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Economic Commentary

We are a global independent economic research and markets strategy firm, providing clients with unbiased insights and actionable investment guidance.

The Year Ahead 2020

YEAR OF THE RAT (CAN YOU SMELL ONE?)

2020 Macro/Market Themes

- Recession risks will remain elevated
- Political and trade uncertainty dampens capex outlook
- Deflationary pressures remain intact — the world is awash with excess capacity
- Monetary policy to remain ultra-accommodative
- Treasury yields should drift lower
- Minimal expected returns in broad stock market
- No sustainable recovery until debt excesses are resolved
- Focus on liquidity and avoid leveraged credit and CLOs
- Tough to bet against the U.S. dollar
- Downtrodden energy stocks offer super-value
- Japan remains a bona fide turnaround story

2019 IN CONTEXT: RALLIES EVERYWHERE!

I have to admit that this is right up there with the most challenging 'year-aheads' I have ever prepared. The similarities to year-end 2007 and today are remarkable, as are the differences. **The confidence bands around any forecast at any time are typically wide, but they are wider now than in 2008.**

Back in December 2018, the market had experienced an abrupt 20% decline as the trap door opened underneath the equity market. The panic seemed like the beginning of the end of the bull market and economic expansion. Perhaps it was. Most stocks were heading into bear market terrain, and the credit markets absolutely froze right up. The combination of global trade friction, and the last Fed tightening move of the cycle, conspired to generate a risk-off investment backdrop that didn't come to a complete halt until Jay Powell and crew issued a mea culpa of sorts shortly thereafter. If you recall, it was leaked that Treasury Secretary Mnuchin was on the phones talking to the major banks, in a sign that the fabled 'plunge protection team' was getting ready to put a floor under the situation. **The rally back to the highs was as breathtaking as the plunge was ominous.**

CHART 1: The Bull Market in Equities Persists
United States: *S&P 500*
(index)

Source: Haver Analytics, Rosenberg Research

There has never been a year in modern history like we saw in 2019. The safe-havens rallied, with gold up 18% and the long Treasury bond delivering a near-18% total return. And the pro-cyclical asset classes also rallied in size, with the S&P 500 triggering a total return of over 30% and Baa credit spreads tightening by more than 70 basis points in the corporate bond market. I should add in the oil price jumping more than 30%, though this was much more of a supply story than one of global demand.

While the equity market recovery suggests that it was a mistake to have believed it was the end of the economic expansion a year ago, Treasury bonds have proven to be a great place to invest through 2019. **Economic fundamentals also fly in the face of the new equity market highs that have occurred since the trough at the very end of 2018.**

If you look at the historical record, quite often dramatic moves in the financial market towards the tail end of a given year are actually an exhaustive event. What transpires in the subsequent calendar year is often a new and different trend. The October 1987 stock market collapse, and retesting of the low in that year's fourth quarter, failed to tell you how good 1988 was going to be for the economy and the markets. The same thing can be said for late 1992 when Alan Greenspan was lamenting about 'hundred mile an hour headwinds', but the following year was stellar for fully-invested market participants.

Fast forward to the end of 1999 when everyone was marveling at the dotcom companies, the internet and the Tech sector. Who knew then that we were just a few months away from a secular peak? When Enron and WorldCom went down for the count in late 2002, and ushered in a fresh down-leg in what had been a three-year tech-wreck bear market (not to mention the onset of Iraq War II), you could have been forgiven (but ended up being completely wrong) to have maintained that bearish view into 2003. **Think also of late 2007, when the consensus view was for a 'soft landing' and then what happened the following year as the bulls got gored (I recall all too well the flack I received while at Mother Merrill after publishing my *Recession Now, Deflation Later?* report on October 27, 2007, two months before the downturn nobody saw coming).**

And, of course, staying too bearish for too long was the wrong side of the trade at the end of 2008, even if the opening months of the following year were rough with the trough influenced primarily by zero rates, QE and TARP — which meant the banks would be saved by Uncle Sam instead of being nationalized.

BONDS PROBABLY HAVE THE STORY RIGHT

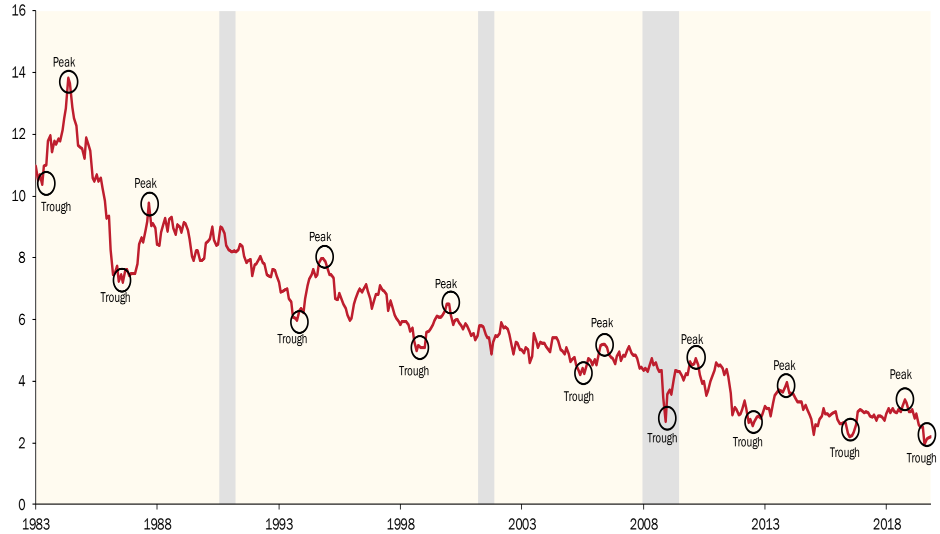
It is clear that it would have been a very hard sell a year ago that every single risk-on asset class from equities, to corporate bonds, to commodities would end up rallying as much as they did in 2019. And so perhaps the message for 2020 is to fade all the optimism since fading the pessimism a year ago paid off very well. **The sharp slide in Treasury yields this past year does not exactly comport with the risk-on view that has morphed into the consensus forecast.** Fed policy, the trajectory of GDP growth and global economic fundamentals in general all tell a cautionary tale. Both bonds and stocks can't be right at this moment in time.

