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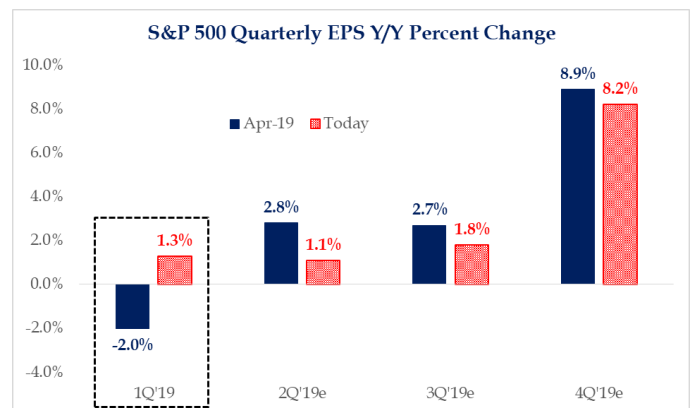
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Handicapping the Outlook for U.S.-Sino Trade Negotiations

Every step of the way this bull market has been doubted. Each pullback put into evidence that the cycle had reached its endgame; each recovery off the lows, a furtherance of the disequilibrium caused by monetary malfeasance. There was just no way that equities, with the durability of the business cycle in doubt and the headwinds of political discourse stiffening anew, should continue to press to all-time highs – and twice in seven months! Right? Surely such moves were illustrative of just how misplaced investors' confidences had become. And yet, not more than two weeks ago the market stood as high as it ever has. Sure felt good. Much of the lingering concern that the economy was weakening too quickly was offset by fairly robust data

for the first quarter. U.S. real GDP for 1Q'19 was up +3.2%, significantly stronger than economists' forecasts. S&P profits, which had been expected to decline -2.0% Y/Y for the quarter are poised to come in up +1.3% Y/Y. What's more, the outlook has improved. While the trajectory for U.S. growth is likely to continue to slow, it is still growing. Though less optimistic at the start of the year, the Street has more recently come toward our view – that the U.S. remains in the protracted Slowing Expansion phase of the cycle – and have adjusted their expectations for the back half of the year upward. Then, in early-May, U.S.-China trade negotiations took an ugly turn.



What caused this public flare-up so late in the process?

In a communique outlining its concerns (and requirements) for a deal, China mandated that all tariffs need to be removed. This runs counter to the U.S. position that some tariffs

should remain in place as an enforcement mechanism and to compel the Chinese to comply with the deal terms. This has long been a sticking point, but one we felt could be resolved by the two presidents, one-on-one, working-out the final details. Instead, it became the issue that broke the trust of negotiators.

What measures have the U.S. and China enacted as talks have stalled?

The U.S. runs a trade deficit with China of roughly \$420 billion (we import \$540 billion worth of goods and export \$120 billion worth of goods), which is roughly -4% of its GDP (China runs a trade surplus that is about +2-3% of its GDP). Most recently, The Trump Administration increased tariffs from 10% to 25% on \$200 billion in goods from China. The new import duties will not apply to goods already in transit rather they will apply to goods shipped after May 10th. Under normal circumstances it takes about 3-4 weeks for ships to make the journey. Furthermore, the Administration said it was preparing to impose 25% tariffs on an additional \$325 billion in goods from China.

In response China increased tariffs from 10% to 25% on \$60 billion of U.S. This is a proportional response. It is important to remember that China cannot retaliate dollar for dollar with the U.S. They may resort to non-tariff barriers for retaliation. Most notable, China could devalue its currency to offset the impact of higher tariffs or, it could sell U.S. Treasuries. The Chinese principal

negotiator, Vice Premier Liu, has indicated the latter was an option and there is a belief that China sat out a Treasury auction last week. We view the likelihood of either of these moves as remote. From there, the menu of options for the Chinese thins (Enact an export bans on goods the U.S. cannot easily substitute; Increased safety inspections and border delays; Increased frequency of audits and heightened Supervision of U.S. companies operating in China; and, more stringent financial regulation.)



