WELCOME TO 2019

FASTEN YOUR SEATBELTS….ITS GOING TO BE A BUMPY RIDE!

The coming year is likely to be even more turbulent than 2018. A host of factors are set to converge in 2019….factors that will generate dramatic news headlines and produce challenging markets for investors. A basic premise of the Global Investment Letter is that we live in an era where investors no longer have the luxury of ignoring geopolitical influences. The combination of a fragile global economy and multiple geopolitical stresses has produced an investment environment that will require attention and skill to navigate in the years ahead.

The United States deserves pride of place for first consideration given its role as the world's largest economy. The Trump administration enters 2019 facing a variety of challenges. The new Democratic majority in Congress cannot be counted on to rubber stamp Trump's policies as the previous Republican dominated Congress did. The United States enters 2019 with a partial government shutdown over the allocation of some $5 billion demanded by President Trump to build a portion of his promised border wall with Mexico. The shutdown could last some time as the promise of a wall was a key pledge by Trump to his electoral base. A Democratic Congress is unlikely to agree to funding for a wall. At the same time, the Republican U.S. Senate is unlikely to produce a bipartisan bill that does not include provisions for a wall as Trump will veto it. Thus, this government shutdown could last far longer than its predecessors. The issue will eventually be resolved, probably with a solution that allows Trump to claim he has been successful in securing funding for his wall while the Democrats refer to it as funding for border security. Still, the highly polarized nature of American politics will likely extend the duration of a shutdown before a resolution can be finessed.

The Mueller probe is expected to report its findings in the first half of 2019. It remains to be seen what conclusions are drawn from the probe, but whatever the result, they will be surprising to some faction of the populace. The Mueller report can be expected to have an effect on markets regardless of its conclusions. A benign outcome for the Trump administration would be positive for markets. A report concluding that serious wrongdoing occurred, and its ensuing consequences, would likely weigh on investor sentiment until a resolution is reached.

Trade talks between the United States and China will continue in January in an effort to reach an agreement before Trump's threatened imposition of tariffs on substantially all Chinese imports becomes a reality. There is growing confidence at time of writing that an agreement can be reached. The real probability of a deal, however, may be less than many believe. Trade protectionism is important to Trump and his electoral base, making substantial concessions difficult. The Chinese have their own reasons to demonstrate strength and are not as dependant on exports to America as many assume. It is hoped that an agreement can be reached. Trade is the source of much of the world's wealth and thus trade tariffs historically have had a negative effect on economies.

It should be remembered that the protectionist trade policies of the Trump administration are not restricted to China. In time, the U.S. administration's attention will focus on the European Union and

Japan. The potential for more generalized American trade protectionism is most definitely a threat to the global economy and hence markets. An ironic outcome of greater trade protectionism by the U.S. will likely be the continued strength of the American dollar, which will serve to offset the intended effects of the tariffs. Trade wars tend to bring about currency devaluations by exporters to compensate for the tariffs. Moreover, the damage to the global economy will likely produce capital flows to the United States as a safe haven, which will boost demand for dollars further. The law of unintended consequences remains alive and well.

The European Union must contend with a variety of issues in 2019. Brexit is the highest profile given the shambolic negotiation effort of the British and the rapidly approaching deadline. At time of writing, no deal has been reached. A "hard" Brexit, i.e., leaving the European Union with no agreement in place, would produce an array of complications that would have a significant negative impact on the British economy. The possibility of a "hard" Brexit remains high, although the chance of a more pragmatic and politically expedient approach appears to be rising. The practical alternative is to kick the proverbial can down the road by extending the negotiation period and thereby delaying the implementation of Brexit and offsetting the financial consequences of a "hard" exit in March. An extension would presumably be acceptable to the European Union as more time might produce a change of heart on the issue by the British. Pushing Brexit forward so that the next government can contend with it is in the finest political tradition. Either outcome can be expected to have a significant effect on British markets.

The European Union has other issues to manage in the coming year. The current Italian government is euroskeptic, with fiscal policies that are at odds with European Union mandates. Friction can be expected to continue between Rome and Brussels, with the threat of an Italian departure from the European Union being the ultimate trump card for the Italian government. The Italian government may be emboldened to eventually pursue this course of action as there exists a good deal of public sentiment in Italy in support of the idea.

Economic matters will also command Europe's attention in 2019. Evidence of weakening business conditions is growing, most importantly in Germany, Europe's largest economy. The European Union is the most trade sensitive economic bloc and Germany is the most export dependent of the European economies. The prospect of a softening global economy combined with the rise of protectionist trade policies will impact the European Union more than any other region.

The lack of strong leadership in the West increases the risk of geopolitical volatility in 2019 and beyond. With the upcoming departure of Germany's Angela Merkel from the political stage, there is currently no clear leader. France's Macron made an attempt to assume the mantle of leadership vacated by Merkel but is constrained by considerable domestic issues. The lack of political cohesion among the major members of NATO may well encourage an adversary to test the resolve of NATO members.

While military action involving major powers in 2019 remains unlikely, the probability has been rising in recent years. American trade sanctions against China are part of a larger initiative to constrain Chinese influence in the 21st century. The tensions generated by the trade dispute are mirrored by the sabre rattling in which the two nations regularly engage in the South China Sea. The proximity of forces increases the risk of an inadvertent escalation of conflict. Elsewhere, Iran and Saudi Arabia continue to vie for influence in the Middle East, both directly and through proxies. Additionally, North Korea may reenter global headlines in 2019 if the Trump administration tires of a lack of progress in its efforts to achieve North Korean nuclear disarmament. As a final note on the subject, military action has been used by leaders throughout history to divert attention from domestic issues.

The withdrawal of the United States from its traditional post WWII role as world leader has created a multi-polar world order with substantially more moving parts, which increases the potential for geopolitical volatility. The interdependent nature of today's global economy makes geopolitical developments more relevant for investors than previously.

The rising potential for adverse geopolitical developments, combined with the tenuous nature of the global economy, will present a variety of threats and opportunities (some no doubt surprising) for investors in 2019 and beyond which is reflected in our analysis of individual markets. We, at the Global Investment Letter, look forward to making the journey with you.

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