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4 FORECASTS, 3 THEMES & 3 REACTIONS FOR **Apocalypse**

Apocalypse is originally a Greek word meaning "revelation". It seems fitting to use it for our most recent edition of The Mercurial Investor, the trade situation continues to impact markets and on that front China, one of the biggest foreign creditors to the U.S. Government with an investment in treasuries that are in excess of \$1.2 Trillion, sold a whopping \$120 billion in U.S. paper with maturities exceeding twelve months.

In another turn of event the Trump White House announced the United States will implement tariffs on Mexico due to the alleged border crisis. This increases the trade disruption and adds significant pressure with the still open U.S.-China trade war and with an already fragile global growth could provoke a global retraction for most markets.

Apocalypse is quite proper to describe the current situation with China, Even though President Trump is correct in his assessment of the situation the situation will get much more complex. With the latest move from China to defend itself from the pressure the U.S. has made with implementing a new round of tariffs. We can report that for the fourth week in a row most stocks have lost value. The doubling down of the trade war and increased political tensions with trade partners is creating increased volatility and an overall market

sentiment. The month of May provided a significant loss in value most stocks, creating investment opportunities and on the flip side it made bonds rally and this combination is optimal for those portfolios that are balanced. U.S. and global yields declined, with the 10-year Treasury ending at 2.13%, the lowest level in 21 months, and German yields dipping further into negative territory. Market volatility tends to rise during times of greater uncertainty when expectations are changing. Owning the right mix of stocks and bonds based on your comfort with volatility and goals can help you keep a long-term term perspective and stay invested during pullbacks.

Forecast 1: U.S. Tramples on trade Markets to Suffer Impact:

The U.S, Mexico and Canada reached a trade agreement that would allow their previously implemented tariffs on steel and aluminum exports to the U.S. to be pared back. It is noted that the heavy hand of political wrestling that was involved in this tariff elimination was part of proposals lawmakers made to vote on the U.S.-Mexico-Canada Agreement, known as the USMCA. It would not be surprising if the U.S. implements quotas on Mexican and Canadian exports. In a statement at an event last Friday, Trump said, "Hopefully, Congress will approve the USMCA quickly."

This deal lifts tariffs of 25 percent on steel and 10 percent on aluminum that the U.S. implemented on both Mexico and Canada more than a year ago. As for the renewed U.S.-China trade war, it is noted that President Trump is indeed correct to rekindle the tariff war with the Asian nation because it reneged on a deal that would have implemented a permanent tariff system between the two countries.

The impact on China will be higher if all its exports to the U.S. are taxed at 25 percent. The U.S. exported nearly \$120 billion in goods to China in 2018 and China sold \$540 billion in products to the U.S. According to a recent economic poll, the overall impact of China's gross domestic product (GDP) is said to be between 1.2 percent and 1.4 percent, which will create havoc for the Chinese economy.

President Trump decided to escalate the trade war on the very same weekend of Beijing's 100th anniversary.

Dow to lose 700+ during U.S.-China trade war below the timeline:

- March 2018
Round 1: Tariffs on steel & aluminum imports announced on multiple countries; Dow falls 491 points.

Round 2: Steel & aluminum tariffs implemented; Dow falls 1,150 points.

- June 2018

Round 3: Tariff exemptions eliminated for EU, Canada and Mexico. EU and Canada announce tariffs on commodities and consumer goods; Dow falls 973 points.

- May 2019

Round 4: New tariffs on \$200 billion in China imports were being implemented; the Dow falls 1,180 points.

Round 5: Mexico threaten with the imposition of tariffs, markets tanked. The markets have been down this road before as they react to the news, with many 10 percent corrections and too many market retractions to count. These are times of investment opportunities.

Forecast 2: The Measure of Success & Failure of President Trump: Will Trump Be Impeached?

When Gallup asked American voters what they hoped for a President of the United States, their top five responses were:

- Honesty
- Consistency
- Morally Sound
- Good Judgment
- Experience

It's quite telling that more than 85 percent of U.S. voters place honesty, consistency and morally sound ahead of good judgment and experience. We also note that on this list of qualities a U.S. President should have we could not find other highly used political arts that include:

- Deception
- Flip-Flopping
- Hypocrisy
- Lying
- Action out of Self Interest instead of the public good.