We have to choose which asset class has the story right, and history sides with the Treasury market. So, that indeed is how we are tilted for the coming year. Defensively positioned — again. In addition, from a total return perspective, a near-20% gain in the long bond not only didn't hurt you, but meaningfully outperformed the S&P 500 on a risk-adjusted basis and by not having to take on any inherent equity (capital) risk.

CHART 2: The Secular Bull Market in the Long Bond Remains Fully Intact

United States: *30-year Treasury Bond Yield*

(percent)



Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Rosenberg Research

Right now, it is critically important to get as close to the truth of clients' risk tolerance. There have probably never been as many characteristics of a top as we are experiencing today. At some point, as unpopular as contrarianism can be, we all need to ponder deeply about Bob Farrell's Rule #4:

"Exponentially rapidly rising or falling markets usually go further than you think but they do not correct by going sideways."

No one really knows how far up the top is, but what happens after the top does not fit into very many people's risk tolerance. In the meantime, another year of double-digit returns on the highest quality, long duration bonds is our expectation and the interest rate risk associated with them is entirely manageable from our perspective as market economists.

While I cannot pick the date, I can tell you that this turbocharged debt cycle will end miserably, not unlike 2008 and 2001. Don't try to time the inevitable mean-reversion trade. Just heed this first Bob Farrell rule of investing on 'mean reversion' and know that it's out there. In nearly eleven years the S&P 500 has soared nearly five-fold to multiples (on earnings, sales and book value — take your pick) we have only seen twice in recent history. **Corporate bond spreads off Treasuries squeezed to levels that fall well short of compensating for imminent default risks, and there really is no reason to wait for the herd to head for the exits.** That time will come sooner rather than later because Mother Nature will not tolerate leverage and multiple-expansion supplanting corporate earnings and productivity growth indefinitely.

RECESSION ODDS STILL ELEVATED

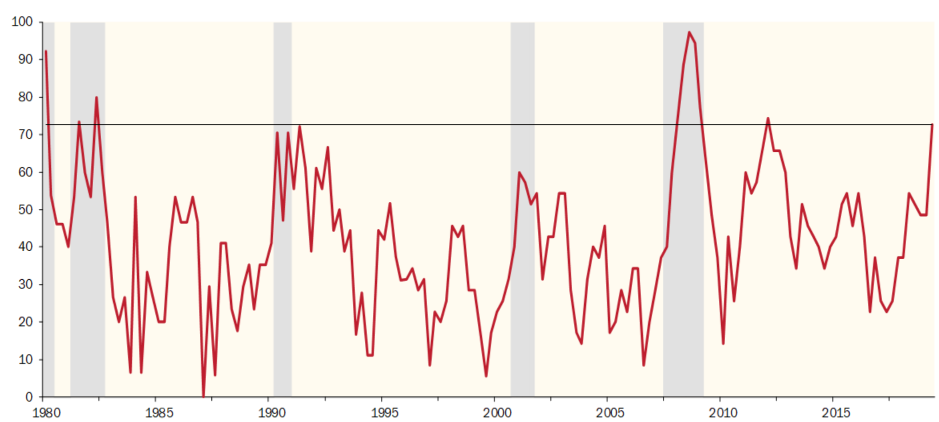
It seems that we have been premature in our recession call, but in late 2007, we had to wait a year for the 'Powers That Be' to validate our timing. In the U.S. the consumer hung in well enough and long enough to cushion the rolling recessions in housing, manufacturing, nonresidential construction, capital spending and exports. **Weakness is beginning to reveal itself in consumer spending in recent months**, together with a shift out of discretionary expenditures such as apparel, jewelry, home improvement, furniture, appliances and restaurants.

Perhaps the lags are much longer this time around, but the cutbacks in business spending on plant and equipment have not clearly impaired the labor market yet, which is what it will take to inevitably cause an official downturn. Some cracks began emerging in the tail end of last year, with small businesses cutting back on staffing (as per the ADP reports) and they tend to lead the jobs cycle. We also did see a 1.7% annualized decline in real retail sales over the three months to November.

On a GDP basis, it has not materialized. Europe barely escaped one. Parts of Asia did contract and both China and India slowed precipitously, but not enough to generate an overall economic recession. The U.S. economy endured a profits recession in 2019 and real GDP excluding the consumer contracted in both the second and third quarters. **We, along with the New York Fed, saw growth sputtering to little better than a 1% annual rate as the year drew to a close.** While there will be modest fiscal stimulus in 2020, it won't be enough to prevent an outright recession, or certainly a pace of activity that is below potential and thereby generates deflationary or disinflationary pressures. No asset class we can point to has this prospect remotely priced in for the coming year.

