Remarks from Jon Woloshin, UBS Wealth Chief Information Officer
Appalachian Hardwood Manufacturers, Inc. Annual Meeting 2/23/19

Being in Fort Lauderdale makes me think of college. This is where people came on spring break and I was thinking back to when I was a freshman in college. I took a class in a large stadium type of hall the old stadium seating, and it was during our final exam, which took three hours. The professor had a lectern similar to this. He said you have three hours to work so bring all your blue books, you remember blue books back in the day. In three hours, I want all your blue books here if they are not here in three hours I will not take it. So at the end of the class, he said everybody put down your pencils and turn in the books. One kid just keeps writing, and the Professor says three hours, let's go. He doesn't flinch. Professor says,I'm not taking your exam, you fail. Now our finals were easily 50% of our grade. This was serious business. So the kid walks down to the big pile of blue books and the professor is standing there.

He motions to the kid and says I told you I'm not accepting your exam and the kid pulled his shoulders back and says, any idea who I am? Professor says no and quite frankly I don't care. The kid shoved his paper into the pile of papers. What is the moral of that story? And I think it goes to something, and Stephanie said this in her presentation, she said two things that really intrigued me, she used the phrase "lack of understanding" and "social media," those two things have a lot in common and the moral of that story is lack of information and lack of understanding can really get you heard. And in my world doing economic research on companies, a lack of understanding can cost our clients a lot. And so I know there's a lot of things that are important to your business, not the least of which of what's going on in the world.

And I will tell you, oh, let me start with what our view of where this is going to go. And then we'll sort of our base our case, we will not have the trade war with China, now again, we live in a world of tweets, which I wish we didn't, I'm not exactly what we call a social media expert, but I recognize this is a reality of the world that we live in. You can take away the soundbites and tweets the snippets and frankly the biases that are out there. Let's come and look at what we think is a reality. Well, number one, the vice premier of China is going to be meeting with President Trump and his advisors and my understanding is the President of China gave him special envoy status. Now we'll see. Time will tell whether that means anything or not.

The bottom line is he can speak for the government of China. That's number one. Number two, this is a much more complex calculus. I can't tell you the number of times I hear from people who say China holds all the cards. No, they don't, this is what I hear all the time, well China holds roughly a trillion dollars of our debt, therefore they can do whatever they want. Uh, first of all I think, I believe it's Donald Trump, before he was president, was credited with this phrase. You owe the bank $100, you have a problem. You owe the Bank a million dollars they have a problem. I don't know if he said it, but I always loved that line. The point being that a $1 trillion even by Washington standards is a lot of money. And so I recognize certainly that any government that holds that much of our money, we're dependent on foreign governments to supply our debt. It is not a one way street.

Now I'm not saying we would ever default on our debt, but in some cases it's in the back of our mind, but a little bit beyond that. Look at this economy. Uh, you know, China has been a controlled economy. It's not a free trade economy like our's and many others. But the bottom line is the amount of debt outstanding in China at the corporate level, the personal level or government level, the debt to ratio in China is 160%. Contrast that to this country. It's about a hundred percent. So China's got some serious issues. Growth is slowing in China. Their real estate market is, I don't want to tell you, it's in the same shape our's was in 2007-2008 but there are a lot of issues there. The short answer is this. It is in China's interest as well as in our interest to get this sorted out.

I'm not going to tell you it's not going to be without i'ts bumps, not without it's headlines. And Lord knows the president needs to put the Twitter away but he won't. So I mean in our business, I mean every day we wake up and my colleague that covers the industrial companies, he's like, I don't know, today we're going to solve this or not. In the stocks you are moving around the plate. The bottom line is you filter out the noise and that's one of our jobs as analysts and strategists is to filter out the noise. It's hard and Lord knows that you guys live this every day in your world. But understand the filter out the noise. The other thing is don't underestimate this. The president needs and wants a win here. We're now in the 2020 election cycle. A lot of you here in the room as my kids like to call are seasoned.

So we actually see some people that have seen a lot of election cycles. The politics in this country are unfortunately very, very polarized. Uh, it is what it is. I don't like it. And I'm sure most of us don't like it. So the bottom line here, the president, we are smack in the middle of the 2020 election cycle and the president needs a win. So ultimately we believe this will get sorted out. We're not particularly worried about the March 1 deadline because we have a high rate of confidence if no deal struck that will get extended. Now I understand there are some tariffs are already in place. I also understand and I recognize the Chinese currency, it's not a freely floating currency. So the bottom line here is that there were some things that are unfair. I know the President took a lot of grief for calling the Chinese a currency manipulator.