Experts before President Trump was elected thought that any candidate could not identify with any of the good traits above would not make it past the Iowa

Caucus, Obviously President Trump and his phenomenon changed that. President Trump had laid out his plan during a speech at Gettysburg that spelled out his plans of action, our goal is to review his plans versus his accomplishments.

- **Propose a Constitutional Amendment to impose term limits on all members of Congress:** Republican Sens. Cruz, Rubio and others, proposed a Constitutional amendment that would impose term limits, with no success.
- **A hiring freeze on all federal employees:** Implemented and shortly eliminated.
- **A requirement that for every new federal regulation, two existing regulations must be eliminated:** President Trump signed on January 30, 2017 an executive order requiring that for every new federal regulation implemented, two must be rescinded.
- **Renegotiate NAFTA-** Done a new trade deal was agreed is now call USMCA, but not been ratified by Congress and President Trump is imposing tariffs to Mexico due to the migration situation.
- **Withdraw from the Trans-Pacific Partnership-** Done
- **Infrastructure Investment- the proposal to invest \$1 trillion in rebuilding the nation's infrastructure over the next 10 years-**Being negotiated with Congress, depends in bi-partisan support.
- **Repeal the Affordable Care Act (Obamacare)-** Attempted but failed.
- **Regulatory Reform-** President Trump ordered to reduce regulations by 75%.
- **Tax reform-** the tax reform became law in December of 2017 with the tax cuts have increased economic growth with GDP growing at 3.0%, increased job creation and reduced unemployment to historic levels.

- As you can see a lot of what the President had planned to implement has indeed happened, and it has allowed for the U.S. Economy to grow and prosper. As we note by comparing the movement in all these variables, at first glance, it seems that the President is doing an excellent job regarding the economic metrics that are used to judge how the U.S. Economy is performing. Also, when we compare our economic benchmarks during his tenure, we not that of 13 benchmarks only 3 are worse than when he took office. See Table below.

On the negative side, most experts agree that most of the President's challenges have been self-inflicted, below our top five:

- **Use of his Twitter Account-** He continues to overshadow his policy achievements, by tweeting over mundane and even Byzantine and divisive topics.
- **The U.S. image and influence abroad are at their lowest levels.**
- **Failure to accept climate change-** backing out from the Paris climate agreement is generally seen as a significant misstep.
- **Little effort to seek Bi-Partisanship-** For a President that boasted his abilities as a negotiator and deal magician, it seems odd that he would only focus on the Republicans and not seek to unite the Country.
- **Not Understanding his role as President-** It seems to most that The President lacks an understanding as to how to approach his job and the power that comes with it.

Small issues have eroded his standing as a world leader. Investors may be pleased with the President and, regarding economic performance, most conclude it was a great year for the economy, however regarding image,

U.S. Economic Benchmarks			
President Trumps Benchmarks	May-19	Jan-17	Change
Price Per Gallon Regular Gasoline	\$2.93	\$2.44	20.3%
Dow Jones Industrial Average	25,776	19,819	30.1%
Nasdaq	7,628	5,561	37.2%
S & P 500	2,822	2,271	24.3%
Unemployment	3.60%	4.70%	-23.4%
Average GDP Growth Rate in office	2.80%	1.78%	64%
Labor-force participation rate	63.00%	62.70%	0.5%
Home ownership rate	64.80%	62.90%	3.0%
Median household income	\$63,688	\$58,221	9.4%
National debt	\$22,028,706,063,175	\$19,962,644,407,252	10.3%
Credit Ratings	S&P (AA+), Moody's (AAA), Fitch (AAA)	S&P (AA+), Moody's (AAA), Fitch (AAA)	Unchanged
Access to markets	Full Access	Full Access	Unchanged
Approval Rating	41.2	46	-10.43%

policy, perception, and approval most Americans find that he has his work cut out for him.