Regardless, the trajectory for economic growth, both here and abroad, is unmistakable in my view. **The official IMF real GDP growth projections for 2019 were continuously cut until they reached a low of 3.0%, which in fact, was the most sluggish since the tail end of the 2009 Great Recession.** Canada didn't enter recession even if Mexico did, but real per capita GDP did dip fractionally, and all the prior employment boom did was expose the country's secular erosion in productivity. In aggregate, three-quarters of the world economy sputtered into stall-speed real GDP growth in the past year, which may not be recession in a classical sense but is the next rung up on the ladder.

CHART 3: Share of Countries with 2% or Less Real GDP Growth
OECD
(quarter-over-quarter percent change; annualized)



Shaded regions represent periods of U.S. recession
Source: OECD, Rosenberg Research

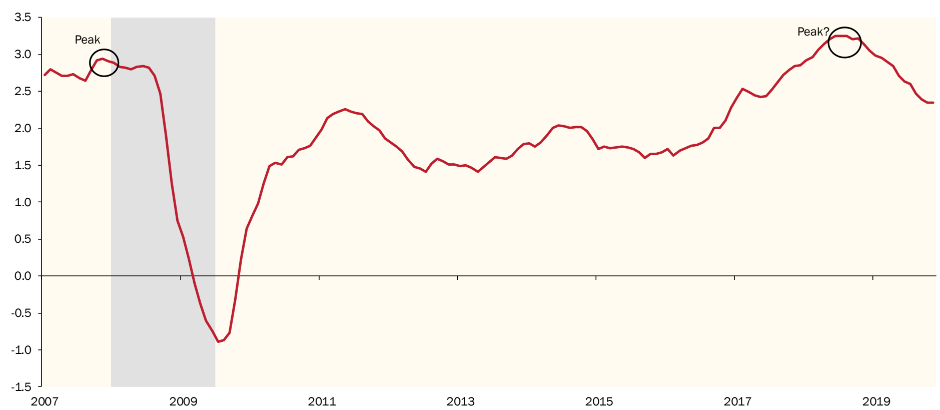
The central banks across the planet, save perhaps the Bank of Canada, felt strongly enough about high and rising recession risks that they behaved as though one had already arrived. **Compared to a year ago, practically all of the economic trends and central bank rate postures have reversed course and headed south, and not all due to trade-related uncertainties**. The reality is global economic growth has been weighed down primarily by an unsustainable debt burden at the household, corporate and government level. The extreme, and unprecedented, degree of leverage has been, and continues to be, the primary dead-weight drag on global aggregate demand. **Pundits who believe deficit-financed government spending will be a panacea in 2020 don't seem to understand that the Laws of Diminishing Returns do apply to excessive indebtedness, with the lack of any follow-through or multiplier impacts from the dramatic U.S. fiscal stimulus in 2018 serving as clear evidence.**

Moreover, the normalized New York Fed recession-risk model pointed to downturn odds of 34% at the start of 2019, hit a peak of 83% in August and has since been sliced to 47%. Much like the shift in the yield curve to inversion and then 'un-inversion' in the aftermath of the Fed's trio of rate cuts, the question really is whether the damage has already been done for 2020 — and if the leading indicators are providing information more about a 2021 recovery. **Attempts to "grow our way out" of this debt morass through inflation have proven futile — there simply is far too much excess capacity across the planet to think reflation is a possibility.** Central banks have already probed the outer limits of nonconventional policy measures. What lies ahead, and is the only out, is a giant global debt default — the only issue is identifying the winners and losers.

CHART 4: Has Inflation Peaked for the Cycle?

United States: *New York Fed Underlying Inflation Gauge*

(year-over-year percent change)



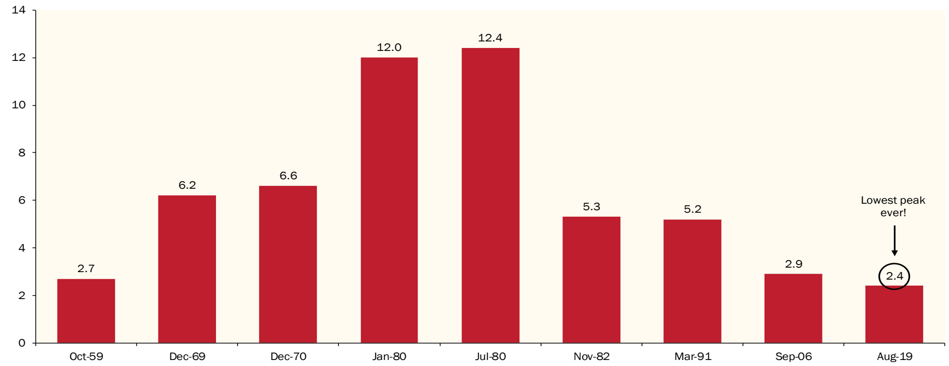
Shaded region represents period of U.S. recession

Source: Haver Analytics, Rosenberg Research

CHART 5: Peaks in Core Inflation Getting Lower…And Lower!