Well, I won't use that word, particularly. When you don't have a freely floating currency it's not a completely level playing field. The other thing I will tell you, is I talked to a lot of CEOs as do all my colleagues, and again, this is not a finger pointing exercise. It's facts, uh, intellectual property and intellectual property theft. It's been going on forever. I met with a couple of semi-conductor manufacturers a couple of months ago and they told me that their technology is stolen all the time. So there's a real serious issues out there that I hope we get sorted out. But I think the key takeaway that I like to leave with all of you is that we do believe this will get sorted out and it's in everybody's interest to do that. What's the economic scenario? What is the end product? You know, the sale at the end is a demand driver for you guys.

Let me start with what our economic outlook is and I'm going to go back to something. Jamie Dimon, who Chairman and CEO of JPMorgan said on their fourth quarter earnings call. He said, if we're not careful, we're going to talk ourselves into a recession. And we thought it was a really, really interesting comment because when I look back and I think it's unarguable that economic activity as measured by gross domestic product or GDP, it slow, I don't think anybody would argue with that. I been doing this, this is my 34th year, and it seems they always tell us we're supposed to be the smartest people in the room. I listened to my colleagues out there, on Wall Street, and if something's not doing this, they think it's doing this, which is rarely the case.

And so the bottom line is the economy slowing? The answer is yes. I don't think anybody would argue with that. And we've had a very, very robust recovery, especially unde President Trump. We've had a very, very long expansion starting in basically late, you know, late 2009 early 2010. But don't, don't confuse just because were in a long expansion, it has to end. We will slow, the answer's yes. It's slowing in China, slowing in Europe, and it's slowing here, but we're still looking at in our predictions.

GDP growth going from about 2.9% in 2018 maybe the mid twos this year. Our best judgment for 2020 today around 2% corporate earnings growth and we measure corporate earnings growth based on the Standard & Poor's 500 versus just a large index and stops. Last year, 2018, 23% growth, obviously an eye popping number. Don't forget, we had the tax bill that passed in late 2017 so everybody says, well this year, obviously it has to be down.

No it doesn't. Our view, depending on whether we have a trade war with China, which we said, we don't believe we do. But in the event that we do our view is we have a trade war then corporate growth at 4%; if we don't we have growth at 6%. Now 6% growth anywhere else in the world is great. When you compare it to 23% of course, all the claws come out and say the economy's going to hell in a hand-basket. Again, something we would certainly disagree with. So the bottom line is overall, we do not see a recession, that's our view. The consumer, we've been hearing, let me see, I think I've been hearing for the last 4 years that the consumer is tapped out. One thing I've to learned, I've covered a lot of sectors in my career, covering the real estate world, they covered the retail real estate holders as well.

Uh, never underestimate the ability of the American consumer to consumer. The bottom line is that and you will consume, now we hear about debt levels with consumers. Yes, debt levels are or high, but debt service levels, i.e. interest rates are low at a 40 year low, that's number one. Number two, obviously the job markets are issue number three. Household net worth in this country is $100 trillion. That's a lot of money. That's up 50% since 2010 and the last one, and I think this really goes to the heart of what ultimately you can crop a lot of year end products. Homeowners just sitting on $6 trillion of tappable home equity. Now we're not saying it's all going to go into home equity loans, but the bottom line here is when I talk to my colleagues who cover the home improvement companies. We CPT demand for a lot of home improvement.

Obviously a lot of that's going to go into privacy, utilizing what you guys put together. So bottom line is, we think the consumer remains in very, very good shape here.

Interest rates, this is one of the most often debated topics and I will tell you if anybody who tells you they know where interest rates are going to be two, three, four or five years from now, please run at top speed the other direction because none of us know the answer to that question. But the key is, and this is what I found particularly interesting. As you know, I think Stephanie said that she's a good at reading human nature and body language. I do love to study human nature and I finally figured out that Undergrad degree in psychology and finally came in some value here in life.

But people, you know, they talk about the stock market being a forward looking discounting mechanisms. But I find it at the end of the day, the stock market is not composed of numbers. It's composed of people. And people are human beings and people have human emotions. And so when President Trump got elected, and when we talked about interest rates, we talked about the 10-year treasury. That's how we think of interest rates. Take your treasury rate was 2.6% when President Trump-Pence is elected, which I think surprised everybody, including President Trump by the way. And all of a sudden everybody said, we're going to have this massive pro growth agenda, which largely we've had. The capital is right down the line.