Forecast 3: The End of Easy Warren Buffett Metric Calls for a Market Crash:

Without any reservation, Warren Buffett and Berkshire Hathaway are probably the best value investing guru's in the market. Mr. Buffett has often used what is referred to as the Buffett Indicator." The Buffett indicator is a metric used to measure the overall health and valuation of U.S. Stocks and like all things Buffett is simply a calculation of the total market capitalization of all U.S. public stocks by the most recent Gross Domestic Product (GDP). As a matter of historical reference, the Buffett indicator surpassed 145% just prior to the dot.com bubble burst, and it reached 110% the week prior to the financial crisis. One must not confuse that the Buffett indicator is a signal that stocks are cheap, and they may get even less expensive, just as it happened during the financial crisis or the dot.com burst. Currently, the Buffet Rule is at 136%, which indicates levels that we higher than the dot.com burst and just below the financial crisis.

However, before jumping to any conclusion, we must consider what has changed, for one the Tax Reform of

2017 has provided companies with a lower tax rate and that translates into increased valuations. What the Buffett indicator is signaling is that the U.S. stocks are mostly expensive and to that point, we have not seen Berkshire make any significant acquisitions lately.

In summary, we must be mindful of the Buffett indicator as it is telling us most stocks have not been as high or near their high as right now. So indeed, a correction may be approaching.

Forecast 4: Government Retirees to lose 15% of their pensions, If not more:

This Financial Oversight and Management Board (FOMB) issued a letter to the Secretary of Justice Wanda Vazquez pension PayGo fees and employee contributions owed by municipalities and public corporations to the central government for the payment of retiree pension benefits.

The central government for decades has mismanaged the Puerto Rico Pension funds, and as the government went bankrupt, the FOMB and the Government implemented a Pension PayGo system to ensure adequate funding of pensions. According to the FOMB maintaining funding of pension benefits for all retirees is one of their highest priorities. Even though the government claims transparency and compliance, the evidence shows

otherwise. Two practices continue to impact the Pension system:

- The method of not transferring the employee contributions that are required by law to be set aside.
- The failure of many municipalities and public corporations to remit their required monthly PayGo fees.

The FOMB found that there are \$340 million in accrued debt from 28 public corporations and 66 municipalities since the implementation of the PayGo system in 2017. This shortfall includes both failures by municipalities and public corporations to make the required PayGo charge as well as failures to remit individual employee payroll withholdings.

Among the accrued debts due to the central government are:

- San Juan \$72 mm
- PRASA \$67 mm
- Ports Authority \$31 mm
- State Insurance Fund \$24 mm
- Ponce \$10 mm
- Carolina \$8 mm
- Toa Baja \$6 mm

If Puerto Rico is to correct its imprudent fiscal actions, situations, as keeping the money to be paid for retirees and using it for other matters, is irresponsible and it will impact their respective pension benefits to the probable tune of 15% or less in loss of benefits.

Theme 1: Special Counsel Robert Muller does not Clear President Trump:

Robert S. Mueller III, the special counsel, during a much-expected press conference, stated that in the conclusion of this two-year office investigation of Russia's interference in the 2016 presidential election. Muller stated, "If we had had confidence that the president clearly did not commit a crime, we would have said so," Special Council Mueller also mentioned that the

Department of Justice policy prohibits charging a sitting President of the U.S. with a crime.



However, he did mention that the U.S. Constitution grants Congress other rights to rightly accuse a president of a crime, in a direct reference towards an impeachment process.

Theme 2: Brexit & Theresa May

Brexit has claimed the office of another British Prime Minister Ms. Theresa May as she could not rally the support needed to pass the latest version of the Brexit Bill which was rejected by parliament three times.

Brexit is the withdrawal of the United Kingdom from the European Union. This situation created by former Prime Minister David Cameron which even though had

campaigned to remain in the European Union, he called for the referendum to fulfill a campaign promise made during the 2015 elections. The election held on June 23, 2016, in which 51.9 percent of the vote supported leaving the EU and thus forcing Brexit.

For Britain, the decision has created a loss of wealth in the country, and the per capita income will be significantly reduced in the near term. Brexit will also cause the eventual breakup of the United Kingdom as Ireland and Scotland will probably decide to leave the UK to return to the EU and its benefits.

I am sure 66,040,229 million British citizens will regret ever embarking into Brexit.

