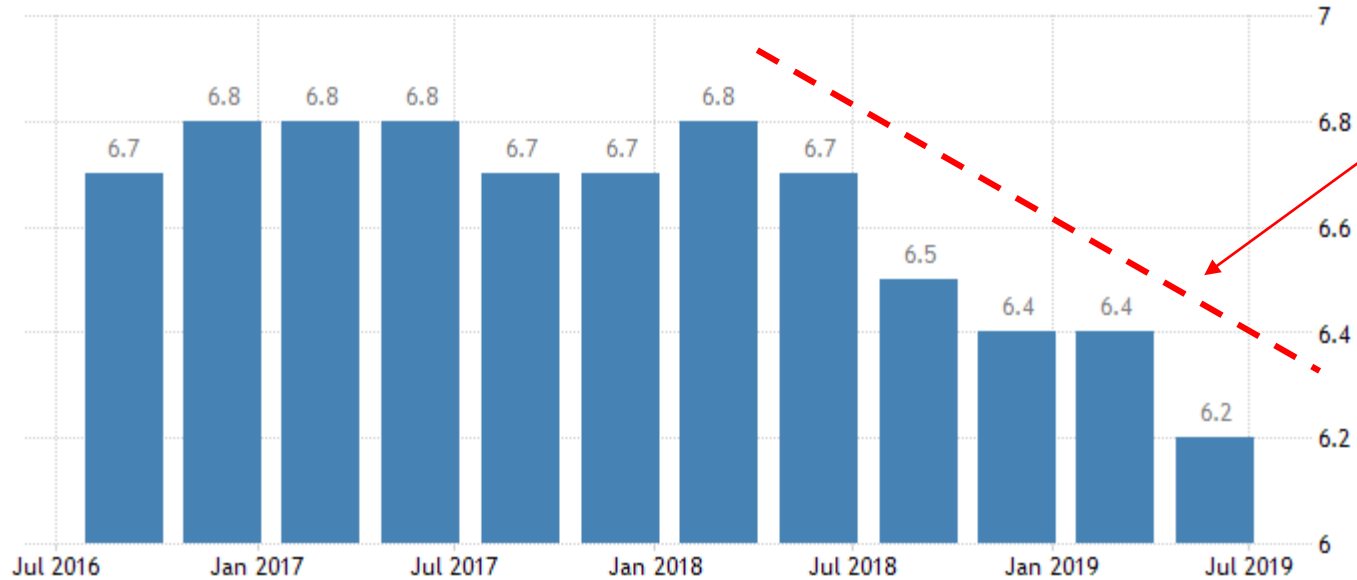


Where do we go from here

- Elections 2020
- The end game?