United States: *Core CPI*

(year-over-year percent change)

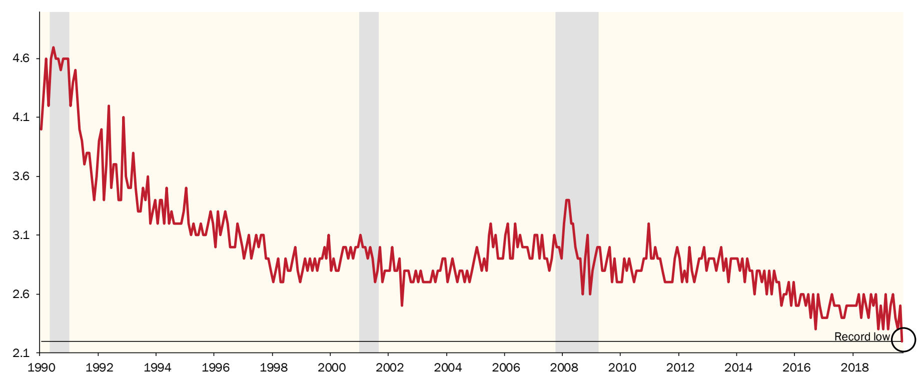


Source: Haver Analytics, Rosenberg Research

CHART 6: Inflation Expectations Grounded

United States: *UMich: 5-10 Year Expected Inflation Rate*

(percent)



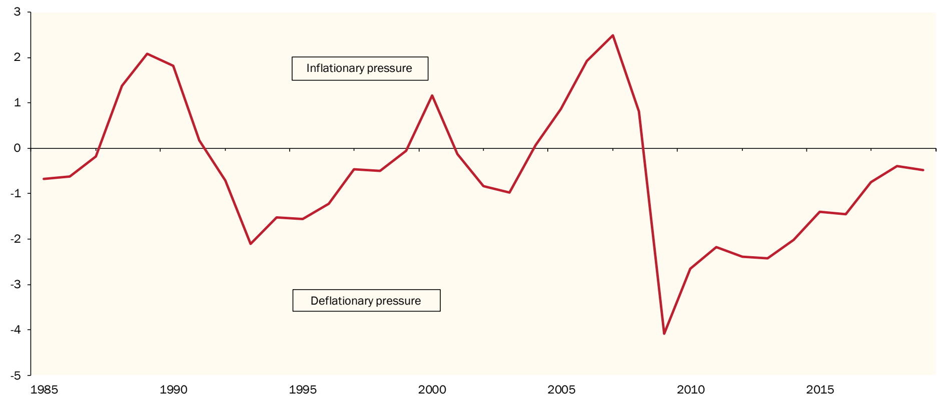
Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Rosenberg Research

CHART 7: For the First Time Ever the Output Gap Never Closed

OECD: *Output Gap*

(percent)



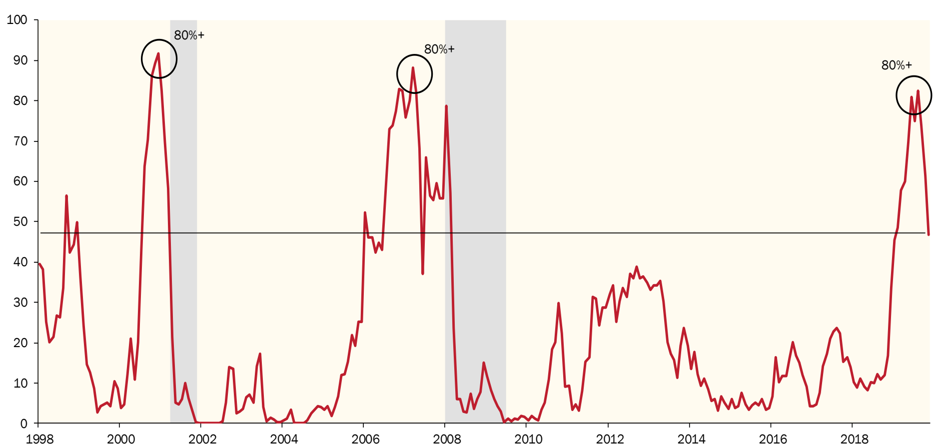
Source: Haver Analytics, Rosenberg Research

We recall all too well the euphoria that followed the early 2001 and late 2007 Fed rate cuts and curve-steepening shifts, that then switched to malaise as the recession nobody saw coming took hold in the next few months. **The lags between monetary policy and the real economy are both long and variable**. We are still feeling the effects of the tightening in Fed policy from 2015-2018, as we were feeling the 2004-06 effects by the time the 2008 recession kicked in. Remember, it cannot be denied that during the summer months the 'normalized' NY Fed recession probability model did breach the 80% threshold, and it cannot be taken back, even if it has receded in response to the Fed's recent liquidity infusions. The Fed has employed both actual rate cuts, and an aggressive QE4, which in the past two months has more than fully funded the U.S. fiscal deficit. **But, with a typical year-long lag, a recession has ensued after the 80% mark has been crossed in the 'normalized' NY Fed model every single time in the past five decades.**

CHART 8: Probability of a Recession 12 Months Ahead

United States

(percent)



