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BIRLING CAPITAL ADVISORS, LLC

The Mercurial Investor

5 PREDICTIONS, 5 ISSUES & 5 ANSWERS FOR 2019

We entered 2019, we face a radically different and more complex macroeconomic and investment environment.

Birling Capital has outlined five key predictions that will have significant implications for global business, including:

- The U.S.-China Trade War getting much worse and intensifying while the China-Russia relationship becomes stronger and has global consequences. The lack of progress will force President Trump to double down on tariffs.
- Emerging Markets are poised to have a credit crisis that will grow in proportion and breadth. From Africa to Argentina, a crisis is looming.
- Bitcoin is to lead the consolidation of the cryptocurrency market. Expect bitcoins to accumulate 75 percent of the market.
- Global Shipping Industry to encounter new sulfur regulations. IMO regulations will have an impact on 90 The world is running out of sand, and its shortages will have an impact as high as 300 percent on construction, pushing the planet to its limit.

As we continue to withstand stronger geopolitical forces, tighter monetary policy and volatility, it boils down to markets creating attractive investment opportunities, with the key being how to profit from them.

Issue 1: Will U.S. growth slow?

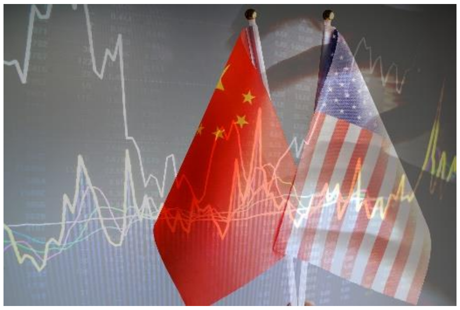
Because we ended 2018 with 3.8 percent economic growth, Birling Capital forecasts it will slow to 3.4 percent in 2019. The outlook for the United States is that its growth will be impacted by political challenges led by the current federal government shutdown, volatile markets, with U.S. stocks having faced the most damaging losses in a decade and ending the year in negative territory. The trade war with China is causing a decline in global growth as tariffs force economic readjustment and signaling the end of an economic cycle.

Issue 2: Is tighter monetary policy the culprit?

Two thousand nineteen will be the first year since the great global crisis that the Federal Reserve Bank will have to implement tighter monetary policies.

Our Fed consensus remains truculent relative to the market and will end 2019 with two to three more hikes of 25 basis points to a funds rate of 2.75 percent to 3.00 percent. Fed policy may loosen up a bit after the recent market turmoil and avoid overheating the economy.

Issue 3: The U.S. role and will Trump be impeached?



The world and the U.S. have reached critical turning points. Starting with the U.S.-China situation, which is much more than trade disagreements, the U.S. National Security Strategy has labeled China a "revisionist state." As it assumes a direct correlation between a state's hegemony, both political and economic, and as either a status quo state or a revisionist state; in China's case, its interest is contrary to those of the U.S. and will also bear the weight of the instability from the European Union. We are confident President Trump will face increased scrutiny from the Democratic U.S. House of Representatives and special counsel Robert Mueller's investigation may lead directly to the President. With both Paul Manafort and Michael Flynn branded as traitors, we believe Trump will be impeached before 2019 ends.

Issue 4: Should investors expect a recession?

While current market turmoil may be leading us to believe a recession could be possible, we do not think it is likely to occur. With consumer sentiment, consumption rates, investment growth high and the labor market created 312,000 jobs in December 2018 and now 304,000 in January, we do not see a recession on the horizon.

Issue 5: The markets—pessimist or optimist views?

The massive selloff following the rate hike this past week was both broad-based and pointed to corporate earnings that have reached their peaks. We have to wonder if the Federal Reserve may have raised rates to the point that the economy may not support it. The current outlook is that the pace of earnings growth will slow from a rate above 20 percent to less than 10 percent for 2019. Across all sectors, we see opportunities for the long-term investor, even with the current market downturn, for the following reasons:

Valuations are attractive. With the S&P down 9.77 percent this year and 18 percent from its high, this means the price per earnings ratio is below its five-year average and presents an attractive buying opportunity for most stocks.

Stay invested; this is a buyers' market and it will pay off. Be very selective: With all the chaos in the market, it is prudent to wisely choose the sectors with companies having high potential for growth and innovation.

Market Update- What a Difference a Month Makes

As the first month of the year ended with most stocks advancing, it is noted that the U.S. stock market finished the week with increases in all market barometers we monitor. The Dow Jones Industrial Average (DJIA) closed the month at 25,063.89, a rise of 2,457.67, or 10.87 percent, and 7.4 percent year to date (YTD); the S&P 500 closed at 2,706.53, a gain of 258.64, or 10.57 percent, and 8.0 percent YTD. The Nasdaq closed at 7,164.15, or an increase of 800.37, or 12.38 percent, and 9.5 percent YTD. Meanwhile, the U.S. Treasury's 10-year note went down to 2.68 percent, or a yield decrease of minus-2.51 percent. The S&P 500 finished its strongest January since 1987, or 32 years ago. See Table 1.