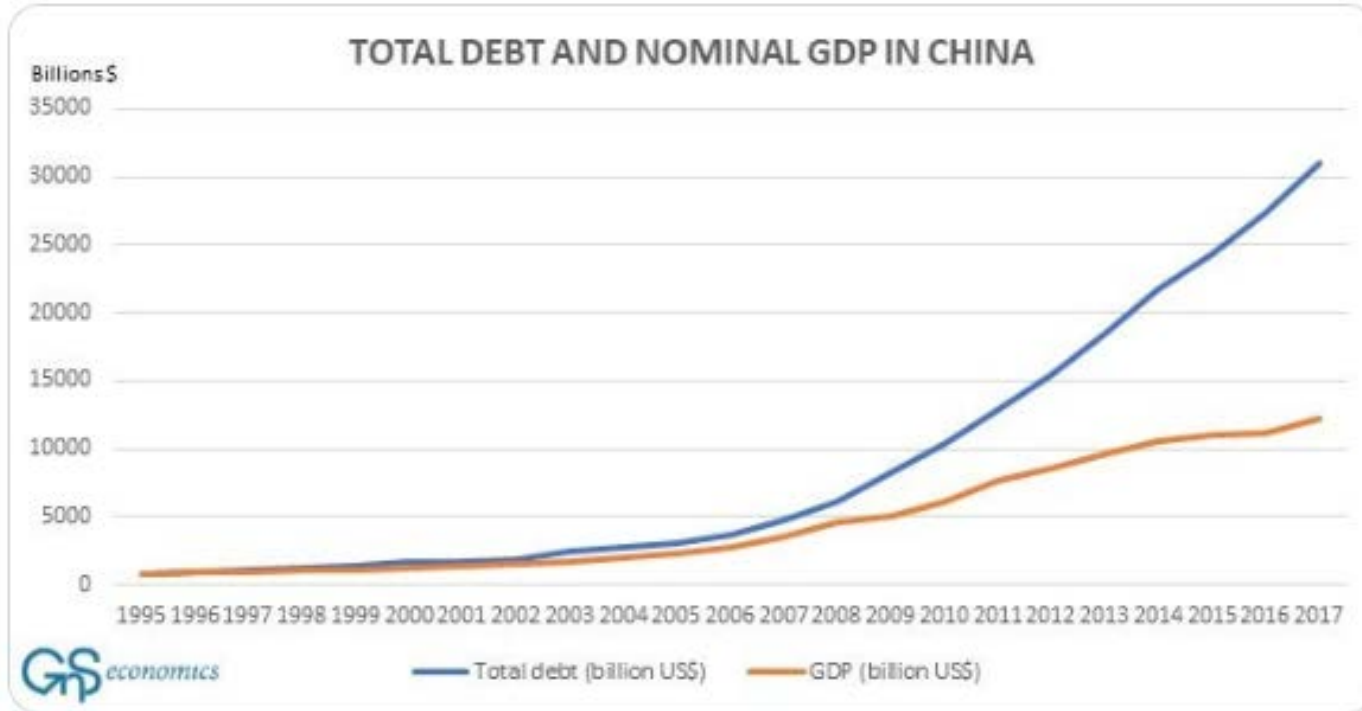
China's GDP growth



SOURCE: TRADINGECONOMICS.COM | NATIONAL BUREAU OF STATISTICS OF CHINA

China is the world's second largest economy and its growth, while still robust, is slowing.

China's Debt Levels Are Expanding



Gold price chart (ticker GLD)



Gold appears to be breaking out to the upside, indicating elevated geopolitical and/or currency risk.



