INVESTMENT NOTES - February 19th, 2019

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The market danced to its own tune last week as global economic data turned down, taxes are about to turn up and stocks disregarded both by rising… Germany's GDP stalled in 4Q, UK's went negative in December. It appears the EU economy topped in Q1 2018. Although China is reporting a 6.5% increase in GDP, a more reliable indicator is electricity consumption which is only 3.5% stronger. America's retail sales dropped the most in a decade and taxpayer refunds are down 8.7% on a y-o-y basis which is in contrast to Amazon's second straight year of paying no tax on hundreds of billions of revenue. Senator Rubio, in response, is circulating a proposed rule to tax share buybacks.

Google paid more in fines last year than it did in taxes. Europe has led this trend although the USA might not be far behind. This coupled with a share buyback tax would create a strong headwind for big tech.

Despite all of this, global stocks are rising. This is a result of central bank tightening being less likely, earnings remaining OK in the U.S. and a successful conclusion to U.S.-China trade talks beginning to be anticipated. Perhaps one of the biggest reasons is that positioning in stocks seems to be too light- the BAML managers' survey revealed the largest cash holding by investors since 2009. Since hedge funds are experiencing redemptions, and banks are unable to take positions like they did pre-regulation, liquidity will remain tight and the market is susceptible to movements like we saw in December- straight up and straight down which is similar to the commodity markets.

Markets might start to react differently to bad news when earnings start to decrease. If the old way to prop up earnings per share, mainly share buybacks, is taxed perhaps one will see more mergers and acquisitions.

Outside of increased M&A, the hope depends on China being able to reflate its economy. The U.S. would probably get on board too by halting QT (which not only helps the U.S. but also many emerging market countries).

If interest rates rise however in reaction to overwhelming supplies of new debt, used to cover maturing debt, there would be a death knell in the equity market. U.S. government debt is $22 trillion at an average coupon of 2%. Interest expense is about $440 billion annually or about 60% of the military budget.

The other death knell could be an increase in taxes in order to reduce income and wealth inequality…

We are looking at RBS, Banco Sabadell and Roche for potential new equity holdings.

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