Jobs growth of 304,000 surpasses expectations

The U.S. Bureau of Labor Statistics reported total nonfarm payroll employment increased by 304,000 in January, reaching the 100th month of increases to the U.S. workforce. The jobs numbers are also evidence of robust wage growth of 3 percent, compared to January 2018, which surprised most because the increase was able to brush off the impact of the partial federal government shutdown. However, when reviewing the 4.0 percent unemployment rate, which increased from December's 3.9 percent and was above last fall's 49-year low of 3.7 percent, the current unemployment number was expected to reflect the impact of the government shutdown. Digging deeper, it is noted that job gains occurred in several industries, including leisure, hospitality, construction, healthcare, transportation and warehousing.

The drivers of market growth were:

- Much stronger-than-expected earnings from corporations in every segment.
- The Federal Open Market Committee (FOMC) made a wise decision to keep interest rates untouched, as expected.
- The Federal Reserve Bank retracted its statement that pointed to further gradual rate increases, in part because of the global economic slowdown and indications of inflation pressures.
- A robust labor market and wage growth that can support continued consumer spending without driving a spike in inflation.

As the first month of the year ends, it is noted that during January, equities increased at the fastest pace in 32 years, with the DJIA rising to 7.4 percent YTD and up more than 14 percent from the market lows during the winter holiday season. Nonetheless, continue to expect slower growth and continued volatility.

The Federal Reserve Bank's firm grip on monetary policy will continue to be volatile as the Federal Reserve adapts to current economic conditions, with less intervention expected regarding raising rates. Having said that, it is forecast that rates will rise slower than usual, with the yield curve remaining flat, as the current economic outlook for the U.S. economy is to grow at a modest 2.5 percent rate. Expect slower growth than last year, but at a steady enough pace to maintain the current bull market.

Table 1: Market Comparison

Market Close Comparison	1/3/2019	2/1/2019	Change
Dow Jones Industrial Average	22,606.22	25,063.89	10.87%
Standars & Poor's 500	2,447.89	2,706.53	10.57%
Nasdaq	6,453.50	7,263.87	12.38%
U.S. Treasury 10-Year Note	2.75%	2.68%	-2.51%

Court reverses P.R. POBs ruling

When the Pension-Obligation Bonds (POBs) were structured, their income stream process was similar to the Sales Tax Financing Corp. (Cofina by its Spanish acronym), with all proceeds from government agencies' pension payments going directly toward paying the POB debt. The POBs provided liquidity to fund the pensions, and the government's strategy was to utilize the $3 billion and invest in the markets using several expert money managers to handle the strategy.

An example would be if the government invested the funds in the DJIA in 2008. The $3 billion would have grown 327 percent to $9.81 billion. If it had invested in the S&P 500, it would have grown 306 percent to $9.18 billion. If it had invested in the Nasdaq, it would have grown 512 percent or $15.36 billion. As can be seen, the actual POB transaction was not flawed; what was faulty was the government' execution of its investment strategy, which left most proceeds in an account in the Government Development Bank that pays little or no interest.

Fast forward to the recent court decision affecting bondholders that own nearly $3 billion of debt issued by the Puerto Rico Employees Retirement System that has a claim on the pension funds.

The Final Word: Execution the Discipline of getting things done

In 2019, more than any time in history, Puerto Rico needs to be creative with the tools it has. While it is true the recently approved Opportunity Zones create a once-in-a-lifetime opportunity to redevelop Puerto Rico and the hurricanes brought us within view of the abyss, we must, nonetheless, march on toward our next moves. Local opportunities may include:

- Starting to pay our bondholders some of the money we owe them.
- Creative use of the public-private partnership model to create hundreds of new possibilities.
- Decentralize and reduce the government to align it with current realities.
- Focus on economic growth and development.
- Seek Municipal Reforms to allow for centralization of services, programs, events, activities, purchasing and other critical services.
- Take advantage of the inflow of federal Community Development Block Grant funding.
- Create a government divestiture program to sell unneeded assets.
- Eliminate obsolete government rules, regulations, programs and agencies.
- Transform the government monopolies and define essential services.

One phrase defines it all for Puerto Rico: 'Execution.'

As a final thought, a quote by British writer W. Somerset Maugham: "We are not the same persons this year as last; nor are those we love. It is a happy chance if we, changing, continue to love a changed person."

Why we need to Create Supra-National Goals

Puerto Rico is in dire need of a series of goals that are placed above and beyond any consideration and any party. Goals that the whole nation can understand, support, protect and promote, We call them "Supra-National Goals" and they are as follows:

- Transform Puerto Rico into a country with robust economic development and sustained growth of 4% over the next two years.
- Create 150,000 new jobs in the private sector in the next six years.
- Increase our labor participation rate to 55%.
- Reduce the unemployment rate to 5% in six years.
- Reduce the governmental apparatus by transferring to the private sector any corporation, operation or service to the private sector can perform with greater efficiency.
- Transform the education system from the elementary to the university level to one focused on entrepreneurship, trades, and transformation.
- Measure ourselves with all international metrics to maintain competitiveness.

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