What will the impact of latest round of tariffs?

The hit to U.S. GDP is likely about -0.1% point for every 2 months we go along with the higher China tariff rates, or roughly -0.5% points for a year. A little more than half of this, in our estimation, is through reduced confidence and lower investment. The hit to China GDP should be substantial as well, though there may be offsetting local stimulus. (President Trump has renewed calls for the Federal Reserve to lower interest rates.) While not our base case, it should be

noted that if the Administration chooses to raise tariffs on all \$540bn of goods imported from China for a full year, the risk of a recession in the U.S. rises. The Fed could cut rates in this scenario, but would likely be stubborn given the current data profile.

Can the U.S. economy withstand a protracted trade war with China?

Some clients have suggested to us that because U.S. growth is solid (3.2% real GDP in 1Q) and inflation is low that the President feels emboldened to ratchet up the intensity of the negotiations. As we note above, the U.S. economy is in decent shape and inflation has been low. Our Economics team has laid-out a number of reasons why global trade disruptions are never timely, particularly now:

1) While U.S. growth has been solid, some of the 1Q boost came from inventories (+0.7% points) which should be paid back in future quarters.

2) U.S. manufacturing employment has already started to slow, and U.S. manufacturing PMI measures are still in a downtrend (following global weakness last year).

3) A key fear at the end of 2018 was the Fed would over-tighten against this global backdrop, which has been alleviated by the FOMC pause in 2019. The economy is just starting to see the positive effects of this monetary policy pause. Another market

hiccup now would tighten financial conditions. The Fed appears reluctant to ease at this point.

4) While inflation has been low, there are still signs it is not dead (rising capacity utilization, rising wages, slowing supplier delivery times). The bond market is not providing a lot of cushion against even a small amount of inflation, with the 10-year Treasury yield at 2.5%.

5) U.S. bank lending standards, while still expansionary, do not look particularly easy. This is a leading indicator for payroll employment.

And, 6) The U.S. budget deficit is large for an economy at full employment. This is manageable if we see capital spending rise, which, in tune, would boost productivity and pay for higher wages. But business seem reluctant to start this process without some clarity on trade policy.

Tangentially, global has a tough time last year. China has already seen weakness due to deleveraging, so the impetus to get a deal done is likely mutual.

Are we still on track for a deal?

China and U.S. policymakers went out of their way to make the point that trade talks did not collapse following last week's short negotiations. This helped stocks to finish last week on a strong note, but the near-term outlook does not look positive. Neither side indicated they would return to the

negotiating table with the terms as they stood before talks broke down. There is a possibility that Trump and Xi will see each other at the G-20 meeting in June which provides an opportunity for some of the issues to get resolved then. But that means the tariff increase will go into effect and stay in place.

The Chinese have expressed concern that the purchase of goods from the U.S. needs to be in-line with reality. Our Policy team reads this as China saying the U.S. was trying to front load too many Chinese purchases of U.S. goods into late-CY'19 and CY'20. The Chinese also offered the ever-vague requirement of, “balanced text that ensures the dignity of the two countries,” which implies that China is against changing its laws for structural reform. The US will not agree to a deal that does not enshrine the changes into law. The path forward will likely require the U.S. to remove all tariffs and for China to memorialize the agreed structural changes in its laws.

The stock market views the outcome as binary (yes/no) that the trade deal gets done, despite the fact that short of the last few – critical – implementation points, it has largely been negotiated. What is making this difficult is simultaneously bracing for (significantly more) near-term volatility while allowing for the fact that a “good” deal could ultimately be positive for investments in cyclicals. We remain confident that that the outcome reconciles to the upside and a deal gets done. As Strategas’ chief

economist Don Rissmiller has noted: “This is not the best time for a trade war. It might be fair to say there is no good time for a trade war.” We agree. Let’s hope president’s Xi and Trump do too. Hang in there.