The housing market's finished. By the way, I'm not going to talk about housing. It's not finished, but I'll come back to that. And we sat there and said, let's look at facts. And again, what is our job as analysts and strategists look at data income to the best technical conclusions and objective conclusions. And so when we looked at the data, we said the economy is good, but is clearly slowing. The Federal Reserve, and I think the biggest difference between Janet Yellen, the prior chairman of the Federal Reserve and the current one Jerome Powell, Janet Yellen I thought, you know, to the attempt that any of these Fed speakers to speak anything that's remotely English to the rest of us was fairly clear in saying we will be data dependent where Jerome Powell was more, you know what, I'm going to sort of step on the gas here in terms of raising rates and we all scratch our heads a little bit and said, why didn't you do that?

So finally Chairman Powell and his last public continence that we're going to be data dependent and we're not just going to be off autopilot. Hallelujah, thank God. So what does that say to us? What it says to us as the Fed understands the economy is in relatively good shape, but it is slowing. So we've traveled with, that's how to think about interest rates and obviously the ultimate impact of the economy. We did, we're on a lower for longer environment. Again, just so you don't think I'm contradicting myself. None of us know what interest will be three, five, seven, 10 years from now and as a real estate analyst and investor, obviously I want to know that, but the point being that we don't think when they're running away interest rate inflation. Our chief interest rates strategists thinks the ten year treasury over the next 12 to 18 months, will trade at 2.7 and 3.2%. Think about that based on historical rates.

Again, unfortunately some of us are old enough to remember those fantastic interest rates in 1980s, forgetting that because those are obviously horrible. The point is it's been lower for longer and that's going to be very positive for consumer demand. Could be very positive for housing. Could be very positive for commercial real estate, all things near and dear to my heart and ultimately for driving demand for your products. We'll be talking about housing a little bit. I've been covering the housing market for a long time. It's a cyclical industry. I don't think I'm telling you anything you don't know, but I can't tell you the number of articles that I've read in the last six months that says this is 2008 all over again. Housing. Nothing could be further from the truth. Now I submit to you and I did not bring slides today, I can give you reams of data that will show you why, but I'll just give you some of the highlights.

They always say in our business never say it's different this time, but every cycle has its differences. This is just history. Never perfectly repeats, but it does rhyme. But what are some of the biggest differences? What do you think about the underwriting or lack of underwriting? And one in terms of mortgages. If anybody saw the movie or read the book, The Big Short that, I mean that really encapsulated the craziness that went on. Steve Carell played one of the guys who figured this out, and he's in an exotic dance club to be charitable. And he's talking to one of the dancers. She said you know I own six condos. That's what's we're talking about. What was wrong? You're just giving money to anybody, literally with a pulse. And I heard the CEO of the home building say, we'll sign up anybody with a pulse I literally heard that on the conference call.

Those days are over. Thank God. So the quality of underwriting, the quality of borrowing is much better. The home builders, they have gotten religion. Uh, now you may say, well that's not great for us. They're still building. They're still building specs. They're much more production building than building specs. The point is they are not building to access. They understand their balance sheets better, they're being much more thoughtful and buyers should be much more thoughtful. So I look at things like delinquency rates, foreclosure rates, whether it's 30-day delinquency, 90 day delinquency. These numbers are near all time lows. So the bottom line is the market is in much better shape. That said, is it perfect? No. Let me come back to the tax bill a minute.

We have some issues. There's affordability issues and a lot of markets. You know I live in New York. A lot of affordability issues. Cause what we have here is just, there's no such thing as a national housing market. But if you look at home prices nationally, since the recovery started compressing the wages had done this, you don't have to have an economics that's not sustainable long term. So when we do it every year, we do a year ahead outlook for our different sectors. And I said I think housing will still be to the upside. And what I meant by that was I think single family housing starts, will continue to improve, albeit at a slow pace. We're running about 850,000-860,000 single family starts today. I think that number will slowly increase. I'm not in the camp of a million and million and a half and I'm definitely not in that camp because you know there are some issues out there and there's a demographic issues. I'll talk about the multi-family market.

I'm incredibly bullish on the mult-ifamily market and I will come back and talk about that. And I think prices again nationally will creep up. It kind of goes to what we call mean reversion, but a long term averages and maybe 2-3%. We can't have home prices going up 6-7% that's just not sustainable. There are some markets who'll have challenges. Coastal California, Seattle, very, very expensive markets. Those would likely see challenges. I was just in Denver this past week, the housing market is doing great. Uh, what's that have in common, job creation. We had good job creation and we had good wage growth and we still have a lot of issues here. So, you know, it was never good to talk about politics with clients, but you can't escape it because it's reality.