Theme 3: Trade War Escalated & Global Stocks Impacted: The trade situation continues to impact markets and on that front China, one of the biggest foreign creditors to the U.S. Government with an investment in treasuries that are in excess of \$1.2 Trillion, sold a whopping \$120 billion in U.S. paper with maturities exceeding twelve months. This is the latest move from China to defend itself from the pressure the U.S. has made with implementing a new round of tariffs. We have often worry that since China is such a large owner of U.S. Treasuries if it

decided to sell all its \$1.2 trillion holdings it would create a vast financial instability to the market and that will impact global markets in a very tangible way. After last week's 600-point drop. The Dow Jones Industrial Average closed the month at 24,815.04, a loss of 1,777,087, or -6.69 percent, and the S&P 500 closed at 2,752.06, with a loss of 193.77, or -6.58 percent, and The Nasdaq closed at 7,453.15, a loss of 642.29, or -7.93 percent. Meanwhile, the U.S. Treasury's 10-year note fell to 2.14 percent a loss in yield of -6.93% for the week.

As for the rest of Wall Street, we continue to review the weeks most active NYSE traded stocks.

New York Stock Exchange Most Active

1. **Advanced Micro Devices \$27.41**
2. **Credit Suisse AG \$25.75**
3. **Sirius XM \$5.31**
4. **Apple \$175.07**
5. **Intel \$44.05**
6. **Microsoft \$123.68**
7. **Nutanix \$28.07**
8. **Comcast \$41**
9. **Marvell Technology \$22.30**
10. **Cisco Systems \$52.0**

Market Close Comparison	5/30/2019	4/30/2019	Change
Dow Jones Industrial Average	24,815.04	26,592.91	-6.69%
Standard & Poors 500	2,752.06	2,945.83	-6.58%
Nasdaq	7,453.15	8,095.39	-7.93%
U.S. Treasury 10 Year Note	2.15%	2.31%	-6.93%



CPA Cesar Hernández-Monagas, Principal, Birling Capital

On May 14, 2019, Governor Ricardo Rossello signed a new law to create the "Ley de Desarrollo de Zonas de Oportunidad de Desarrollo Económico de Puerto Rico de 2019", to promote incentives and a regulatory environment favorable for establishing in Puerto Rico qualified opportunity zones; and for other related purposes. The "Tax Cuts and Jobs Act of 2017" ("Federal Tax Reform"), introduced a series of changes to federal tax legislation. One of the changes is the creation of Qualified Opportunity Zones ("Zonas de Oportunidad Cualificadas"). Under the modality of qualified opportunity zones, investors may defer the

taxation of capital gains because of the sale of an asset, carried out before January 1, 2027, if they invest an amount equal to the profit made in a Qualified Opportunity Fund.

An opportunity zone, in general, must have a population census that qualifies as a low-income community. To qualify as a low-income community, the corresponding population census cannot have a poverty level of less than 20%, nor an average household income exceeding 80% of the average state or metropolitan area income.

The process of designating the opportunity zones took place at the beginning of 201

8 and included a nomination process by the states and the territories. In the case of Puerto Rico, all low-income communities have been automatically designated as qualified opportunity zones. Also, 26 other population censuses that did not qualify under the definition of a low-income community were designated. In total, approximately 95% of Puerto Rico is considered a qualified opportunity zone under the federal parameters.

One of the essential points that were the subject of analysis for this federal law is that the contributory benefit of the zones of opportunity is limited to the tax rules at the national level. The effect of federal legislation has been to create competition between states and territories. For this reason, states are being aggressive in establishing the contributory, regulatory, and economic framework that is the most attractive for a qualified opportunity fund.

Faced with the reality that Puerto Rico is going to be competing with other states to be an investment destination, this incentive legislation is approved for qualified opportunity funds to invest in priority projects in zones of opportunity, and that is not sheltered under laws of incentives in force.