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Policy Opportunities Portfolio Update

The May 2019 rebalance for the Policy Opportunities Portfolio reflects lobbying priorities for the first quarter of 2019. This rebalance we welcome 14 names into the strategy, five of which have never before entered the Portfolio, while removing an equal amount. We embrace turnover, especially the higher levels that typically accompany first quarter rebalances to the Portfolio, as it keeps the strategy levered to active companies and active issues. Our core thesis behind the strategy is that lobbying is a non-traditional factor not typically accounted for in analysts' models. By capturing lobbying and updating the Portfolio quarterly, the strategy is designed to continuously capitalize on the earnings benefit from lobbying that is, in our view, mispriced.

Looking at sector exposure, a barbell strategy has emerged this rebalance with Industrials and Health Care each comprising 26 percent of the sector weightings. Industrials, the cyclical trade facing trade uncertainty, and Health Care, the defensive trade facing bipartisan criticism over drug pricing and 2020 rhetoric. Consistent with the prevalence of trade concerns, the Portfolio's exposure was increased to Consumer Discretionary and Materials. Exposure was reduced in the Communication Services, Information Technology, and Consumer Staples.

Trade has been the top issue for companies in the Portfolio since it shifted away from tax reform at the start of 2018. For the companies entering the strategy this quarter, five of them are lobbying on China trade issues, six are

lobbying on USMCA/NAFTA, and 5 are lobbying on issues related to 232 tariffs. Retail, reminiscent of its mobilization following talk of a border adjustable tax component to tax reform in 2017, re-entered the strategy this quarter. Given that the Administration's threatened third round of tariffs would comprise over 70% of US consumer goods imports from China, this is a timely entrance.

Health Care is facing headwinds from all corners of Washington. It is also one of the most responsive sectors in terms of turning on the lobbying dollars when threats are on the horizon – we saw this with the ACA, Hillary Clinton's threats ahead of 2016, and the Trump Administration's targeting heading into 2018. Bipartisan agreement over drug costs has continued to grow and this quarter three pharmaceutical companies and one biotech entered the strategy off pricing issues. There was no change to the strategy's Managed Care positions, but the use of Medicare-for-all as a litmus test for Democratic candidates is going to cause uncertainty in the entire sector, similar to what we saw with HillaryCare in the early 1990s and the ACA before single payer was ruled out as an option.

We see performance opportunities in positive trade outcomes. While US-China issues have escalated in recent weeks, it may be a blessing in disguise for the other trade fronts. Renewed talk of resolving the steel/aluminum 232 tariffs on Canada and Mexico would have a dual benefit if it lifts the tariffs and moves USMCA another step closer to passage. We maintain the belief that the strategy is an opportunity to hedge political volatility which is unlikely to catch a break as 2020 draws nearer. Such volatility could create further opportunity if it leads

