INVESTMENT NOTES - February 13th, 2019
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Last week was a very busy week for us as we brought our cash position to 5% and increased our Euro exposure to over 50% as per our mandate (the six month grace period ended). We purchased a Japanese equity ETF, NDX, more VW, Italian, Greek, Chile, Bahrain and Indonesian sovereign t-bills and shorted the VIX index.

Our general thought process for these trades was that between the Fed put being on again, trade talks producing a postponement of the March 1 deadline and perhaps some progress, Brexit being postponed and Washington getting its act together, the market would be biased upward. The most important of these events for the market is the reappearance of the Fed put. The other factor is that investment managers are very underinvested. In examining the January performance numbers, there were few managers that captured the full rise in the index and therefore are behind in performance already this year. If the market stays at these levels or rises this week, we anticipate a large amount of cash being invested the second half of February.

Since we now have more than 50% in Euro designated investments, we thought it was a good time to evaluate our outlook for the Euro. The gorilla in the room for the future of Europe is the public social expenditure as a percent of GDP. Here are the statistics: France 31%, Belgium/Finland 29%, Italy/Denmark 28%, Germany 25%, Spain 24%, Greece 23%, Japan 22%, UK 21% and USA 19%.

The EU is frustrated over Brexit. A recent car bomb explosion outside a courthouse courtesy of The New IRA as well as discovery of a weapons cache along the border, demonstrate what a contentious issue the Irish backstop really is. The backstop is a tactic on the part of the Europeans to keep the British at arm's length, knowing that the Irish situation was unlikely to be sorted before any Brexit deadline. However, the Europeans did not plan the demise in their own economic data.

German retail sales fell 4.3% in December- the worst number in 11 years. Germany's factory orders were -7% YoY in December. Britain's growth estimates for this year have been cut to 1.2% which will be the worst year since 2009. The European Commission also cut their forecast for Eurozone GDP from 1.9% to 1.3%. Investor confidence in the European continent is at its lowest level in 4 years. Italy is discussing using gold reserves to plug budget holes, and also selling property. France has just been told by their audit office that they are going to be over budget. Spain just raised their minimum wage by 22%. The Greeks have raised their minimum wage even though unemployment is running at 18%. Not a rosy picture….

The sell side is saying the ECB is unlikely to raise interest rates this year and they are awaiting news on bank recapitalization. In a Barron's interview this past weekend of the ECB's Benoit Coeure, he blamed the European slowdown on US trade tensions, China and anything that can't be blamed on Draghi. He also expressed belief that the ECB toolbox is adequate (we doubt it) and if things get worse they stand ready to provide newly creative and legal solutions.

Geopolitical tensions within the EU are also increasing. Spain just had thousands turn out for a right wing backed rally against PM Pedro Sanchez in Madrid as the Vox party continues to strengthen. Italian Deputy Prime Minister Di Maio raised the hostility level with Macron by meeting with the Yellow Jackets, and France recalled its ambassador to Italy. The Germans have also suggested to France to turn their seat at the UN into a EU seat- which didn't go over well with France making clear their opposition to the Nord Stream gas pipeline (vital for German energy security) afterward. The United States ambassador to Germany has also been vocal about disappointment with the German decision to deport a terrorist to Turkey having previously requested an extradition to the US. The US has also commented on Germany's failure to meet defense spending commitments. Lastly, Ireland rejected the European commission's plan to remove national vetoes on taxation.

Anti-European parties are expected to win more than a third of the seats in the upcoming European elections which would directly affect the EU's legislative practices going forward. This is not helped by Merkel and Macron's open discussions on plans for a European armed force.

Recent stories of massive planned tax and tariff cuts in the event of a hard Brexit, provide a possible explanation as to how the UK could emerge from this negative spiral in a positive manner. The EU seems to be going in the opposite direction and determined to hang on to its bureaucracy.

We cannot find anyone positive on the EU economy for the previously mentioned reasons. The only bright spot is if the US and China make huge efforts to reflate their economies- since they account for 40% of the world economy, their efforts may pull Europe along with them, however, the best investment returns will come from the leaders, not the followers. Therefore even though we have over 50% in Euro investments the underlying on most of them are not in the EU and we have chosen to have our EU investments in Sovereign bonds.

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