To achieve these objectives, this measure proposes an incentive framework for a period of 15 years. The proposal is similar to the incentives offered by other incentive laws, with the following particularities:

- 1. A contribution of 18.5% on the net income of an exempted business.**
- 2. Exemption in the taxation of dividends.**
- 3. 25% patent exemption and property taxes.**
- 4. 25% exemption from construction fees.**
- 5. Maximum investment credit of 25% that is transferable.**
- 6. A priority credit system for priority projects in areas of opportunity.**
- 7. Deferred taxation of capital gains for earnings invested in a qualified opportunity fund in Puerto Rico Under standards similar to those approved in federal law.**
- 8. Contributory exemption for interest earned on loans to exempt businesses.**
- 9. A quick procedure for the evaluation and issuance of permits for exempted businesses and projects agreed upon in an alliance contract under Law 29-2009, as amended.**

In the light of the compelling interests involved, a particular procedure is established for the efficient and expeditious processing of permits for priority projects in areas of opportunity which, although with more abbreviated terms procedurally, ensures that applicable substantive legal requirements are fully complied with. Under this particular procedure, government agencies with interference in the processing of permits, licenses, franchises, consultations or certifications for priority projects in areas of opportunity shall be governed by the provisions of This law. The substantive requirements applicable to the permit shall be those established by the law or regulation governing the permit.

There are already multiple funds that include Puerto Rico in its investment strategy under this program, and the government estimates that some \$600 million will be attracted.

Projects that are being evaluated by these funds include housing developments, infrastructure projects, small business development, real estate, energy projects, mixed-use developments, and hotel development.

In Birling Capital, we can provide you with additional information on this topic.

The Final Word: Who is on First and What's on Second

On the 100-mile by 35-mile island of Puerto Rico, we disagree about a variety of issues, including status, race, environment, healthcare, trade, public policy, municipalities, equality, political parties, candidates and our leaders.

Most people express their views in the nearby "cafetín," bar, church, workplace, newspaper, radio and the most favored, on social media. On social media, we see a Puerto Rico that has turned both hurtful and virulent with personal rants that have become embittering to a pulp.

One thing no one disagrees with is that we all want a bright future for Puerto Rico, and we all would like to see the island thrive and prosper. For once, we would like to see debates not based on not knowing the facts or a misunderstanding; we want to see disagreements that develop from a complete comprehension, from having thought about and examined the ideas from those

having different points of view. If you must disagree with someone, you must first thoroughly understand the subject matter, you must read, research, listen, and observe. As we continue to disagree, we must provide those whose ideas we do not favor moral respect, sympathize with their motives, and line of reasoning. We must always keep an open mind for an opportunity to be persuaded by the other person's line of thinking.

As Puerto Ricans have closed their minds to other people's opinions, this phenomenon has had an impact on all colors, races, social statuses, professions, and even our leaders. In my view, when we intelligently disagree, it means we are all thinking and evaluating other points of view. I was brought up to believe that where there is intelligent disagreement, there is the lifeblood of any developing society.

As we continue to witness the bickering with the government, Legislature, municipalities and overall society on one side with the Financial Oversight & Management Board (FOMB) on another hand, we wonder if those doing the opposing have stopped to think for an instant.

- **Who caused Puerto Rico's bankruptcy?**
- **Why does the FOMB exist?**
- **Why does Puerto Rico's central government owe \$340 million to the PayGo pensions and then doubles down and says it will pick up the tab for municipal pensions?**
- **Why does the government not pay its water or electric bills?**
- **Why are more than 50 municipalities in deficit?**
- **Why do we have two bankrupt monopolies with the P.R. Electric Power and Aqueduct & Sewer authorities?**
- **How will Puerto Rico's so-called economic improvement look when we begin to pay our bonded debt?**

When did the "dying art of disagreement" die in Puerto Rico? Probably two generations ago.

When governors, senators, representatives, mayors and any other elected official view their election as a permanent job, and not as an opportunity to serve the greater good.

- **It died when the right sound bite was better than telling the truth to the people.**
- **It died when we gave away Section 936 for nothing, forever exposing the fragility of our economic model to advance an ideal.**
- **It died when we stopped respecting our governors, senators, representatives and mayors, and vice versa.**

As our population dwindles from its high of 3.79 million in 2002 to 3.1 million people in 2018, any politician must wonder how their collective policies have made 690,000 Puerto Ricans leave their country in 16 years.

"I don't think you can put a monetary value on the damage that our political class has done to three generations of Puerto Ricans." We hope that you have enjoyed the last issue of The Mercurial Investor © and we very much welcome your comments, thoughts, and ideas; you may reach us at frc@birlingcapital.com or 787-247-2500.



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