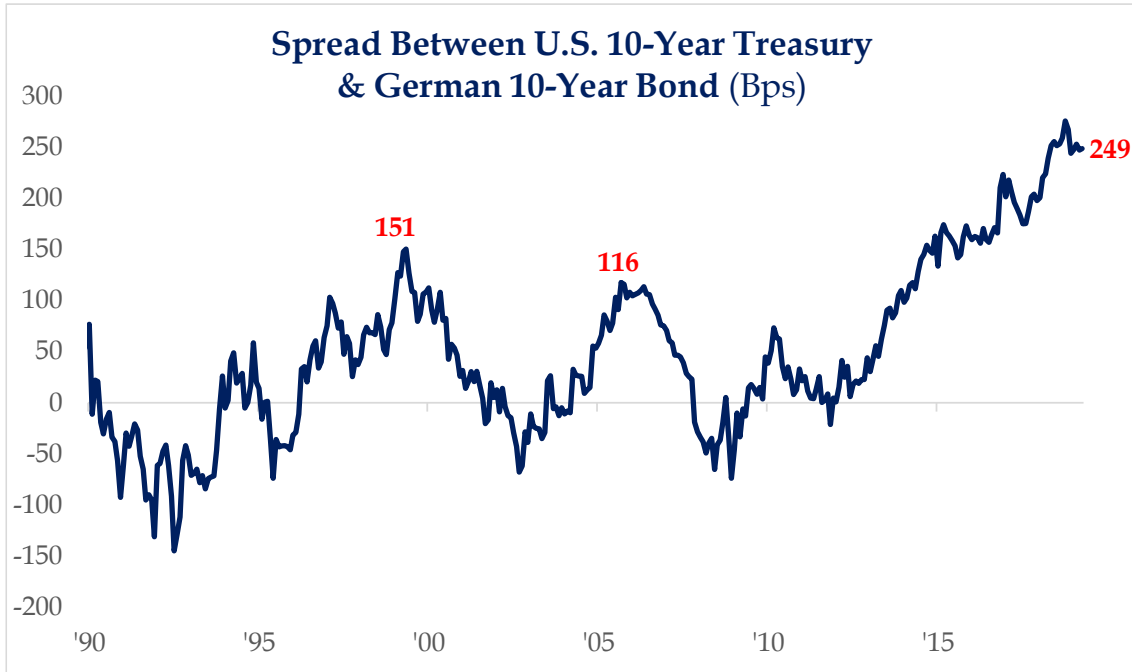
investors to doubt whether policymakers can pass a budget by October 1st to prevent sequestration levels of funding. This could further create opportunity for the Portfolio due to its heavy exposure to Aerospace and Defense companies.

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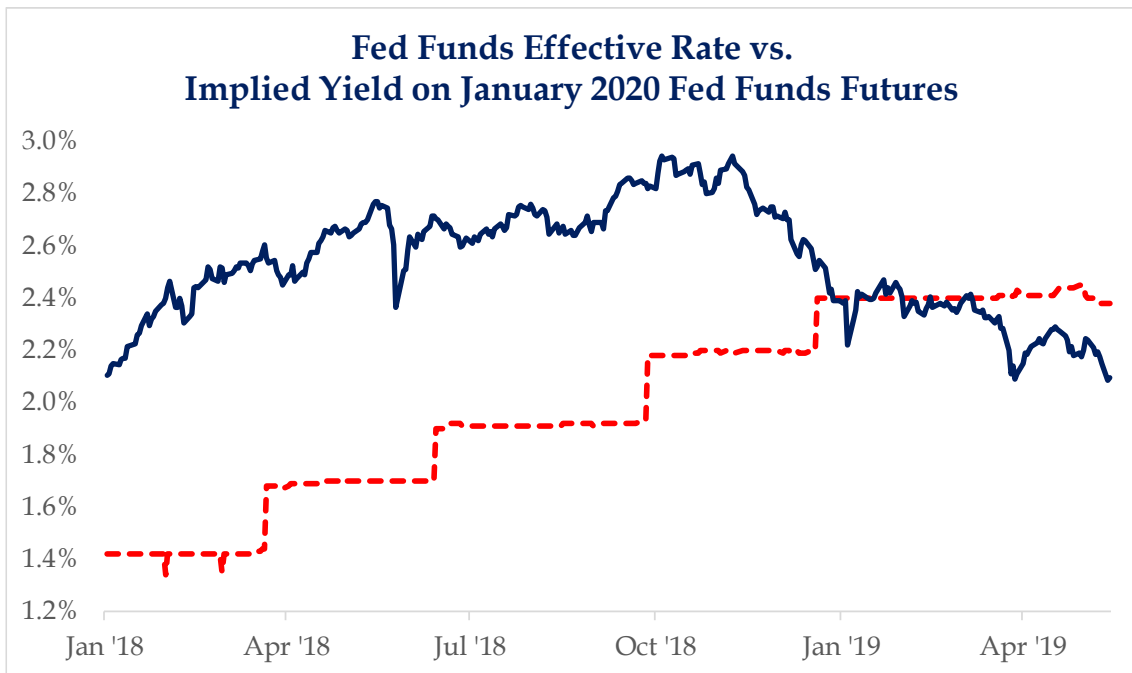
May Recommended Asset Allocation

