MONTHLY MARKET REVIEW

MARCH 1, 2019

ROCKEFELLER
CAPITAL MANAGEMENT

The One That Got Away

Big Apple losing HQ2; Fed's capitulation buoyed sentiment

JIMMY C. CHANG, CFA

Chief Investment Strategist
Senior Portfolio Manager

Rockefeller Capital Management

(212) 549-5218 | jchang@rockco.com

The breath-taking rally off the Christmas Eve bottom continued unabated through much of February. Investors were cheering on the progress in the Sino-U.S. trade negotiation which has gone well enough for President Trump to delay his deadline for raising tariffs on Chinese imports to 25%. It appeared that the erstwhile "Tariff Man", fresh from the glow of being nominated by Japanese Prime Minister Shinzo Abe for the Nobel Peace Prize, had his mind set on ending the trade war and signing a historic deal with Chinese President Xi Jinping at Mar-a-Largo. Market sentiment was further buoyed by dovish messages from the world's major central banks. As of February 22nd, the Dow Jones Industrial Average Index (DJIA) has notched nine consecutive weeks of gains, a rather rare streak that last occurred in 1995. The VIX Index, a so-called fear gauge for the market, mirrored the DJIA's streak with nine consecutive weeks of decline, which was unprecedented. Chinese equities reclaimed bull market status as the CSI 300 Index has rallied as much as 26% off its January 3rd bottom. The prospect of Chinese reflation also drove up crude oil and base metal prices. The odd man out for much of the month was the U.S. Treasury market, which traded in a narrow range until the stronger-than-expected GDP data for the final quarter of 2018 was released on February 28th. The 2-year/10-year yield differential has yet to break above the late December levels in spite of the rally in risk assets. That said, investment grade and high yield bond spreads have continued to narrow. Currency traders seemed hesitant to make a big bet as the U.S. Dollar Index has fluctuated within a 2% range over the past four months. However, the British pound climbed to 8-month highs with the prospect of a hard Brexit having diminished. On the geopolitical front, the market largely shrugged off the military conflict between two nuclear powers – India and Pakistan – as a one-off issue even though the Kashmir conflict has dragged on for 72 years. The standoff between Maduro and Guaido could have wider economic impact as a Guaido victory would mean higher Venezuelan crude oil output down the road. Lastly, the failed Trump-Kim summit showed the limit of President Trump's "special relationship" with strongmen; they were merely buying time to wait us out.

EQUITY MARKETS INDICES[1]	1/31/18 Price	2/28/19 Price	MTD Change	YTD Change
MSCI All Country World	491	503	2.5%	10.5%
S&P 500	2704	2784	3.0%	11.1%
MSCI EAFE	1831	1874	2.3%	8.9%
Russell 2000®[2]	1499	1576	5.1%	16.8%
NASDAQ	7282	7533	3.4%	13.5%
TOPIX	1567	1608	2.6%	7.6%
KOSPI	2205	2195	-0.4%	7.6%
Emerging Markets	1050	1051	0.1%	8.8%
FIXED INCOME				
2-Year US Treasury Note	2.46%	2.52%	6	3
10-Year US Treasury Note	2.63%	2.72%	9	3
BarCap US Agg Corp Sprd	1.28%	1.21%	-7	-32
BarCap US Corp HY Sprd	4.23%	3.79%	-44	-147
CURRENCIES				
Australian *(AUD/$)*	1.37	1.41	-2.5%	0.7%
Brazilian Real *(Real)*	3.65	3.76	-3.0%	3.1%
British Pound *($/GBP)*	1.31	1.33	1.2%	4.0%
Euro *($/Euro)*	1.14	1.14	-0.7%	-0.8%
Japanese Yen *(Yen/$)*	108.89	111.39	-2.3%	-1.5%
Korean Won *(KRW/$)*	1112.72	1124.44	-1.2%	-0.8%
U.S. Dollar Index *(DXY)*	95.58	96.16	0.6%	0.0%
COMMODITIES				
Gold	1321	1313	-0.6%	2.4%
Oil	53.8	57.2	6.4%	26.0%
Natural Gas, Henry Hub	2.81	2.81	-0.1%	-4.4%
Copper *(cents/lb)*	278	295	5.9%	12.1%
CRB Index	180	183	1.7%	7.6%
Baltic Dry Index	668	658	-1.5%	-48.2%

Instead of railing against Amazon's "corporate greed" in extracting so much subsidies, activists should petition organizations such as the U.S. Conference of Mayors and the National Governors Association to get cities and states to call a truce on the corporate welfare arms race.

CADABRA MAN

In 1994, a cerebral 30-year old with a prematurely receding hairline was made the youngest Senior Vice President at a New York-based hedge fund. Instead of furthering a lucrative career on Wall Street, he was intrigued by the potential of the Internet to transform industries. A few months later, he quit his job and moved to Seattle to pursue his entrepreneurial dream. In July 1994, playing off the abracadabra incantation, he named his on-line book selling company Cadabra, Inc.

