Winslow, Evans & Crocker, Inc.℠

JUNE 2016 GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

GLOBAL ECONOMICS

Douglas E. White, CFA
Chief Investment Officer
Executive Vice President
(617) 896-3518
dwhite@e-winslow.com

Rand Folta, CFA
Executive Vice President
(617) 896-3590
rfolta@e-winslow.com

INSTITUTIONAL TRADING

Fixed Income

Nomi Caperton
Managing Director
(617) 896-3526
ncaperton@e-winslow.com

David Strimaitis
Managing Director
(617) 896-3577
dstrimaitis@e-winslow.com

Equity

John Bridges
Managing Director
(617) 896-3524
jbridges@e-winslow.com

William Kleinfeld
Managing Director
(617) 297-2155
billy@e-winslow.com

SETTLEMENT AND TRADING

OASYS: WYNS
MPID: WYNS
DTC: 0443
Clearing: Pershing, LLC.

WINSLOW, EVANS & CROCKER

175 Federal Street, 6th Floor
Boston, MA 02110
Phone: (617) 896-3500
Member: FINRA/SIPC

Overview

In our commentary last month we highlighted that the market's rebound from the February bottom was due in large part to the dovish comments from Janet Yellen in concert with the easing of financial stress indicators. As you can see in Chart #1 credit spreads for high yield and investment grade bonds remain well below their earlier peaks but, for the month of May, they were essentially flat.

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CHARTS 2-4

The more sophisticated financial stress indices published by the St. Louis and Kansas City Feds also remain well below their earlier highs and, in the case of the weekly St. Louis index, continued to trend down, Chart #2.

As the financial conditions continue to ease the economic data continues to be mixed. The consumer appears to still be the driver behind the economy as auto sales were higher than expected, retail sales and consumer confidence rose and personal consumption expenditures (PCE) came in at the highest monthly increase since 2009, Chart #3! Durable goods orders and unfilled orders were the best since January and July of 2015, respectively, Chart #4!

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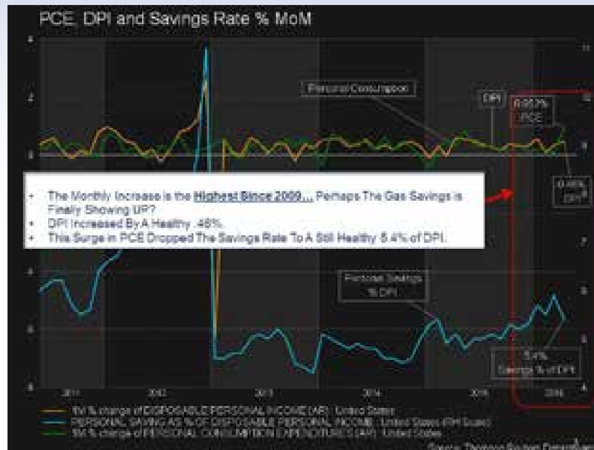

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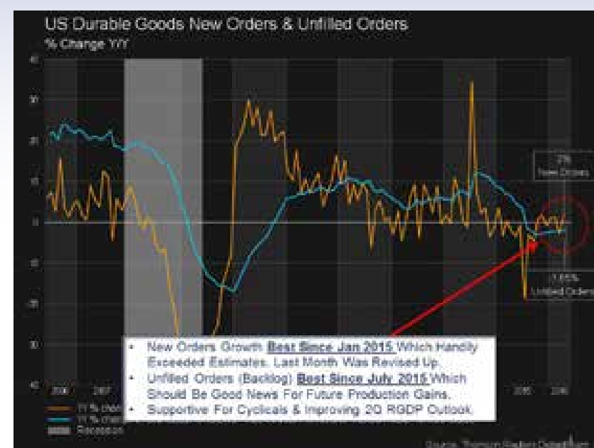

CHARTS 5-6 Although there were some disappointing numbers such as the April payrolls, the market seemed to take it in stride as it rose 1.53% for the month and cyclical stocks resumed their leadership over defensive issues, Chart #5. Top performing sectors were Technology, Healthcare and Financials. Bank stocks rose in anticipation of higher short term rates resulting from further tightening by the Fed. Based on all of this economic data the Atlanta Fed's "GDPNow" forecasting model raised their second quarter RGDP growth target from 1.75% at the beginning to the month to 2.5%, Chart #6.