Strategas Recommended Asset Allocation (May'19)						
Equities				Bonds		Cash
B'mark	MSCI ACWI	69%		Barclays Agg	25%	6%
		60%	M/M CHG		38%	Cash 2%
	Domestic	37%	+200bps	Core Credit	21%	Cash 6%
	International	32%	-300bps	Extended Credit*	4%	+100bps
Overweight	Dev AC Core	23%	-200bps	Local Currency EMD*	2%	Cash 6%
	US LC Value	11%		US Dollar EMD*	1%	+100bps
	EM AC Core	9%	-100bps	US High Yield*	1%	
	US MC Value	5%				
	US MC Growth	3%	+100bps			
Neutral	US MC Core	2%		Agencies	1%	
	US SC Core	1%		TIPS	0%	
	US LC Growth	9%	+100bps	IG Corporates	9%	
Underweight	US LC Core	6%		US MBS	8%	
				U.S. Treasuries	3%	
				ABS/CMBS	0%	

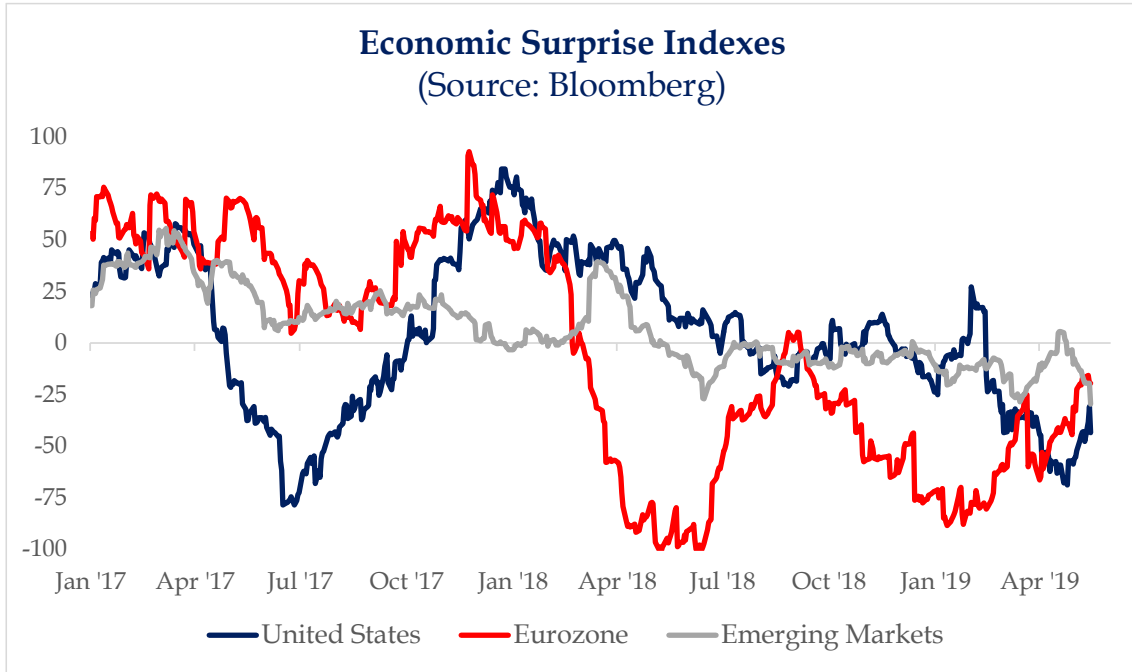
Spread Between 10-Year U.S. Treasuries & German Bund Remains Near Historical Highs



The Market Continues to Believe The Fed Should Cut Rates



Economic Surprises Are Turning Lower Across The Globe



And The U.S. Dollar Continues to Exhibit Strength



Investment Grade Spreads Remain Narrow



As Does High Yield



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