AUG. 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

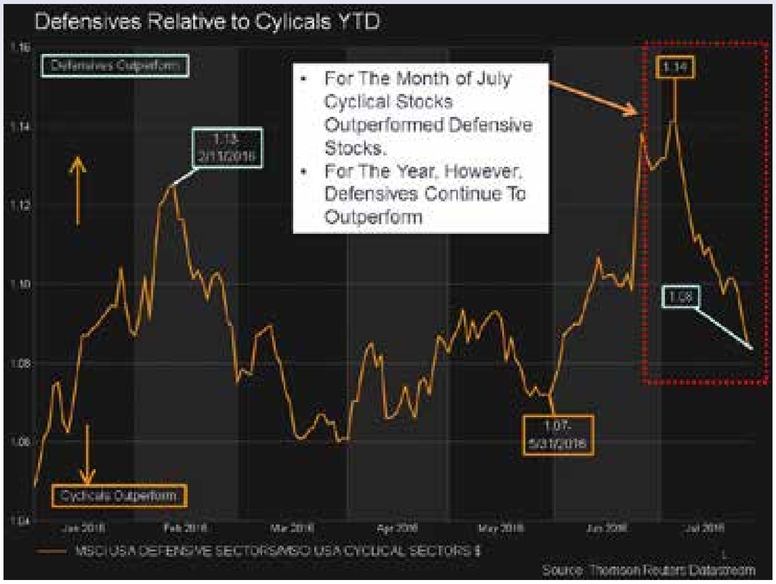
SETTLEMENT AND TRADING
OASYS: WYNS
MPID: WYNS
DTC: 0443
Clearing: Pershing, LLC.

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

Overview

As we discussed in last month's report, the decline of 5% in the US equity markets after the surprise Brexit vote was not likely to lead to a recession or to a bear market. Indeed, the month of July has seen the S&P500 appreciate by a little over 3%. In Chart #1 you can see that cyclical stocks outperformed defensive stocks during this time which is indicative of a more optimistic outlook for the economy.

1

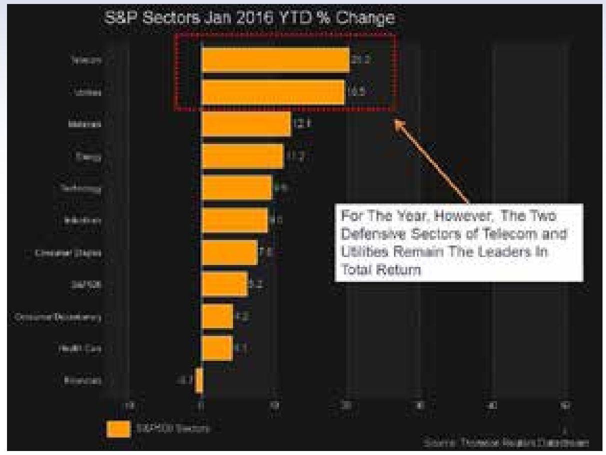


CHARTS 2-4

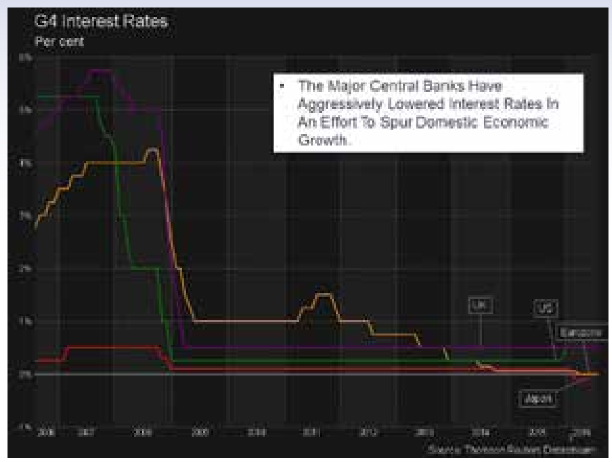
For the year, however, the Telecom and Utility sectors remain the best performers, Chart #2. This is due in large part to investors searching for the higher yields that the stocks in these sectors provide. The easy monetary policy being pursued by the central banks of the major economies is driving down interest rates to levels not seen in a generation, Chart #3. In Chart #4 you can clearly see that the yield on the 10 year US Treasury Bond has been steadily trending down since the beginning of the year while inflation expectations, the blue line, have recently begun to trend back up. This is a clear indication that the enormous amount of liquidity being generated by these central banks is in a global hunt for higher yields.

Although global central banks will continue to pursue easy monetary policies as their economies remain sluggish there is a risk that in the near term the US may see a modest rise in rates. As indicated above in Chart #4 there appears to be a disconnect between the yield on the 10 year Treasury bond and inflation expectations. This divergence can be seen with other indicators as well.