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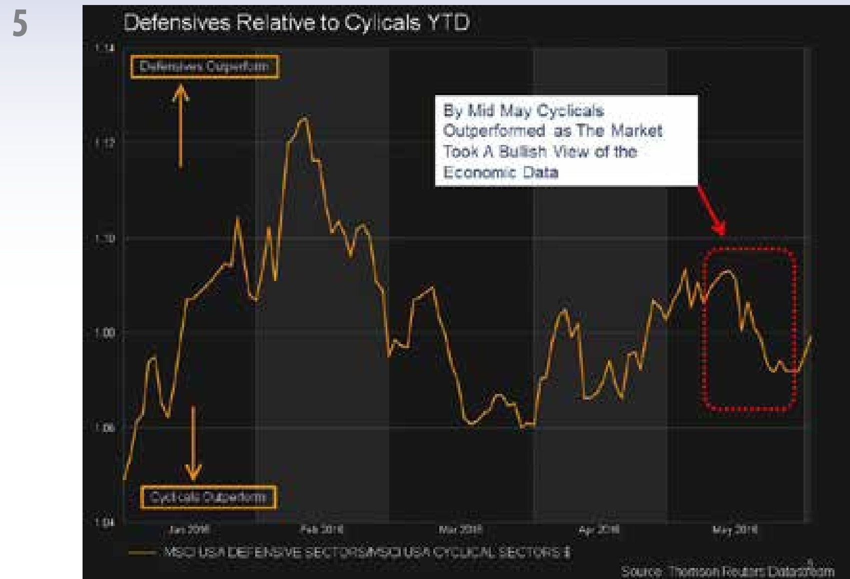

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CHARTS 7-8 The major problem that we highlighted last month is that the equity market has had a strong recovery from its February lows without a concurrent increase in earnings estimates, Chart #7. Furthermore, the growth rate in forward earnings estimates has remained essentially flat even though ISM new orders, which normally correlate well with earnings, have stayed in the expansion range above 50, Chart #8.

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CHARTS 9-10 This divergence may be a signal that there will be a slowing in future ISM Manufacturing and Non-Manufacturing surveys. Another conundrum can be found in the flattening yield curve and the extremely strong performance of the Utility equity index, Chart #9. In this chart we have inverted the Utility index which is the blue line. You can see that the Utility index is near a 20 year high at 143.87 and appears to be signaling that the yield curve will continue to flatten. This implies that the economy will be slowing and, in fact, the May non-farm payroll came in far below expectations while the prior two months were revised lower, Chart #10.

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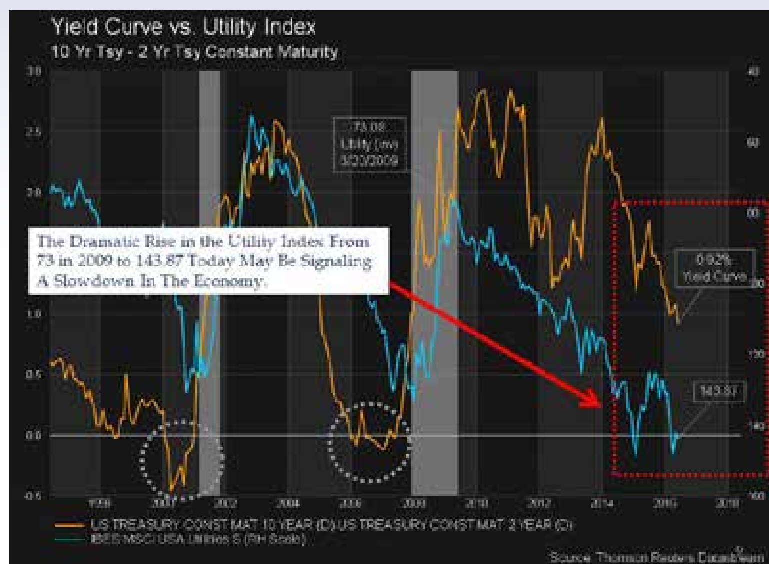

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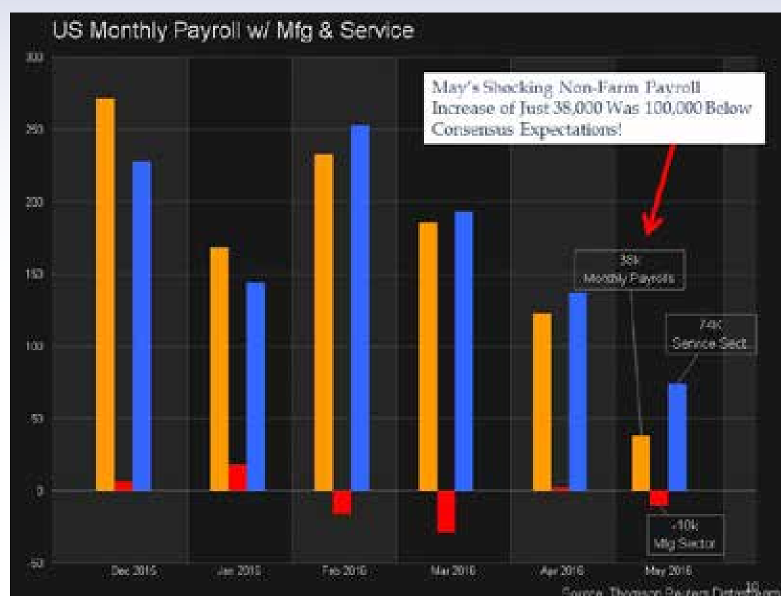

