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Stolper Asset Management
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Portfolio Comments
For the Quarter Ending September 30, 2019

In his 1936 book, *The General Theory of Employment, Interest and Money,* British economist, John Maynard Keynes attributed the term 'animal spirits' to the unseen forces that influence human conduct, including investment decisions and consumer behavior. Specifically, he wrote that decisions are often "taken as the result of animal spirits - a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities." And so it seems, over this past quarter that the U.S. equity markets have lurched up and down by turn, but ultimately sideways, seemingly driven by oscillating sentiment towards economic and political news. While others interpret and emote, we, as value investors place even greater stead in our facts-based, fundamental analytical approach and do not feel compelled to act for the sake of it. That said, there's been no shortage of headlines to react to.

The S&P 500 closed on September 30th at 2,977 representing a return of 1.70% for the third quarter, and 20.56% for the first nine months of 2019. The DJIA ended September at 26,917 for a return of 1.83% in the past three months and 17.50% for the year to date. Notwithstanding the aggregate performance, it was yet another quarter of records surpassed as the S&P 500 breached a closing high of 3,000 for the first time on July 12th, coming a day after the DJIA closed above 27,000 points for the first time. They both went onto slightly higher record closings later in July. While it might not always feel like it, the current bull market has been going strong for over a decade!

The mere duration of the indices' ascents seems to have some on high alert for an impending recession, with the term commonly defined as two or more back-to-back quarters of falling output measured by the simultaneous contraction of factors such as GDP, industrial output and employment. A sudden change in policies, political or monetary, or a sharp price rise for key commodities such as oil, as well as investor panic can shock an economy into recession. More insidious factors, permeated by general malaise, can equally be the culprits. Capital that might otherwise be invested in expansionary projects instead stays on the sidelines stymying growth. The merry-go-round of earning and spending powered by consensus optimism begins to slow.

It is in such an atmosphere of faltering optimism that statistics such as the shape of the yield curve and the overnight repo market rate are brought to mainstream attention by economic forecasters. Headlining the quantitative spotlight has been the U.S. central bank's benchmark overnight lending rate, as set by the Federal Reserve. Fed Chairman, Jerome Powell, has come under sustained and vocal pressure from President Trump to backtrack on the Fed's course of slowly raising rates towards a 'normalized' level. Mr. Trump wants to drive borrowing costs down to encourage capital spending and keep bond yields low to push investors into riskier assets such as equities. Higher demand can exert upward pressure on stock market valuations, which are then touted as a barometer for the economy's health. The President's wish was granted not once, but twice, this past quarter with 0.25 percentage point cuts announced at both the July and September Fed meetings, leaving the benchmark rate now in the target range of 1.75-2%. The July cut was the first reduction since 2008, and the one that followed 60 days later was widely anticipated. The President was not wholly appeased, at one point tweeting "My only question is, who is our bigger enemy, Jay Powell or Chairman Xi?"

Mr. Trump's economic altercations with China's president, Xi Jinping, have indeed waged on in an intensifying trade war. So far, the U.S. has imposed tariffs on an estimated $550 billion worth of Chinese products and China, in turn, has set tariffs on US$185 billion worth of U.S. goods. There is some hope that bilateral high-level talks scheduled for October will yield conciliatory results, although President Trump's castigation of China during his recent address at the United Nations General Assembly is not setting a placating tone. Mr. Powell has spoken directly about the difficulty the Fed faces in assessing and responding to this trade war but, in aggregate, economic data is not signaling an imminent domestic recession. Even though manufacturing activity is weakening and inflation remains low, consumer spending is robust and unemployment is staying low. How aggressively the Fed moves in the future will largely depend on the momentum of these figures. As the Fed Chair concluded, "Our eyes are open, we're watching the situation."