As predicted by the near-term treasury spread

Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Rosenberg Research

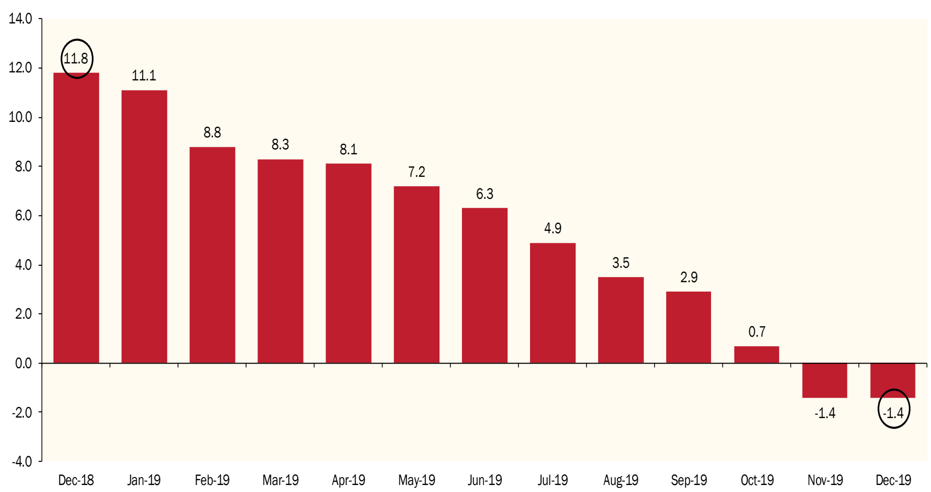
And, of course, there are ongoing uncertainties around the global trade picture (not to mention the U.S. fiscal outlook) as it pertains to the November 2020 election. I see little reason for a capex cycle to emerge in 2020 given the wide divide that has opened up on tax policy between the Democrats and Republicans — to the point where even a centrist like Joe Biden is now campaigning on rolling back the Trump tax cuts of 2018. What business is going to embark on a major multi-year spending project not knowing what the after-tax rate of return on the capital invested is going to look like?

STOCK MARKET NO LONGER AN ECONOMIC BAROMETER

Lately, the equity market no longer seems to trade off the economic fundamentals. Never before has there been such a loose relationship to economic growth. **While the GDP recession never did materialize, the median economic sector stopped expanding mid-year and the portion of the economy that is not the consumer has contracted for two quarters in a row**. That may well be a bit of data mining, but it is to show how narrowly concentrated the economy has become.

Not just that, but corporate profits are set to be in a four-quarter recession and investors have barely blinked. More like shrugged. At the start of 2019, the consensus was for a V-shaped earnings recovery to take hold by year-end, but instead of double-digit growth that the consensus had once penned in, Q4 2019 is now seen as coming in at -1.4% on a YoY basis.

CHART 9: S&P 500 2019 Q4 Earnings per Share Estimate
United States
(year-over-year percent change)



Source: FactSet, Rosenberg Research

If corporate earnings had gone up four quarters in a row and the stock market plunged 30%, such a mismatch would make the temptation to turn bullish irresistible. Please stand by. But what happened in 2019 was the exact opposite. That was not in the consensus forecast at the turn of the year, and the stock market soared by more than 30%.

So, the market has rallied completely on the back of multiple expansion — to the point where the price-to-earnings, price-to-cash flow and price-to-book ratios are all near-one standard-deviations above their historical norms. The price-to-sales multiple for the S&P 500 actually is back to where it was at the 2000 dotcom bubble peak.

CHART 10: Most Expensive Stock Market Since the Dotcom Boom

United States: *S&P 500 Price-to-Sales Ratio*

(ratio)

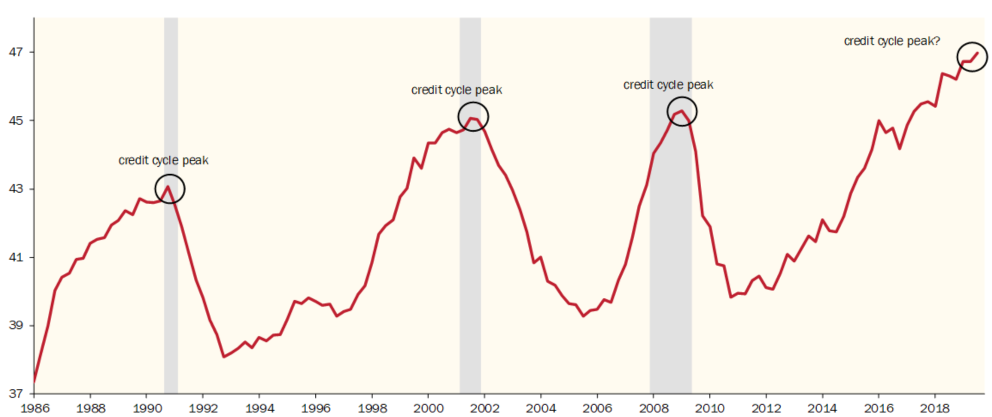
Source: Bloomberg, Rosenberg Research

The ratio of corporate debt-to-GDP is at all-time highs. In addition to the unprecedented fiscal stimulus at this late stage of the economic cycle, and accompanying trillion-dollar deficits, we also have corporate leverage ratios at record levels. **An enormous volume of corporate debt has been issued exclusively for the purpose of buying and retiring shares.** This includes both buybacks and acquisitions of other companies. And in classic mature-cycle fashion, we are seeing some cracks emerge in the junkiest parts of the U.S. credit market. This is an area to be focused on as leveraged credits are in an eerily similar situation to what was surfacing out of the subprime mortgage market back in 2007.

CHART 11: Corporate Balance Sheets are not in Good Shape!