2



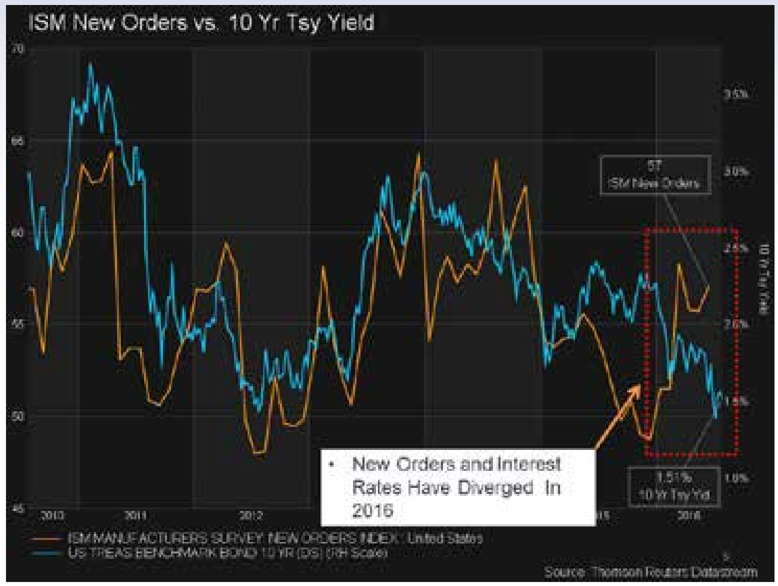
3



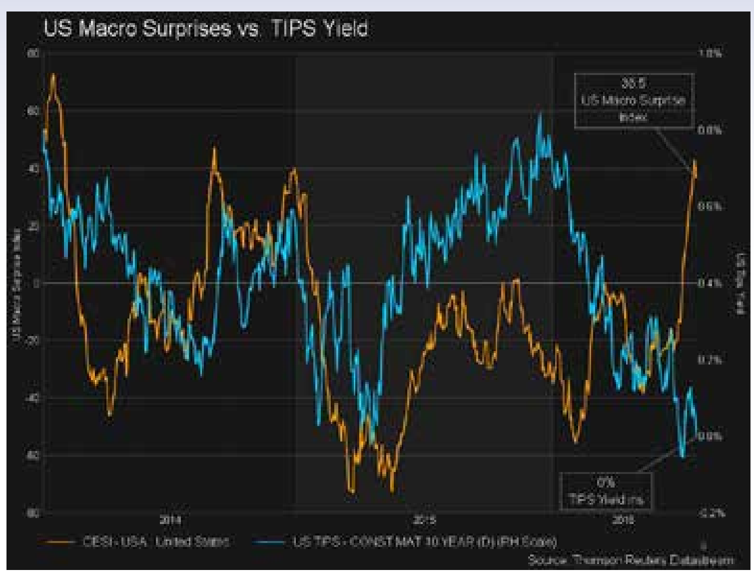
4

CHARTS 5-6 In Chart #5 it is clear that in the past as the new order component of the monthly ISM Manufacturing Survey has increased so have interest rates. For 2016, however, this relationship has, for now, broken down. Even more dramatic is the breakdown in the relationship between the US Economic Surprise Indicator and the TIPS yield, Chart #6. One would expect that as US economic indicators have been better than expected then inflation should rise, as pointed out in Chart #4, and rates should follow. If we do see even a modest increase in interest rates it will likely mean that the outperformance of the defensive sectors will reverse.

5



6



CHARTS 7-9

In Chart #7 you can see the very sharp inverse correlation between the level of interest rates and the appreciation in the Consumer Staples index. We should note that the divergences cited above may be resolved by a move back down in the various economic indicators rather than a rise in the level of interest rates. Indeed, the initial measure of the second quarter GDP is 1.2% which is significantly below the consensus estimate of 2.6%.

While we try to remain diligent in looking for indicators that may cause even a temporary change in trends such as the defensive versus cyclical relationship we remain bullish for several reasons. First, the twelve month forward earnings yield for the S&P500 is over one standard deviation above its long term average relationship with the 10 year US Treasury bond yield, Chart #8. A more dramatic view of this relationship is shown in Chart #9 in which the gold line represents the level to which the S&P500 would need to achieve to be at parity with the yield on the 10 year bond. As you can see it would need to rise to 8361 from today's 2170! Although this dramatic a rise is very unlikely it does demonstrate that at today's level of interest rates the US equity market is not excessively overvalued.

7

8

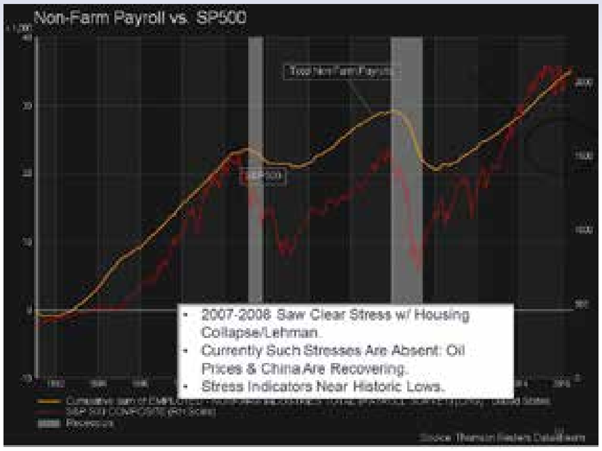
9

CHARTS 10-12

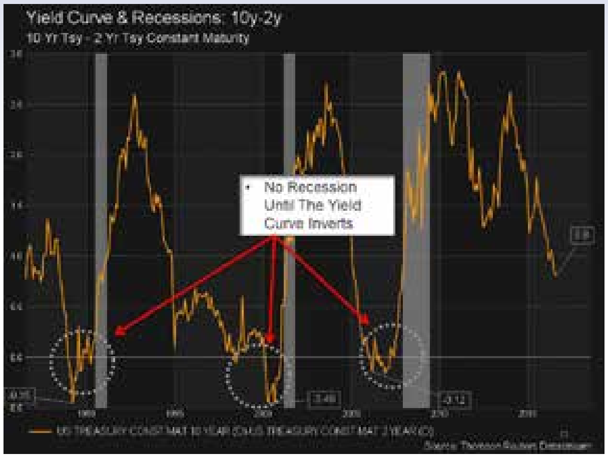
Second, employment has remained strong throughout the recent market volatility which is consistent with a strong equity market, Chart #10. Finally, we do not see a recession in the near term. The yield curve has not inverted, Chart #11, and the Leading Economic Indicators have yet to exceed the peak of the prior recession, Chart #12.

Please contact your advisor if you would like to discuss any of the topics mentioned above.

10



11



12