Winslow, Evans & Crocker, Inc.℠

SEPT. 2015 GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

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Overview

In our August commentary we focused on the potential economic and market risks of a worsening Chinese economy. As you can see in Chart #1 our Economic Momentum Indicator, in blue, has been steadily declining since around 2010. This is not surprising for an economy that is transitioning from one that is infrastructure intensive to one that is consumer centric. The concern, however, is that the downward trend of this momentum has accelerated over the past 18 months and is now implying that GDP growth will be in the 5% to 6% range, well below the recently recorded 7% level.

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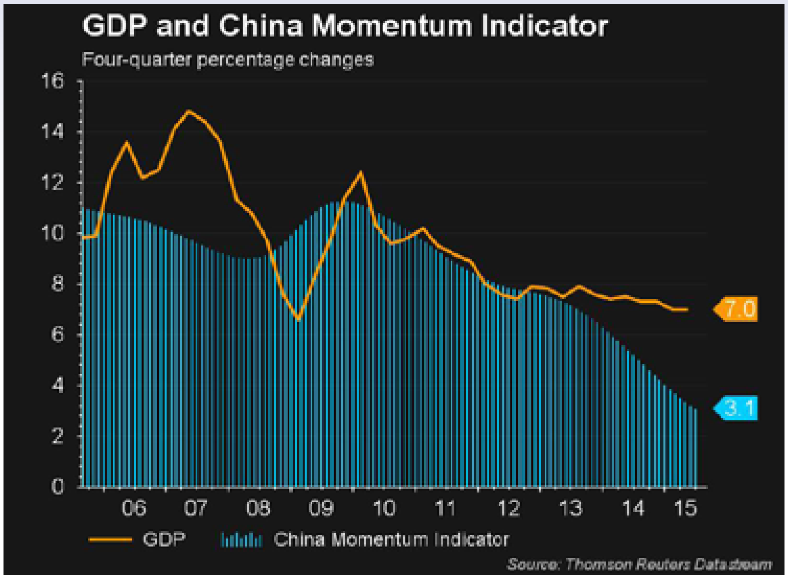

CHARTS 2-4

This negative trend has recently been confirmed by the decline in the China Purchasing Managers Index (PMI) into contraction mode, i.e., below 50, for the past two months as illustrated by the yellow bars in Chart #2. This weakness has also spilled over to other Emerging Market economies as their PMI data has also remained below 50 for the past two months having fallen from 49.1 to 48.6. On August 10th the Chinese government decided to devalue their currency, the Yuan, by about 3%. This action heightened the concern over the Chinese economy and triggered a sharp sell-off in global equities. As shown in Chart #3 the S&P500 dropped 11% from August 17th to August 25th. From its May 21st peak it dropped over 12%, which put the market into correction mode. In our view it is important that this recent market turmoil be viewed as a correction in what we still believe to be a bull market. Since the post-recession market bottom of March 9th, 2009 there have been only two other corrections of greater than 10%, the first in 2010 and the second in 2011, Chart #4.

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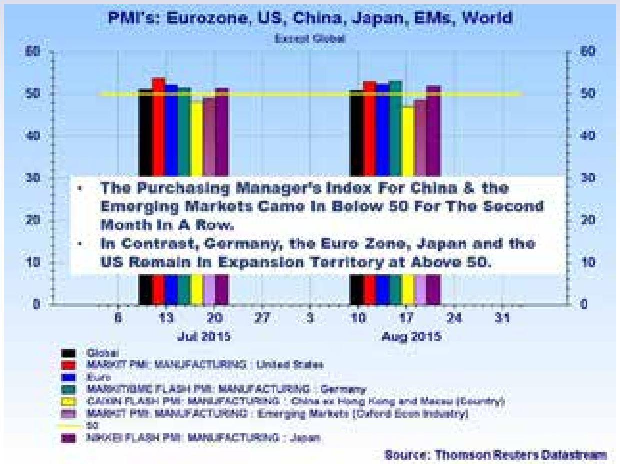