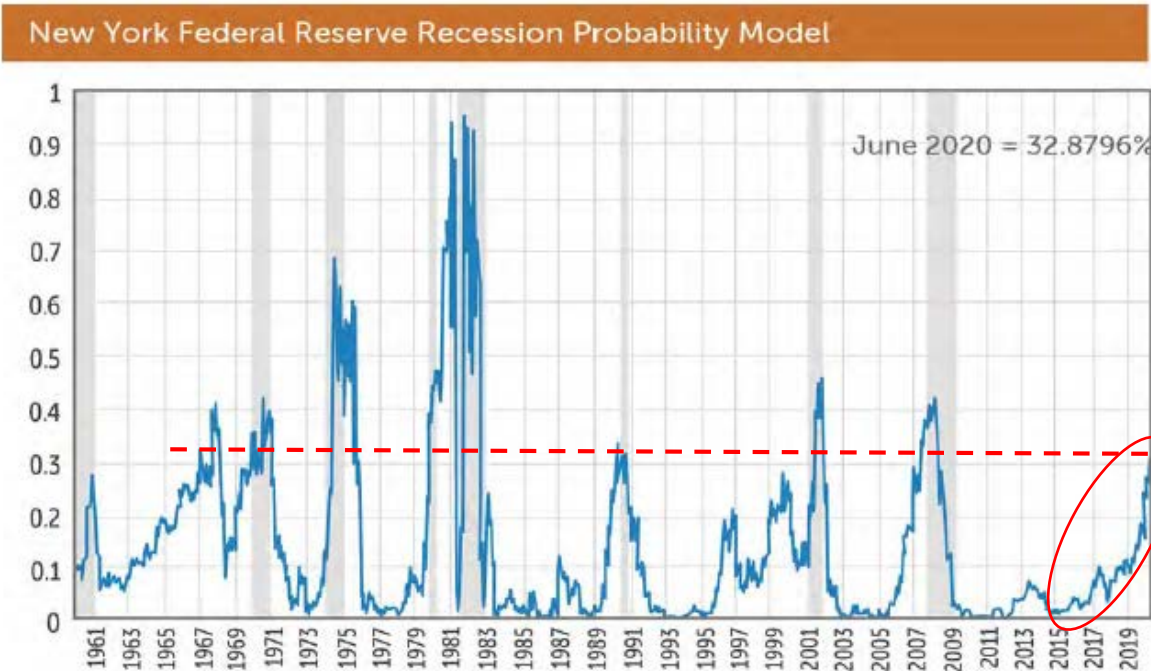


Conclusions

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New York Federal Reserve Recession Indicator



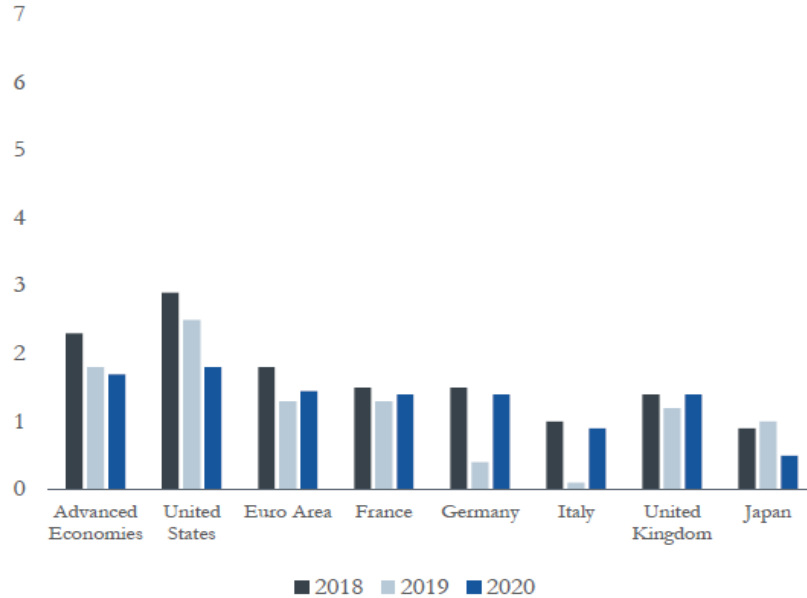
Probability of a recession in the next 12 months is about 33 percent.

Approaching levels were in the past, recessions have occurred.

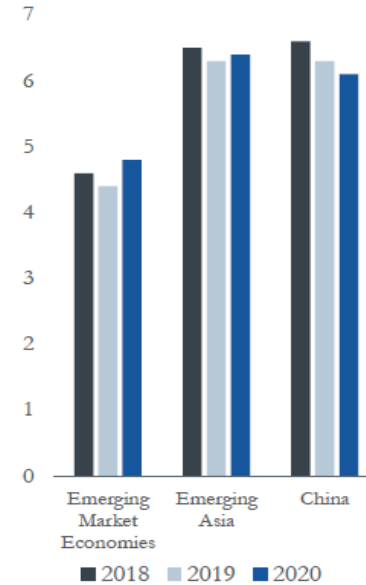
Source: New York Federal Reserve

World GDP Forecast

Developed Economies



Emerging Economies



Source: International Monetary Fund. As of March 2019.



Positives / Negatives

Positives

- Economy still growing, albeit slowly
- Macroeconomic indicators not flashing red
- Inflation remains in check
- Fed pause in “monetary normalization”
- Healthy Corporate profitability
- Credit spreads are tight
- Consumer balance sheets are healthy

Negatives

- Economic growth is slowing
- Aging business cycle
- Large federal deficits, growing federal debt
- US yield curve inversion
- Stock market volatility elevated
- Debt with negative yields is pervasive
- Elevated geopolitical risks

Markets are signaling caution.
Keep an eye out for “red flags” in macroeconomic data for confirmation.

Conclusions for transactions

- Demographics
- Uncertainty
 - Taxes
 - Interest rates
 - Election
 - Global economy
- No slow down for 2020