I think some of the president's a pro growth agenda certainly is going to be stymied by the amount of Democrats in Congress. There's a lot any president can do with regulatory relief, the executive order. And we think the president certainly will take advantage of that. But none this we don't think will overheat the economy, which is positive. So net in housing, we're still constructed, no pun intended, we are constructed by housing, albeit at a slower pace. Now I know a lot of people got up yesterday, with the existing home sales numbers and they were below 5 million. It was like 4.998 million. I can't tell you that the trillions of dollars to trade on one data point. And I will tell you that when I, when I was taught this business a long time ago, there's something called the mosaic theory, which is what is the mosaic?

It's just like these seemingly unconnected data points and you connect all these dots in forms like a mosaic. That's what doing research and investing is. It's not one data point. And so when I sit and literally like the employment, however it comes out once a month and literally they are breathless, oh my God, and the number was x. Seriously, there is nobody out there going one, two, three, four, five. It's not happening. So I always beg clients, please turn the television set off. But any of this stuff does go on. But if we're going to look at and be objectively honest about this, it's a whole mosaic and we have to put together so when we look at it and we think housing will be okay. Slower than it was, should surprise anybody but rolling over 2008 absolutely not.

Commercial real estate. I get this question all the time. Everybody wants a baseball analogy because I'm in Florida is spring training. I'm not a baseball guy. I'm a football guy. But everybody said, what inning are we in? I'll ask the question. I don't think it's the right question to ask. Top of the Ninth. And when I say that to clients and the phones start coming out and sell. Sell, sell. No, please don't do that, absolutely not. The question I believe people should ask is, can we go to extra innings? You answer, I believe is yes. Largely it comes down to two things. Interest rates, which we've talked about and I think there should be lower for longer. The other one is capital. There is the amount of capital is out there. Private equity loan to sitting on $300 billion of dry powder to buy commercial real estate and that's just private equity global. You start to add up all the other institutional buyers and forget the individuals like you and me would make the other institutions.

You're after $1 trillion and that's before leverage bottom line years. There is a longer cycle here. What I believe is it going to be a particular interest to your world is multifamily. I've been really bullish and multifamily for a lot of years and a lot of it has to do with the demographic composition of the country and one of the things in the work that I do is trying to figure out where people go and why. Because you know real estate is a hyper local business and so understanding where people are leaving, like we're in New York where I live people were leaving in droves, you couldn't keep driving businesses away. That's a different kettle of fish. But it's also where they going and why. And so I think a lot about that. So I do a lot of demographic work in my research. And what is the biggest portion of the population? It's the millennials.

There's about 86 million people to the ages of 18 and 34. So if you think about that, and I have two of them at home, one of them you just got out of the house, Yay me. How the other one's graduating college in May. So I finally got a little bit of a raise coming. Uh, if you think about what they're faced with, very different from when I came out of Grad School in 84, they live in a globally different world and they are faced with opportunities and challenges that most of us never saw. So what does this mean for them that not only do take want, but they need more flexibility in their lives. They value experience. And again, there's no such thing as a monolith. They value experience over stuff. If I look at the trends, I mean one of the big trends out there is micro apartments, 300 square foot apartments and that'd be an anathema to most of us in this room.

My son just moved into Manhattan. He shared 950 square feet with two other guys. They turned up a large one bathroom, three bedroom, probably not for me but he's having the time of his life. He loves it there. So if you think about kind of what they need, what they want, and sort of what their lifestyles are, it's just different. The other thing is, and this is just an unfortunate reality, is they go back to what you mentioned about does everyone need to go to college? But I haven't had enough discussion for years. There's a trillion and a half dollars of student debt outstanding. That is a lot of money. That number was $230 billion in 2003 think about that for a second. So if I think about all those things that, not that I expected it to be to study the intricacies of mortgage lending, but I have to do it in my work.

It's not really complicated to get down to if somebody has a $300 a month student loan payment, just thinking about average household income in the country, average home prices. Most of these people can't afford to buy a house and they can't qualify for a mortgage and they can't save for a down payment. So if I take that and I layer on one other aspect, the retiring boomers, many of retirement boomer have realized the millennials are onto something. This is kind of self-contained work-life-play balance and having everything where things are walkable in real estate. There's a lot of focus now on walkability and so they're realizing living downtown Denver is a perfect example where I just was, there's a ton of high-rise buildings in downtown Denver. A lot of them being occupied, not by millennials, but by us who are saying, I don't need that big suburban house anymore.