CHART 11 Although some of these indicators are implying a slowing of the economy it is unlikely that we will soon be going into a recession. As mentioned above, even with all of the confusion caused by this mixed economic data the Atlanta Fed's RGDP forecast for the second quarter is still a healthy 2.5%. Furthermore, if you compare the history of recessions to the peaks of the Conference Board's Leading Economic Indicators, Chart #11, you'll see that we are probably about 6 years away from the end of this economic cycle.

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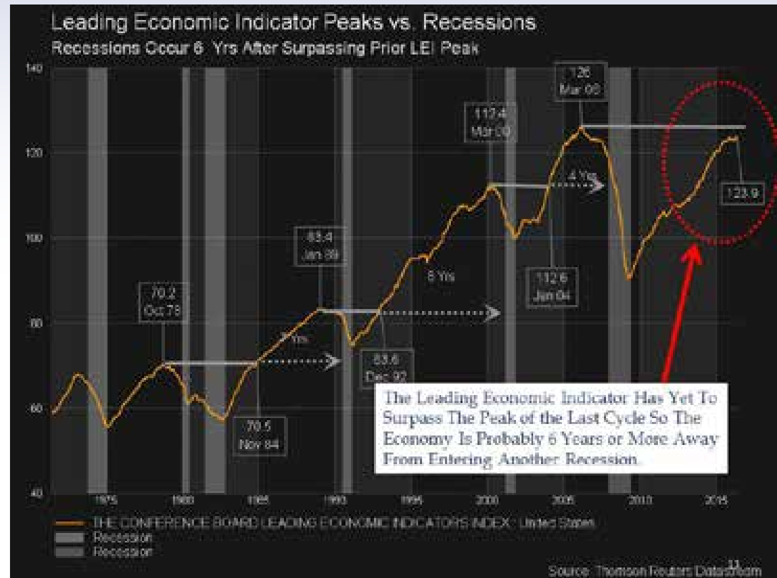

CHART 12-13 As we mentioned in last month's report we have found that companies that have been good dividend growers have outperformed those companies that have been buying back stock, Chart #12. This, we believe, is a reflection of the uncertain outlook over corporate earnings and revenue growth. Until this outlook clears up the US equity market is being supported by very low interest rates and very accommodative global monetary policies. There has been much talk and anxiety about the US Fed increasing interest rates and tightening monetary policy. However, when consideration is given to fiscal policy and to the fact that the Fed is still reinvesting the proceeds from its bond portfolio, the US has the second most loose macroeconomic policy of the major economies, Chart #13.

Please consult with your investment advisor if you would like to discuss this report in greater depth.

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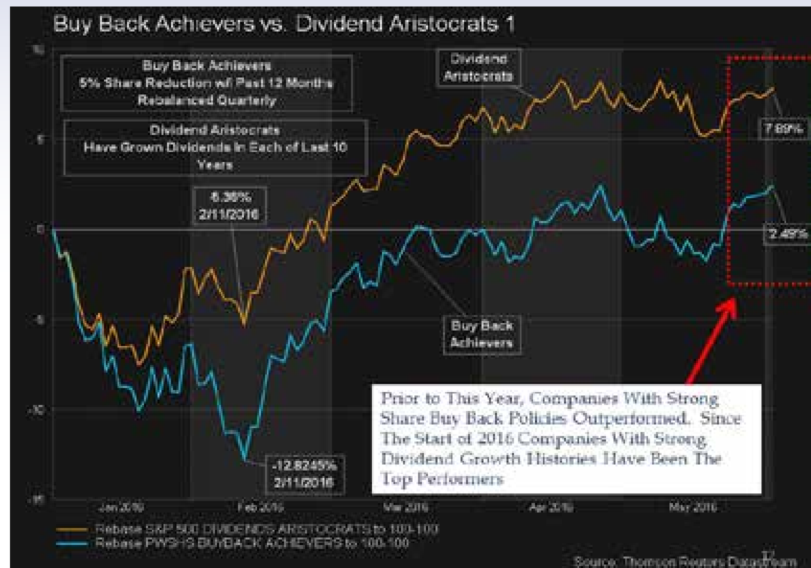

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