United States: *Corporate Debt-to-GDP*

(percent)



Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Rosenberg Research

In any event, we are light years away from a stable equilibrium. **Leverage, financial engineering and the restructuring of the capital structure that followed the recent M&A wave, have become the defining features of this bull market in risk assets —**

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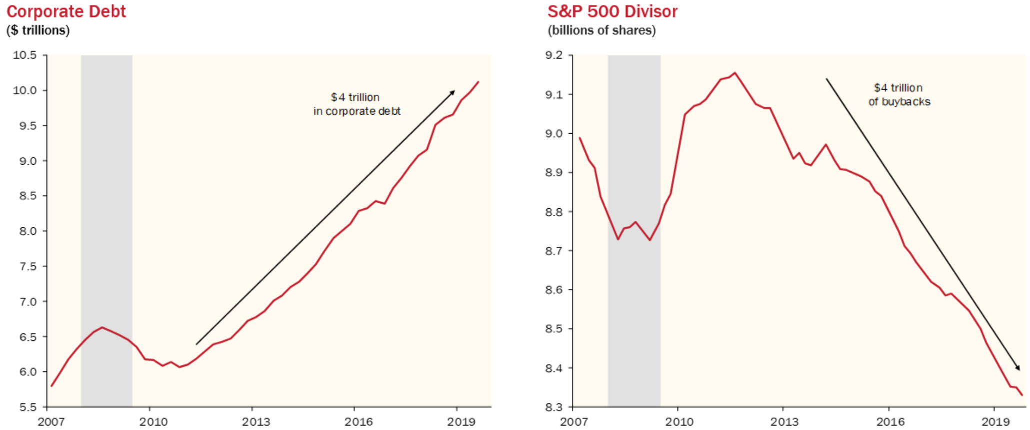
namely equities and corporate credit. The proverbial canary in the coal mine usually resides somewhere in the credit market (think of LBOs in 1989 and subprime mortgages in 2007).

CHART 12: The Biggest Debt-for-Equity Swap of all Time

United States



Shaded regions represent periods of U.S. recession

Source: Haver Analytics, Rosenberg Research

The bottom line is that this is a stock market that is being driven by flows rather than by economic fundamentals. The ongoing wave of stock buybacks has taken the S&P 500 share count to two-decade lows, so to some extent the equity market now behaves more like a commodity. This was achieved primarily by the issuance of low-rated corporate debt. In addition, the Baby Boomer generation has done its best in a decade-long effort to build retirement savings, primarily in index fund purchases in 401(k) plans.

THE BULL MARKET IN COMPLACENCY

The latest leg of the bull phase started with all the 'Phase One' trade talks and these have elicited a hope-based rally — one that is being dominated by sentiment rather than facts on the ground. Perceptions are sometimes difficult to change but investors smell a trade détente that we feel is way too premature. **With all the enthusiasm about the efficacy of a "trade deal" it is important to remember that, like many economic issues, trade is a zero-sum game. If China buys a few hundred billion more dollars of American stuff, that is just a few hundred billion dollars of some other country's stuff they are not buying.**

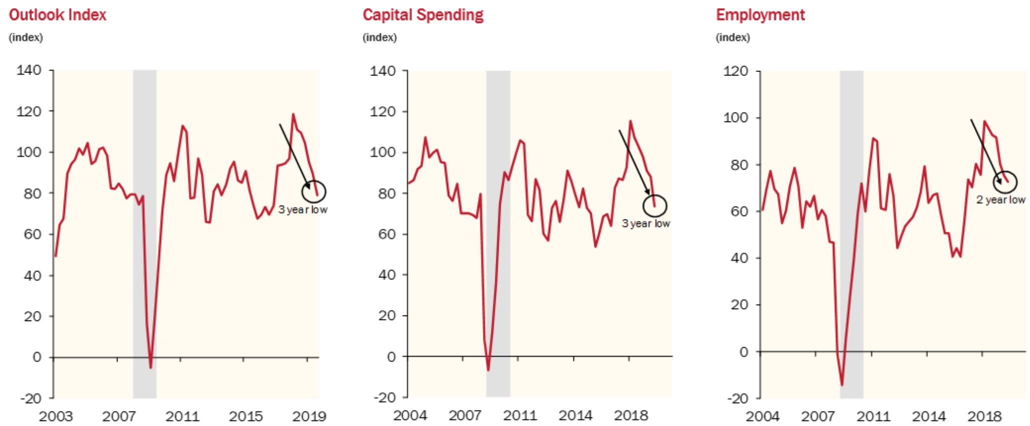
Adding to the complacency, the Fed began QE4 via the T-bill market three months ago to calm down the repo market, and in so doing helped steepen the yield curve and provide an extra liquidity kick to the stock market. All the while, Brexit concerns have fallen by the wayside alongside Boris Johnson's electoral success (though there is still no guaranty a no-deal departure will be avoided by the end of the year).

More importantly, the polls and the market are pricing in that Donald Trump repeats in November 2020. With that comes a significant lessening of the risk of tax increases and dramatic new progressive initiatives that would be part of a Democrat victory. This is the outcome being discounted in the financial markets at the moment.

Be that as it may, the U.S. election and the Brexit vote in 2016 serve as reminders that nothing can be taken for granted when it comes to political prognostications.