China is not the only foreign power the U.S. administration continues to take issue with. Relations with Iran have been strained following President Trump's May 2018 withdrawal from the 2015 Joint Comprehensive Plan of Action (JCPOA or "Iran Nuclear Deal") and the imposition of economic sanctions against Tehran. Rhetoric further escalated following September 14th drone missile attacks in the region that inflicted heavy damage on oil production infrastructure in Saudi Arabia. The act of aggression spiked West Texas Intermediate Crude prices close to $63 / barrel briefly, although Saudi production quickly recovered and the price has retreated back below $60. The U.S., alongside key allies - including Britain, France and Germany - blamed Iran for the strikes, the latest in a spate of tanker bombings and pipeline assaults since May. Iran has denied responsibility for the latest attacks which were claimed by Houthi rebels that the Saudis are battling in Yemen.

The gravity of how Western powers navigate this situation is immense. Military conflict against Iran initiated by the U.S. would have far-reaching human, political and economic worldwide consequences going far beyond the price of oil. Much will likely depend on the counsel President Trump receives from his key military and intelligence advisors. This month saw the departure of John Bolton as Mr. Trump's national security adviser amid public clashes over key foreign policy stances towards Iran, North Korea, Venezuela and, most recently, the

Taliban. The President has yet to have a major international diplomacy 'win' and has been in a deal making mood, while Mr. Bolton favored towing a hard line on all fronts. He is to be replaced by the relatively-unknown Robert O'Brien, whom Mr. Trump had formerly appointed as an envoy for hostage affairs. Mr. O'Brien will be the fourth appointee to take on the role in three years, a record. The vacuum left by the polarizing character of John Bolton may be more likely now be filled by Secretary of State, Mike Pompeo, in terms of having the ear of the President.

Notwithstanding pressing foreign relations issues, President Trump is now also potentially facing a massive political battle at home. On September 24th, Speaker of the House of Representatives, Nancy Pelosi, announced that an impeachment inquiry into Donald Trump is being launched. The use of such a weapon has been debated and threatened by the Democratic Party for much of the President's term, first over allegations of collusion with the Russian government to interfere in the 2016 U.S. Presidential race (the Mueller Report, finally released earlier this year, did not find evidence to support such a claim) and then over possible obstruction of justice during the accusation inquiries.

The tipping point that led to the bold impeachment inquiry move was news of a whistleblower's report that the Office of the Director of National Intelligence (ODNI) initially withheld from Congress. The report points to a July telephone conversation between Donald Trump and his Ukrainian counterpart, Volodymyr Zelensky. A rough transcript of the call released by the White House, confirms that Mr. Trump encouraged Mr. Zelensky to "look into" matters concerning former Vice President Joe Biden and his son, Hunter Biden, and that the U.S. President offered the potential assistance of his personal lawyer, Rudy Giuliani, and Attorney General William Barr to help with any investigation. The understanding is that such an investigation might focus on possible corruption charges involving a Ukrainian gas company on which Hunter Biden served as a highly-remunerated board member, and whether Biden senior used his position as Vice President to interfere in the Ukraine's anti-corruption initiatives in ways that could have protected his son's role. This is very murky territory given that Donald Trump could reap political gain were a presidential election adversary, Joe Biden, became mired in a corruption allegation scandal. Adding to the quagmire, one week prior to the call, Mr. Trump ordered that $400 million in military aid to Ukraine be withheld (it was later released) potentially furthering the appearance of coercion and a quid-pro-quo tone. At this point, opinions are divided along partisan lines and an impeachment inquiry does not equate to an impeachment – first Congress needs to decide if Mr. Trump's actions amount to "treason, bribery or other high crimes and misdemeanors" that warrant a trial in the Republican-held Senate. Stay tuned.

Currently, Mr. Biden doesn't need Mr. Trump's help to slip in the Democratic Presidential Candidate polls. The longtime frontrunner is now running neck-and-neck with Massachusetts Senator Elizabeth Warren, according to some counts, with Vermont Senator Bernie Sanders, making his second straight White House bid, trailing by a fair amount in third. Joe Biden still enjoys substantial goodwill among the Democratic base for having served under President Obama, but has struggled so far to build any substantial momentum. Conversely, the more progressive messages and promises of wide sweeping social and economic reforms put forth by Senators Warren and Sanders have sparked more enthusiasm. It remains relatively early days in a still-crowded field of candidates, but other hopefuls face an uphill battle dislodging these three frontrunners.