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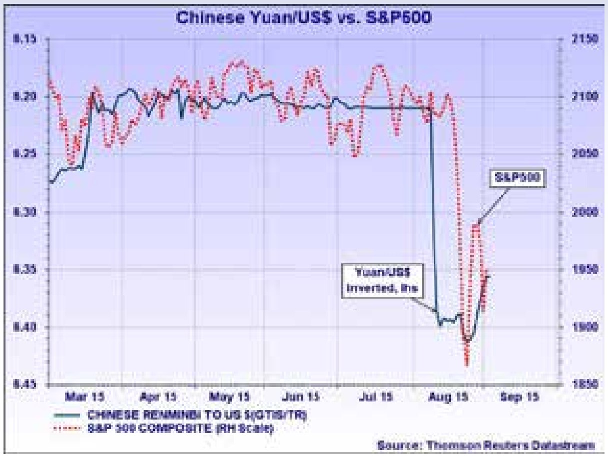

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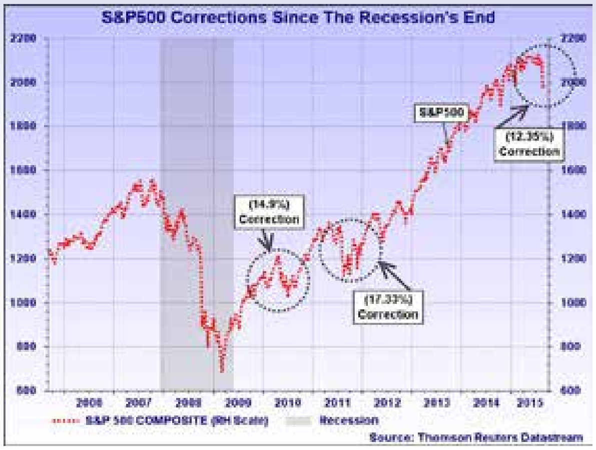

CHARTS 5-6

Since the trough of the market on August 10th, 2011 the S&P500 had risen by 57% to its peak on May 20th of this year without a correction of more than 10%! On Chart #5 we overlay, in green, the consensus forward twelve month earnings estimates. You can clearly see that the S&P500 rose in line with the increase in earnings estimates until late 2014 when earnings estimates dropped. The market correction from the May 20th peak was likely as much of a delayed reaction to lowered earnings estimates as it was to concerns over slowing global growth.

We acknowledge that China remains the main downside risk to further slowing of global GDP growth but we still remain constructive on US equities for several reasons.

First, the US economy continues to show improvement without any concomitant increase in inflation. For example the ISM Non-Manufacturing Survey, which represents around 80% of the US economy, has shown unusual strength for the past two months. The New Orders component of the survey reached its highest level in ten years in July and, as you can see in Chart #6, it correlates very well with NGDP growth.

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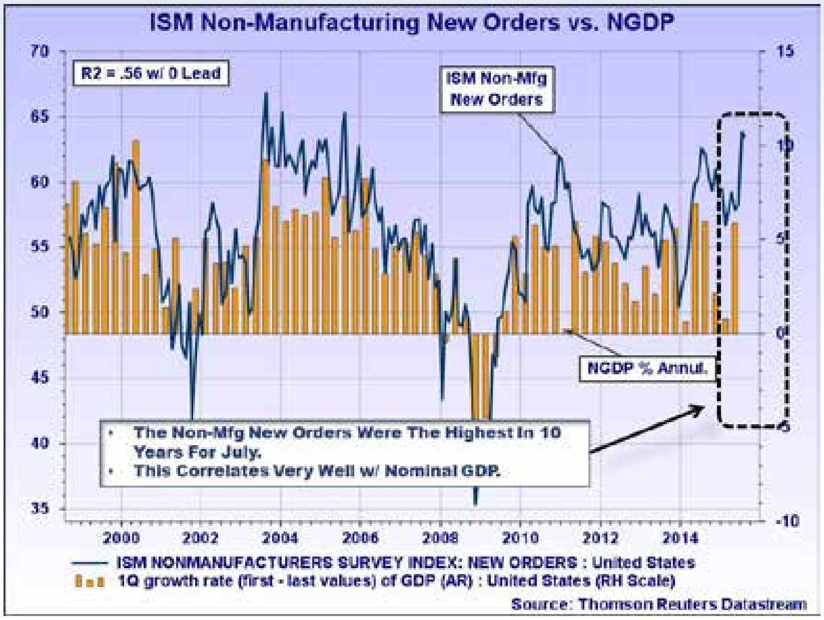