If anything, from a macroeconomic standpoint, capital spending projects are likely to be put on the shelf until a more certain fiscal outlook emerges after this year's election. That was surely the message in the fourth quarter Business Roundtable survey, which showed CEO sentiment and capital expenditure plans sagging to their lowest levels in three years, despite the 'Phase One' trade deal and the stock market hitting record highs on nearly a daily basis as 2019 drew to a close.

CHART 13: The U.S. Business Sector is Not Fooled by 'Phase One'
United States
(index)



Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Rosenberg Research

We are coming off a year where the returns in the items you want to own in troubled times were very positive and the returns in the parts of the market that tell you the sun is shining brightly did likewise. **Both cannot be right, though perhaps everything going up in tandem is part of the global central banks' master plan to provide abundant liquidity in the mistaken belief that 'wealth effects' are going to push economic growth into a sustainable accelerating path. Meanwhile, all that these policies have done is exacerbate wealth inequalities in society, provided an artificial sense of prosperity and created an unprecedented wedge between the financial and the real economy.**

Globally, risk appetite in 2019 was substantially influenced by the world's central banks, which followed the Fed's lead. **By our count, we saw 47 rate cuts in aggregate, amounting to 2,270 basis points of stimulus**. The ECB, as Mario Draghi's tenure ended, tacked on more quantitative easing, and the Fed, between actual easing and the QE4 move, has behaved as if it cut rates 140 basis points last year — not what one would have expected based on the tone of Jay Powell's press statement in December 2018, but the speed at which he changed course was breathtaking. Fed policy and guidance defined how investors wanted to be positioned this past year. It was even quicker than Ben Bernanke's reversal of tone following the 2013 "taper tantrum".

So here we are, more than ten years into this Great Bull Market in stocks and a not-so-great economic expansion. The markets are just as hitched to central bank liquidity now as they were a decade ago at the depths of the worst financial crisis since the Great Depression. **And investors have been lulled into this sense of security, if not complacency, that the Fed will be there to protect them from any bear market or serious correction.** Cutting rates in 2019 with a five-decade low in the unemployment rate, a trillion-dollar fiscal deficit, and a stock market that never did stray that much from the record highs, even in the few corrective phases we endured in 2019, says an awful lot about investors' chronic addiction to central bank liquidity.

It is truly remarkable how far the central banks will go to continue to underwrite the expansion and prevent recession, and the 'wealth effect' models that the Fed deploys encourage market participants to constantly target a higher stock market. In that sense, 2019 must be seen as a huge success — generate a liquidity-induced rally and at the same time paper over a poor year for corporate profits. Of course, all that means is that future returns have been sacrificed given the high starting point for the market multiple following this past year's remarkable P/E expansion. There is no such thing as a free lunch.

DEBT OVERHANG THE PERVASIVE CONSTRAINT

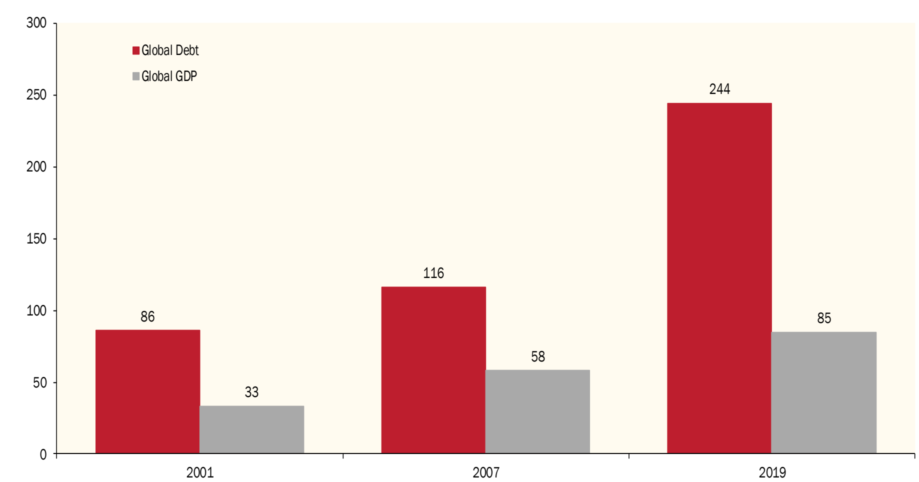
We are going to sound like a broken record, but the world economy and financial markets remain on life support more than a decade after the Great Recession and global credit collapse. Central banks are pinning risk-free rates at, or near, zero in nominal terms (and negative in real terms). **One would expect there to be $11 trillion of negative yielding investment grade bonds globally, and incredibly accommodative monetary policies, if it was associated with fighting a deep recession and bear market.** Yet, here we are today, at or near full-employment in most advanced economies and equity markets at record levels.

This is not a stable equilibrium by any stretch. This cycle was built on a mountain of debt, accommodated by the monetary authorities, which made a mockery of the 2002-07 credit bubble. Back then, the increase in global debt at all levels, household, business and government, exceeded the rise in world nominal GDP by 20%. Since the peak of the last credit bubble twelve years ago to today, global debt has ballooned $128 trillion versus a $37 trillion expansion in GDP — a gap of over 300%! Every corner of the global economy is addicted to debt and the central banks are continuing to play the role of "Dr. Feelgood".