Over in Britain, the colorful figure of Boris Johnson succeeded Theresa May as Prime Minister in July, having emerged as the victor of the Conservative Party leadership contest. He has lost no time in setting off political fireworks as the nation's elected leaders continue to face off over the pressing issue of the U.K.'s exit from the European Union. The extended deadline to reach an agreement with the EU currently stands as October 31st and Mr. Johnson has brashly declared that he'd "rather be dead in a ditch" than ask for a further delay. September got off to a particularly rocky start for the new PM as members of the British Parliament seized control in a vote that ended with Mr. Johnson expelling 21 MP's from his Conservative Party. Parliament voted in favor of a bill that requires Britain seek an added extension to January 31st 2020 if no deal can be brokered, thereby neutering much of Johnson's negotiating power with European neighbors, and further denied the Prime Minister the two-thirds majority he needed to call a general election before the end of October.

In addition, Mr. Johnson invoked powers to prorogue, or suspend, Parliament for five weeks, but the U.K.'s highest court, in a strong rebuke, has since ruled this act as unlawful and the House of Commons is back in session. The suspension of Parliament itself wasn't unusual, it is routinely employed to allow a new legislative program to be developed, but the Supreme Court deemed the timing and length on this occasion to be a nefarious attempt by Mr. Johnson to deprive Parliament the opportunity to scrutinize his Brexit plans. As things stand, a general election before the end of the year is seen as likely by most lawmakers, and the European Union is under little pressure to budge from the negotiation stances it adopted with Theresa May, that ultimately led to her leadership demise. Mr. Johnson at least has a fan in Donald Trump who envisages strong relations and a 'magnificent' trade deal with the U.K. post-Brexit. According to some reports, this endorsement isn't necessarily helping Boris' popularity at home.

Further gloom descended on Britain with the September 23rd announcement that Thomas Cook, the 178-year-old U.K. based travel company, was filing for bankruptcy having failed to secure about $250 million in emergency funding. Around 150,000 Thomas Cook passengers were left stranded worldwide, leaving British and other governments to step in to repatriate travelers. The German state stepped in to offer a $415 million bridging loan to Thomas Cook airline subsidiary, Condor, to keep it operational. Germany's economy, the largest in Europe and the fifth largest in the world by GDP, is already straining, and potentially on the brink of recession as factories struggle with the fallout from international trade wars, its automobile sector is under pressure and the continent is faced with Brexit uncertainty. Startlingly perhaps, German government bond yields are negative from cash all the way to 30-year maturities. Germany's economic weakness helped persuade European Central Bank (ECB) policy makers to up their stimulus measures and resume their bond buying program. In September the ECB cut their interest rate for the first time since 2016, shaving off a tenth of a percentage point to bring it to negative 0.5%. Mario Draghi's term as ECB president will come to an end on October 31st, and his replacement will be Christine Lagarde, the International Monetary Fund's current leader.

In other world news, Israelis went to the polls for a second time this year in the country's bid to voice more conclusive leadership opinions, but the results returned a deadlocked election with the right-wing Likud party and the centrist and liberal, and right-wing political alliance of the

Blue and White tied in polls, in a similar outcome to April. After a delay, President Reuven Rivlin tapped Prime Minister Benjamin Netanyahu of the Likud party to form a new government. Mr. Netanyahu, Israel's longest-serving prime minister, now has six weeks to try to form a government. If he fails to do so, the opportunity could pass to the next candidate chosen by the President.

We're sure you've been wondering throughout this, what we consider to be our animal spirit. At the risk of being predictable, we have to go with the bull of course! This spectacular bull market may be aging but uncertainty drives investors to safety and the S&P 500 has widely out-performed European and Emerging Market indices since the start of this decade. This points to the gap between economic growth domestically and most foreign regions. Sentiment may be turning wary, and some valuations getting a little 'toppy', but these circumstances can foretell a time for value-based investing to shine, and we stand well prepared. We wish you an enjoyable fall and, as always, appreciate your continued trust in us as your financial advisor.