CHARTS 7-8 In Chart #7 you can see that Core Durable Goods orders over the past three months have rebounded sharply from this past winter's problems with weather, currency appreciation, strikes and the collapse in oil prices. Financial conditions are also conducive to continued growth. Although the US Fed will likely raise rates by .25% before year's end the US has never entered a recession unless the yield curve has first turned negative which, as can be seen in Chart #8, is nowhere near doing so at this time.

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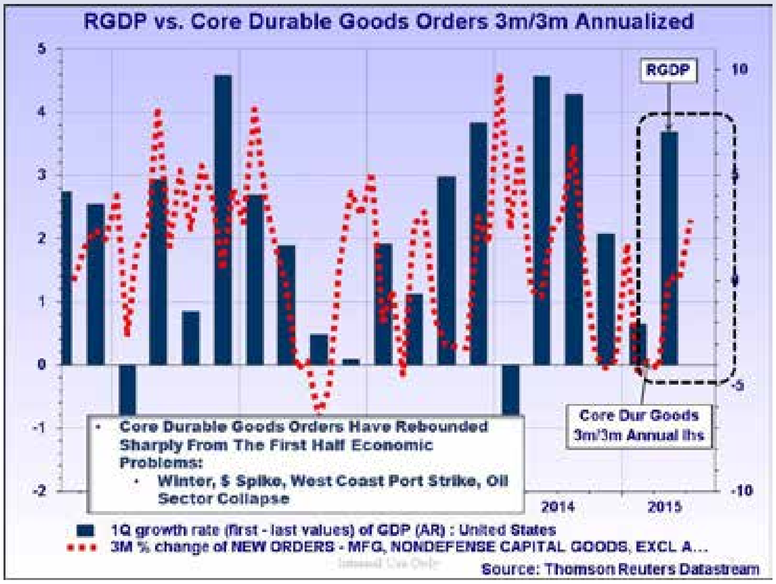

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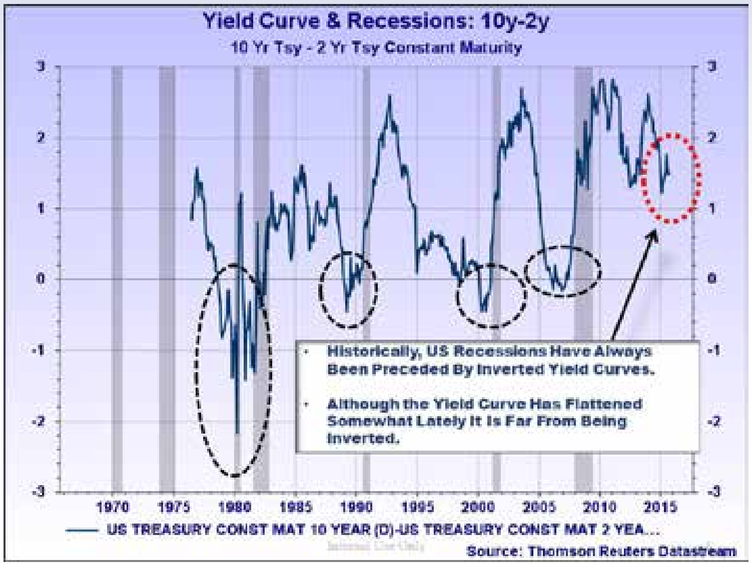

CHARTS 9-11

Another clue that we monitor for signs of an impending recession is the level of the National Income Profits Account (NIPA) capitalized, or divided, by the average BAA corporate bond interest rate, Chart #9. This indicator will peak, on average, about two years before the onset of a recession. As you can see in this chart we are, at a minimum, two years away from the next downturn.