The entrepreneur held 60 meetings in 1994 with friends, family members, and prospective investors to raise seed money for Cadabra. He was attempting to persuade each potential investor to put up $50,000 for a 1% stake in the company, which he valued at $5 million. Some were skeptical of the business plan on the concern that established players like Barnes and Nobel and Borders could easily crush the commodity selling start-up. Eventually, 22 investors signed on, raising approximately $1 million.

Before Cadabra's website went live in July 1995, the entrepreneur had to change the company name after a lawyer mistakenly heard the name as Cadaver. After brainstorming through various names from Aard to Relentless, Jeff Bezos settled on Amazon, a subtle ode to his ambition, which he believed paralleled the largest river in the world. It also helped that the letter A would put his company at the top of an alphabetical list when people search for it on the World Wide Web. The rest, as they say, is history.

Amazon went public in 1997 and grew from an on-line bookseller into a global retail and technology behemoth. The initial $50,000 investment in the company in 1994 would be worth around $8 billion today. It's hard to imagine how those 38 people who turned down Jeff Bezos' investment proposal in 1994 felt about The One that got away – perhaps the biggest investment regret in history.

SOURED APPLE

In September 2017, Amazon announced a search for a second corporate headquarters dubbed HQ2 to house up to 50,000 employees. It set off a frenzy among more than 200 cities in the U.S., Canada, and Mexico to compete for Amazon's estimated $5 billion HQ2 investment. The HQ2 pageant contest was a public relations and financial coup for Amazon, which pitted cities against each other to maximize the subsidies it hoped to extract from the bidders. As Amazon's competitors, suppliers, and even employees can attest to, behind the smiley logo stands an organization known for its ruthless competitiveness, cutthroat culture, and intense frugality.

In November 2018, Amazon announced that it has decided to split its HQ2 into two locations – New York City and Northern Virginia. The company extracted $5.5 billion of total incentives from these two locales, which more than paid for the expected $5 billion investment in HQ2. Amazingly, these were not even the most generous offers – New Jersey and the city of Newark reportedly proposed $7 billion of tax rebates, and Maryland topped it with $8.5 billion of incentives.

While most New Yorkers backed the HQ2 deal – $3 billion of performance-based incentives in exchange for 25,000 jobs and over $27 billion of state and local tax revenues over time – several state and local politicians immediately lashed out at New York Governor Andrew Cuomo and New York City Mayor Bill de Blasio, the two principals behind the closed-door deal with Amazon, for not including them in the negotiation process and for the "unnecessary subsidy" to a company that supposedly wanted to come to New York anyway. Some community and labor activists also complained about the impact of gentrification and Amazon's antipathy toward unions.

The left-wing of the Democratic Party soon made the fight against New York's HQ2 deal a cause célèbre. It was clear that a highly motivated group of politicians and community organizers were going to put Amazon through the ringer and extract pounds of flesh at a minimum. In early February, the Democratic majority in the State Senate appointed a vocal critic of the HQ2 deal to a key oversight board where any voting member has the veto power to block the deal. Facing uncertainty over the HQ2 approval in 2020 and potentially years of attack from local politicians and activists, Jeff Bezos stunned the New York political, business and local communities by abandoning the plan to build HQ2 in New York's Long Island City.

A PYRRHIC VICTORY

Amazon's decision to pull the plug on the NY HQ2 was celebrated by some on the left as their victory over a corporate Goliath. Rep. Alexandria Ocasio-Cortez, who represents an area adjacent to Long Island City, crowed that everyday New Yorkers have defeated "corporate greed, its worker exploitation, and the power of the richest man in the world." She claimed on camera that the $3 billion subsidy can now be invested in local infrastructure, putting a lot of people to work. Unfortunately, the Democratic Socialist firebrand apparently missed a critical point – there is not three billion dollars in the coffer today; the $3 billion subsidy is a reduction on the taxes that Amazon would have to pay New York in the years ahead for its HQ2 in Long Island City. A livid Mayor de Blasio said

there was a "lack of integrity" in this debate, but as a progressive, he also had to take a swipe at Amazon for not being tough enough to handle New York. Governor Andrew Cuomo, who once joked that he would have changed his first name to Amazon if that's what it took to win the HQ2 deal, bluntly called out "a small group of politicians" – his fellow Democrats – for putting "their own narrow political interest above their community." Indeed, a recent Siena College poll of registered New York voters found that 70% of African-Americans and 81% of Latinos supported Governor Cuomo's HQ2 deal. Most everyday New Yorkers want good jobs rather than political grandstanding, and Amazon's HQ2 would have gone a long way in helping the city reduce its reliance on the supposedly greedy bankers and traders so reviled by many in the progressive camp.