So I think what you've got here for a lot of reasons, some by desire or some by necessity, there's going to be a really good runway here in multifamily. So that's going to be, you know, structural demand for your product. It's going to be what goes up. Your products go into end products that people put in their places. So I think the bottom line is if I look at growth housing are looking at multifamily, I think there's a very, very good demand going forward that ultimately will be good for your business. One thing that you do need to think about, and I mentioned it earlier about the upcoming election, they were sitting there, we're talking about politics, it's unavoidable. It is what it is. So we're sitting here and as I mentioned earlier, it's one of the most polarized.

Short of Vietnam, I can't remember a country being this polarized. It's unfortunate. But you know, again, our job is, is to not judge. Our job is to understand the environment and give the best advice we can to our clients. So as we look forward to 2020, and 2020 at some level's a long way away and on some level will be here before we know it, we have to go through what we call scenario analysis. And right now we have a divided congress and a Republican in the White House. So these are what ifs because I would just encourage you, one of the things we always do, because a lot of what we do is trying to think about the future and kind of plan in for it or what happens if, so what happens if we get a situation where we have status quo, then odds are we'll move forward.

And that's fine. What happens if we get a Democratic president, Democrat House, the Republicans keep the Senate. What happens if the Democrats take all three? Because this is the scenario that a lot of people from just pure economic, leaving outside of everything else, and economic growth perspective, the Democrats have been very, very clear on what their view of the tax cuts are on very, very clear. And if you look across the transom of who's announced so far from the money for president, uh, there are some, there are some proposals out there as a capitalist empathetical to growth. But I'll just leave it at that.

And so the question becomes, let's say that happens, then the Democrats had the veto proof majority in the Senate. The odds are no, they will not. So then here's the next part of this scenario. We have to figure out what the Senate will be willing to, what they call, invoke the nuclear option, which is take away the filibuster rule, i.e. simple majority to pass the legislation because if I listen, and again, our job is to listen to what people say, and then interpret it they would like to undo all the tax cuts. We think that would be very bad for the economy. So it could get, and they could do with a simple majority, obviously would say that the precedent. So there's a lot of things about, but I would encourage you in terms of, because you know what, one of the worst things we ever did was forcing public companies to report quarters. Raise your hand if you've run your business for a quarter. Thank you. I didn't take one hand. It's preposterous, no one runs their business for a quarter and shame on us for having done that, but don't don't tell my boss I said that, but the point being that actually in your business you do your multiyear play. Start to think about preparing yourself for these possible scenarios. It is too early to fully handicap this yet, but then we'll start doing it.

All of our businesses, we sometimes get so, so narrowly focused on our little world and it's just human nature is what we do. You want to start thinking about, okay, what are the bigger implications and how might I start yet? I might want to get ahead of it. I live in the suburbs of New York and I take the train into Manhattan and one of the guys I ride the train with, very senior guy, JP Morgan, he reports to Jamie Dimon. And we were talking about navigating challenging markets and he said something that really took me, he said, we all have to go through painful restructuring.

The point being that they're trying to plan and get ahead of what did ultimately we will have a recession in this country. I don't know if it's going to be 2021, 2022 I don't know. None of us know right now, but we will have recession, so planning and thinking about things that sometimes are out of our wheel house. Really, really important. I do not want to end on a down note, so let me talk it all back. Please don't get caught up in the latest tweet, the latest social media posts. I was very intrigued by the 60 minutes reporter who in her own words committed career suicide to actually call out some things in the video. There's an old adage in the newspaper business has been if it bleeds, it leads and people are looking to make noise. They aren't looking to get facts out and if that, if you don't believe that. A friend of mine was on Fox Business News a few weeks ago and he said right before the segment started the uh, the host turned to him and said, I just want you to know we're in the entertainment business. That's what I'm looking to get out of it is entertainment. And that really disappointed me because I always thought at least Fox Business, businesses would try a little harder.

It's really hard. I mean I, I used to work in a recording studio. I was in high school, my father was in the music business and there was something called the signal to noise ratio. You want to have high signal, low noise and what we all need to do is really filter out the noise and there's so much noise out there. So if we could filter that out, what do we have? We have so a slowing economy that is still a good economy, a good job growth. We have a president who believes in crop growth. That's a good thing. You know there, there are some challenges out there, I'm not going to kid you. I think fairly soon we think it will get sorted out one way or the other. What's really going on in the economy is still in good shape. We're still creating jobs. We have a pro growth agenda here. And with that be careful please. I want to thank you all very much for your time and happy to answer any questions.