Tracking global and domestic economic conditions and forming future expectations of economic activity plays a large role in our investment and risk management process. As such we update you on current global and domestic economic trends.

China

China is the world?s second-largest economy and, per the IMF, responsible for nearly 30% of global growth. On January 20, 2019, China reported its GDP rose 6.6% in the fourth quarter. While the growth rate may appear strong, it is the weakest since the first quarter of 2009 and continues a gradual trend lower. The weakening GDP growth has been further confirmed via various purchasing manager surveys, trade data and auto sales which point to a further slowing of growth. Given their size, growing at such an outsized rate in the future is near impossible. Making matters worse, much of the credit stimulus used to promote activity in years past is becoming a headwind to growth. We expect growth to continue slowing in China which will weigh on global economic activity. In the short run, there are two wild cards we are following closely. First, how will trade negotiations affect China?s economy? Second, will China flood the economy with monetary and fiscal stimulus as they did in 2015/2016 to avoid a further slowdown? As we have seen repeatedly since 2008, the amount and type of stimulus that China applies to their economy and markets are of great importance to global financial markets.

Japan

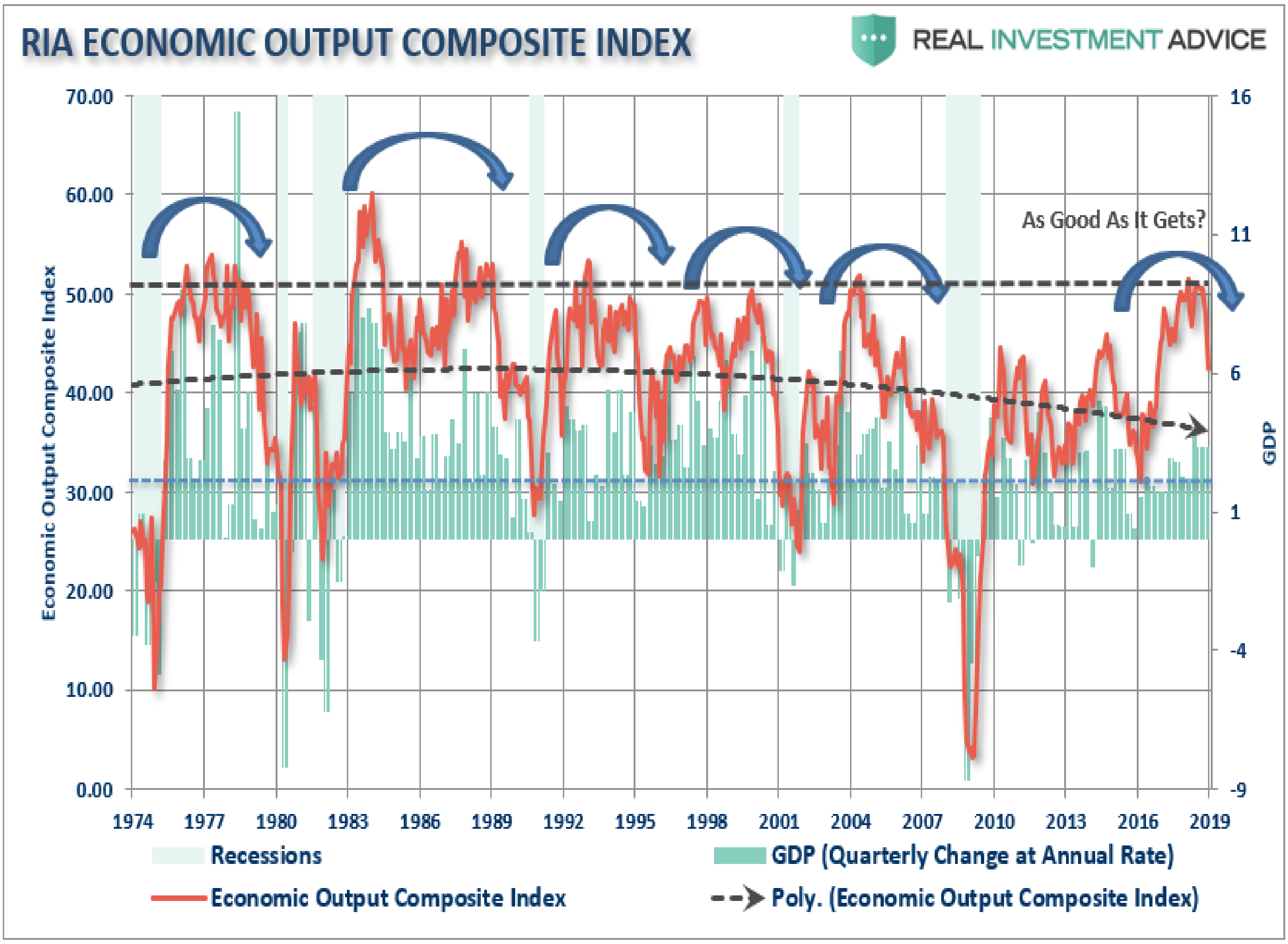
Japan, the world?s third-largest economy, has been experiencing weakness for over a year. In fact, the first and third quarters of 2018 both saw negative GDP growth. High levels of debt and poor demographics do not bode well for economic growth in Japan. Currently, the World Bank expects +0.8 and +0.5% GDP growth for 2019 and 2020 respectively. These forecasts have been routinely revised lower. Of recent events, it worth highlighting that business confidence in December fell to a six-year low and a new consumption tax hike is having the expected negative effects. Additionally, a combination of weaker economic activity among major trading partners and the relative strength of the yen is harming exports. The odds of a recession in the coming quarters is high.