Contrary to Mayor de Blasio's assertion that Amazon was not tough enough, Jeff Bezos showed his mettle by making a tough decision to cut his losses. Why should Amazon, which values quick decision making in hyper-competitive industries, be subject to New York's drawn out, contentious approval process when the Virginia Senate has already approved their HQ2 deal? With other cities still eager to roll out the red carpet, Amazon did not have to deal with New York's extra demands. Indeed, Chicago Mayor Rahm Emanuel, New Jersey Governor Phil Murphy, and scores of other politicians have already reached out to Amazon for a second shot at HQ2. Instead of railing against Amazon's "corporate greed" in extracting so much subsidies, activists should petition organizations such as the U.S. Conference of Mayors and the National Governors Association to get cities and states to call a truce on the corporate welfare arms race. There is an inherent unfairness with new arrivals getting tax breaks while existing businesses are saddled with higher tax burden. But in the real world, the so-called blue states with more onerous tax and regulation often need to offer more subsidies to compete with the red states.

UNNATURAL GAS SHORTAGE

While the media attention was focused on the Amazon HQ2 debacle, there was another local issue that showed how well-intentioned policies could create unintended consequences. Con Edison announced that, after March 15, 2019, it will no longer accept applications for new natural gas connections in much of the southern Westchester County. Con Edison has also requested a 6% electricity rate increase starting in 2020. Local politicians reacted with shock and complained that it would, as one assemblywoman said, "devastate development in Westchester, including affordable housing initiatives, all economic development."

The root cause of the issue is that policymakers in New York and New England have rejected permits for most new gas pipelines for years due to concerns over their environmental impact. Some may have also wanted to limit the pipeline capacity as a means to accelerate the transition to renewable energy. The natural gas pipeline shortage has forced utilities in New England to import liquefied natural gas (LNG) during periods of high energy demand from Trinidad and Tobago as well as unfriendly regimes such as Russia and Yemen. LNG not only costs more than U.S. produced shale gas transported via pipelines, but also causes more carbon dioxide emission due to the extra energy expended in the cooling, compressing, shipping and regasifying processes. It's also ironic that we need to import LNG when the U.S. gas flaring – burning off excess natural gas produced due to insufficient takeaway pipeline capacity – is hitting record levels.

The aforementioned issues showed the difficulty of balancing idealism and pragmatism, and the need for broader dialogue and better coordination among various interest groups to resolve many pressing issues. Unfortunately, the current political climate does not appear conducive to productive discussions and compromises.

DIVERGING MARKETS & FUNDAMENTALS

In spite of the increasingly divisive and dysfunctional U.S. political backdrop, financial markets have mounted a sharp V-shaped recovery off the December lows. While the rally was fairly broadbased, the strongest performers have been cyclical plays as industrials, technology, and energy stocks.

Interestingly, the market's euphoria has been countered by a string of worse-than-expected economic data and downward revision of the 2019 earnings expectation. January vehicle sales in the U.S., Europe, and China have declined by 2.8%, 5.7%, and 17.7% year-on-year, respectively, yet auto stocks have been on a tear. The Citi Economic Surprise Index for the U.S. has collapsed from the high 20s at the beginning of February to negative 30. The S&P 500 Index EPS growth estimate for the first quarter of 2019 has dropped from around 5% to negative 1% since the start of the year.

This counter-intuitive bad-news-is-good-news market may reflect the expectation for a new round of synchronized global easing as well as growth re-acceleration in the second half of 2019. Indeed, Chinese policymakers have been flooding its system with liquidity and the country's total social financing in January 2019 surged 50% year-on-year. The European Central Bank is expected to renew its low-cost funding operations to bolster lending. Here in the U.S., the Fed has made clear of its intention to stop the liquidity-draining quantitative tightening before year end. The surprisingly dovish Fed messaging may be a tacit admission that it had overtightened in 2018.

A pause in the hiking cycle and quantitative tightening is likely to help with valuation expansion. However, a second half growth re-acceleration is not yet a foregone conclusion. With the S&P 500 Index now trading at over 16 times 2019's EPS estimate of 170, the U.S. equity market appears to be fairly valued. Given the recent divergence between equity prices and economic fundamentals, we believe the rally is likely to take a breather in the near term .

For more information on Rockefeller Capital Management:

rockco.com

New York, NY
45 Rockefeller Plaza, Floor 5
New York, NY 10111
212.549.5100

Rockefeller Trust Company, N.A.
45 Rockefeller Plaza, Floor 5
New York, NY 10111
212.549.5100

The Rockefeller Trust Company (Delaware)
1201 N. Market Street, Suite 1401
Wilmington, DE 19801
212.498.6000

Atlanta, GA
3560 Lenox Road, Suite 3000
Atlanta, GA, 30326
404.443.2700

Washington, DC
900 17th Street NW, Suite 603
Washington, DC 20006
202.719.3000

Boston, MA
99 High Street, Floor 17
Boston, MA 02110
617.375.3300

Salt Lake City, UT
2603 East Parleys Way
Salt Lake City, UT 84109
801.736.9950

[1] Index pricing information does not reflect dividend income, withholding taxes, commissions, or fees that would be incurred by an investor pursuing the index return.

[2] The Russell 2000® Index is a registered trademark of the Russell Investment Group. Russell Investment Group is the owner of the copyright relating to this index and is the source of its performance value.