CHART 14: Global Debt Outpaced Income Five-Fold This Cycle

Global

($ Trillions)



Source: IMF, IIF, Rosenberg Research

This is why the global economy is having so much difficulty growing organically, and inflation is unlikely to develop over a reasonable investment horizon. We are far beyond the saturation point when it comes to credit creation and the broader economic impacts. We saw this first-hand with the lack of any multiplier impacts from the U.S. deficit-financed tax cuts in early 2018. **The massive global debt load is a powerful deflationary force constraining aggregate demand growth**. This is a key reason why upward pressure on interest rates have no staying power. This was vividly demonstrated in the most recent truncated Fed tightening cycle.

We have to act based on what we know with some degree of certainty. We know that equity markets are priced for perfection and that the world is far from perfect. We know that central banks will be there for you, but at this point only after the market undergoes a corrective phase at the very least. We know that Brexit still has a lot of trade-negotiation work in front of it and that trade and political developments in the coming year are largely already reflected in equity prices. We know that the recent cyclical peak in core inflation was the lowest peak on record despite all the policy attempts to boost it. We know that every risk asset class is expensive by historic standards. And we know that the credit market, broadly speaking, is as mispriced for an economic downturn as the equity market is.

As far as the odds of an outright GDP recession developing in 2020 go, the jury is still out. In fact, these probabilities remain elevated and are as high today as they were a year ago when the S&P 500 was 30% lower and high yield credit spreads were nearly 200 basis points wider. **The bull market in private equity and debt is long in the tooth and this asset class now looks super-saturated**. The fact that the private equity space is currently sitting on the largest cash hoard ever is an added sign of how the masses are now so willing to overpay for already inflated assets. If there is a canary in the coalmine in this particular area, it was in this past year's dismal price performance in the IPO space, and is an indication of the extreme degree of overvaluation in private companies (not to mention a sign of how opaque the private space is given its illiquid nature and too much cash chasing too few opportunities).

I SMELL A RAT!

This is the Chinese Year of the Rat. Last year was the Year of the Pig, and there was a whole cosmetics bag of lipstick that was applied, primarily by central bankers. There is just too much air underneath equity valuations and there is no room for credit spreads to tighten any further. The world's economic and financial problems have been papered over by even more debt and we now have hit leverage ratios that look to be highly unstable and unsustainable.

In 2020, I smell a rat.

The central bank liquidity taps are likely to be turned on even more, but the impact at current valuation levels across the various risk asset classes will be far more muted now than was the case a year ago. And there is always the prospect that the monetary authorities will stay on the sidelines and await a budgetary tax cut or government spending response, which itself is futile given that fiscal policy in most countries is just as tapped out as monetary policy. **There are no easy solutions and it is doubtful that we will have another year where central banks can transform the weakest period for global economic growth in a decade and pull another rabbit out of the hat in terms of massive excess returns for equity and corporate bond investors.**

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KEY INVESTMENT THEMES FOR 2020

My recommendations for this year are much the same as they were at the end of 2018. Not much has changed except valuations have become more extreme and the economic and market risks are even more acute than they were just over a year ago.

So, what to do? After more than thirty years in this business, I can tell you two things that are certain even in this highly uncertain environment, where market pricing, in the vast majority of cases, are misaligned with the underlying fundamentals:

1. **There is no such thing as a sure thing**
2. **Never put all your eggs in one basket**

So for equities, stick with a theme of quality, low-cyclicality, strong balance sheets and reliable and recurring cash flow streams. For bonds, go for extremely high quality. Get the alpha by going long-duration. **Remember that no one thought you could make money in a 3% long bond world, but it delivered 18% in 2019**. Expect more of the same in 2020. Maintain a healthy allocation in hard assets as a hedge against our deflation/disinflation thematic. **We favor for 2020 the following strategies**:

- Cash (optionality)
- Long duration, high-quality bonds
- Utilities stocks
- Defense/Aerospace stocks (lofty valuations, in our view, are justified)
- Consumer Staples that have a low degree of price-demand elasticity
- Japanese equities, which remain a bona fide secular supply-side story
- Precious metals (especially with the Fed already undertaking debt monetization)
- Farmland/alternative hard assets/commodities in short supply (lithium, palladium)
- Energy stocks that are dirt cheap and priced much in the same way Financials were in early 2009 (for extinction)

As far as investment advice is concerned, there is what to own (as in above), and then there is what to avoid, which is equally important. In terms of what to avoid, try CLOs, credit hedge funds and low-grade corporate bonds and loans. **These investments are 'juiced up' by a ton of leverage and lack liquidity when times get challenging.**

In my view, leverage and leveraged credit strategies are the most dangerous vehicles in this ultra-late-cycle environment. Investors in these instruments are not adequately protected against the looming recession, or recession-like pressures, that will impede corporate cash flows and generate the conditions for a classic end-of-cycle default wave. **Remember, the quality of the investment grade corporate bond market globally has never before been as "junky", or filled with as many low-quality issues, as is the case today.**

For the coming year, invest with managers who are creative, have a thought process in hand that is complete and comprehensible, and who have a proven record in investing around ideas instead of leverage. Make doubly sure that you are long one 'L' (liquidity) and be short the other 'L' (leverage). I cannot stress that enough, because we live in a time of almost unprecedented linear extrapolation and complacency.

Capital preservation is one investment objective that deserves particular thought and attention as we begin 2020. At a time of heightened uncertainty, this is not a bad thing to contemplate. In fact, I would call it prudent.

IMPORTANT DISCLOSURES