Germany

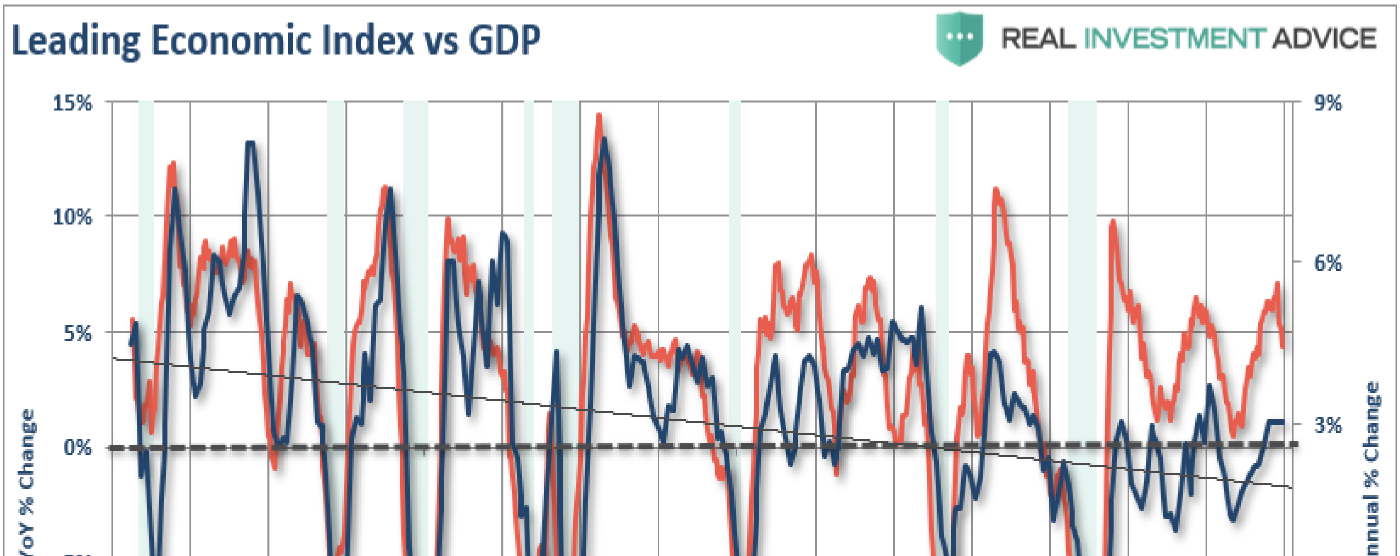
Germany is the world?s fourth-largest economy and the largest in the euro region. Over the last six months, soft and hard data has been notably weaker. A recent string of poor data is behind the government?s revision of Germany?s forecasted GDP from 1.8% to 1.0% in late January and similar revisions by the IMF and Ifo Institute. German GDP fell by 0.2% in the third quarter marking the first decline since 2014. Expectations for the fourth quarter stand at +0.2%. A decline in the fourth quarter (reported 2/14/19) would mark an official recession. It is worth also adding that the weakness is being felt throughout the euro region. The weakness of European economies has been and continues to catch economic forecasters by surprise. The Citi Eurozone Economic Surprise Index which compares economic forecasts versus actual economic data was negative in January and was negative for most of the last year. On January 31st Italy posted a negative fourth quarter GDP number. The surprising data, follows a negative third quarter, and officially puts Italy in a recession.

United States

Currently formulating economic expectations for the United States is very difficult. Before the government shutdown, there were signs from ?soft? economic data points that growth was slowing. ?Soft? refers to surveys and opinions about the activity that companies are seeing. These reports tend to be subjective and not always reliable. Hard data like retail sales, employment, and durable goods reports, can take 6-weeks to three months for release from the time the activity occurred. Given the time delays and the fact that some hard data releases have been delayed due to the shutdown, we are forced to depend more than usual on soft data while other economic reports catch up. Soft data has been running, pardon the pun, soft recently. The graph below is based on a composite index of 12 data points many of which are soft. As shown below in red, the soft data index appears to have reversed course.



One of the components of the index above is the Leading Economic Index (LEI) which, as shown alongside GDP below, is sending a similar message.



Based on weak global growth trends and the soft domestic data, we have lowered our expectations for economic growth in the first half of 2019. Our confidence is heightened by the fact that the growth benefits of the tax cut stimulus and a significantly larger Federal deficit in 2018 will not have the same incremental impact going forward. While the government shutdown was unpleasant for the country, the effects will likely not be felt to any large degree outside the beltway. If GDP growth is weaker than expected for the first quarter, rest assured many will use the government shutdown as a scapegoat. The truth is that a weaker GDP report is likely signaling something more concerning. Markets tend to be forward-looking so it is possible that with the market decline in the fourth quarter, slower economic activity may already be priced in. **Looking ahead, the biggest question in our mind is whether the slowdown is temporary or presaging a recession.** The jury is still out, but the Chinese economy and the relevance of trade talks on their economy is probably the most important factor to that outcome.