

ECONOMY

Investors who remained in the market not only recovered their losses but recorded gains

THINK STRATEGICALLY:

Leadership is All About Character

With Largest U.S. Jobs Growth in 2019, Slowdown, Interest-Rate Cuts Not Expected; Is P.R. Gov't Practicing Excellence or Mediocrity?

BY FRANCISCO RODRÍGUEZ-CASTRO | frc@birlingcapital.com



Foresight

We often should compare our best and brightest leaders with those chess players who not only think about their next move but instead think four or five steps ahead. The best leaders must do the same and have to keep their vision positioned in the future. Their view of the future is as familiar to them as it may be to anyone living in the present. As we embark on this new chapter for Puerto Rico's relationship with the Financial Oversight & Management Board (FOMB), which is mixed with a highly adversarial political stance from the Government of Puerto Rico, one must wonder if our leaders are on a long journey of excellence or a short trip of mediocrity.

How can we know the difference, you ask?

- No achievement ever takes the leader to the top of the heap.

- There is always that one next thing that keeps the leader's mind and vision going, taking us where the leader dreamed in their hearts and as

far-reaching as the planned vision can only take us.

- There may be many leaders who may get the job done; in most industries, competence or education are not rare qualities.

- The most elusive of qualities is character, and we can say without reservation that leading a company or being president or governor is all about character. It is often said you can have notoriety in a moment, but it takes a lifetime to build character.

Jobs growth & interest rates: As hiring accelerates, interest-rate cuts diminish

The U.S. Bureau of Labor Statistics reported the U.S. economy added a total 224,000 new jobs in June, the largest increase of any month in 2019, especially considering that the forecast called for 160,000 new jobs. The reported job gain, which surpassed expectations by 40 percent, alleviates concerns of an impending economic slowdown, and also reduces the chances of an

imminent interest-rate cut by the Federal Reserve Bank.

The U.S. unemployment rate changed little, at 3.7 percent, with only about 6 million unemployed. The particular job gains occurred in professional and business services, healthcare, and transportation and warehousing.

The U.S. labor-force participation rate remained at 62.9 percent; the job numbers seem like a bright spot in a fairly complex mix and data that seem asymmetrical at best.

We are awaiting the full reaction from the market as we come back from the shortened week of the July 4th holiday. With the Fed's continued analysis to consider an interest-rate cut in its efforts to sustain the current economic cycle, two primary considerations may deter the interest-rate cut:

- The U.S. stock market reaching record highs.
- The current upswing in the June hiring report, showing the economy is healthy.

Week in markets: Record highs present; investors be vigilant

With the first semester of 2019 behind us and solid year-to-date returns, the first six months of 2019 have provided a stark contrast with the year—and 2018—as most investors who remained in the market not only made up their losses but have recorded significant gains. The Dow Jones Industrial Average closed the week at 26,922.12, for an increase of 322.16, or 1.21 percent, and a year-to-date (YTD) return of 15.4 percent. The S&P 500 closed the week at 2,990.41 for a gain of 48.65, or 1.65 percent, and

a YTD return of 19.30 percent. The Nasdaq closed the week at 8,161.79, for an increase of 155.55, or 1.94 percent, and a YTD return of 23.00 percent. Meanwhile, the U.S. Treasury's 10-year note rose during the week, reaching 2.04 percent and a YTD return of minus-0.065 percent.

What awaits investors for the rest of 2019?

- The year should provide continued positive returns. The three years market indices were last at 15 percent return or higher in the first semester were 1995, when the market closed at 38 percent return; 1997, which had a 34 percent return; and 1998, with a 29 percent return.

Staying invested has paid off.

However:

- Unresolved trade tensions cause volatility and may continue during the rest of the year.

- The Federal Reserve plays a pivotal role in determining how the market ends in 2019.

- Although every investor is different, allocating the right mix of stocks at 60 percent; and bonds, exchange-traded funds (ETFs) and mutual funds at 40 percent, will reward investors in the latter part of 2019.

Key actions: Stay invested and diversify your portfolio.

Final Word: Overview of FY20 certified budget for P.R.

As established in the P.R. Oversight, Management & Economic Stability Act (Promesa), the FOMB set a schedule for preparing the fiscal year (FY) 2020 budget by June 30, 2019, and issue a compliance certification to the governor and the legislature for the FY 2020 Budget. According to the FOMB, since both the legislature and the government did not comply with the parameters, it was forced to develop a revised, compliant budget for Puerto Rico.

Critical takeaways of the 2020 P.R. budget:

- Total consolidated spending \$27.0 billion, divided 67 percent central government, 25 percent instrumentalities and 9 percent Pay-As-You-Go (PayGo) pensions.
- FY20 general fund budget is \$9.1

billion, divided into 30 percent personnel expenses, 48 percent nonpersonnel and 22 percent PayGo pensions.

Key components of the budget include:

- Health \$4.3 billion;
- K-12 & Higher Education \$3.5 billion;
- PayGo Pensions \$2.6 billion;
- Families & Children \$2.4 billion;
- Public Safety \$1.1 billion;
- Housing \$1 billion;
- Supports the government's priorities of public safety, education and health-care services, and includes a higher level of capital expenditures.

- Funds social security for eligible police, teachers and judges as well as increases in salaries for teachers, police officers and firefighters.

- Allocates sufficient funds to cover PayGo pension obligations.

- Increases local budget funding of Medicaid program.

- Includes a University of Puerto Rico (UPR) scholarship fund to supplement UPR's existing scholarships.

- The budget includes additional controls in the use of capital spending and allows for specific appropriations to be used over a multiyear period.

- Agency expenses cannot exceed their budget appropriation.

- Implement controls on disbursements of appropriations such that they are set aside until the fourth quarter.

- The government must prepare quarterly budgets and provide monthly & quarterly, actual vs. budgeted reports by agency and public corporation.

As Puerto Rico marks its third anniversary with the FOMB, it is quite a contrast to see how the administration of Gov. Rosselló is challenging the FOMB with several actions that have often been resolved in Judge Laura Taylor Swain's courtroom. The budget is one such example, as is Act 29, which keeps all 78 municipalities from paying their share of the pensions and health reform. It might seem obvious that if the government does not comply with Promesa, the bankruptcy will be extended longer than anyone would have expected. It also shows that under Puerto Rico's worst fiscal crisis, we lack a political class capable of rising above the politics to do the right thing. Our road to recovery will be long and stormy. As previously said, it takes a lifetime to build character.

Market Close Comparison	7/5/2019	6/28/2019	Change	YTD
Dow Jones Industrial Average	26,922.12	26,599.96	1.21%	15.40%
Standard & Poor's 500	2,990.41	2,941.76	1.65%	19.30%
Nasdaq	8,161.79	8,006.24	1.94%	23.00%
U.S. Treasury 10-Year Note	2.04%	2.00%	2.00%	-0.065%

Francisco Rodríguez-Castro, president & CEO of Birling Capital, has more than 25 years of experience working with government, and multinational and public companies.