Returning to the potential for a Chinese hard economic landing it is interesting to note that the US has the world's lowest export exposure to China, Chart #10.

The second reason that we remain constructive on US equities is derived from our views on valuation and liquidity. Chart #11 shows that, based on our Equity Risk Premium model, the US market is a little less that one standard deviation undervalued relative to the yield on BAA bonds.

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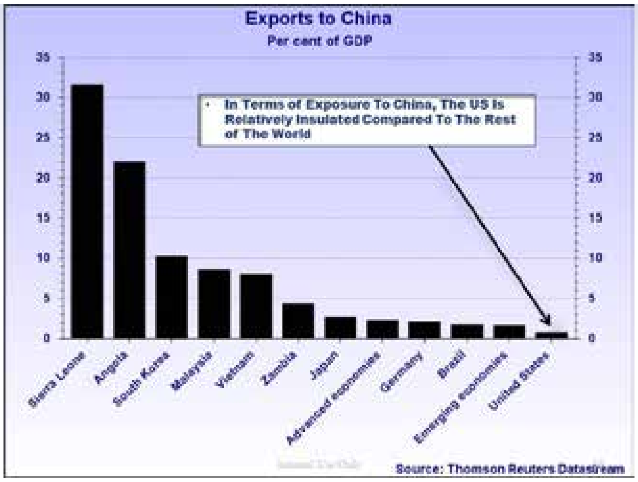

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CHARTS 12-13

The market's Equity Risk Premium usually falls to one standard deviation expensive before entering "bubble" levels as shown by the red arrow on the chart. We also watch a measure called "Excess Liquidity" on a global scale and, as can be seen in Chart #12, it is currently at levels associated with higher equity returns. This is so because all the central banks of the major economies other than the US are increasing financial liquidity at a rate faster than their economies are growing. This excess liquidity is nearly always beneficial for the equity markets.

Finally, US equities will be driven by prospective earnings growth. As noted above we have just finished coming through a downward adjustment period which we believe is now reversing itself. One very important leading indicator that brings us to this conclusion is the new order component of the ISM Manufacturing and Non-Manufacturing surveys. In Chart #13 we have combined the two surveys and correlated them with the historical forward earnings projections.

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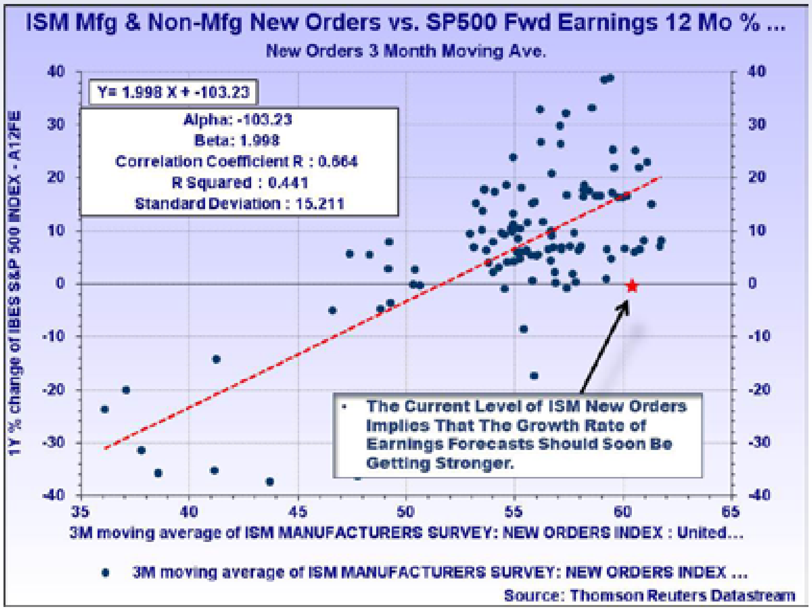

The red star is the most recent data point. The conclusion that we draw from this chart is that the year/year growth rate of S&P500 earnings will soon be increasing because of these elevated levels of ISM new orders.

Please contact your advisor if you have any questions about this commentary and how it may impact your portfolio.