Winslow, Evans & Crocker, Inc.[SM]

JULY 2017 GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

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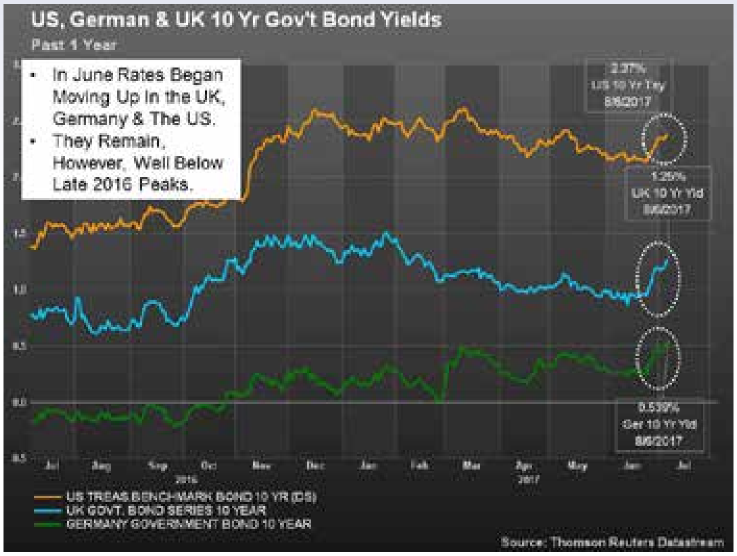
Overview

Interest Rates, Inflation and Hard vs. Soft Economic Data

In last month's publication we highlighted that interest rates and inflation expectations were much lower than had been expected in this environment of low unemployment and record lows in weekly initial unemployment claims. In the interim, however, rates and inflation expectations have begun rising once again both in the US and in Europe, Chart #1.

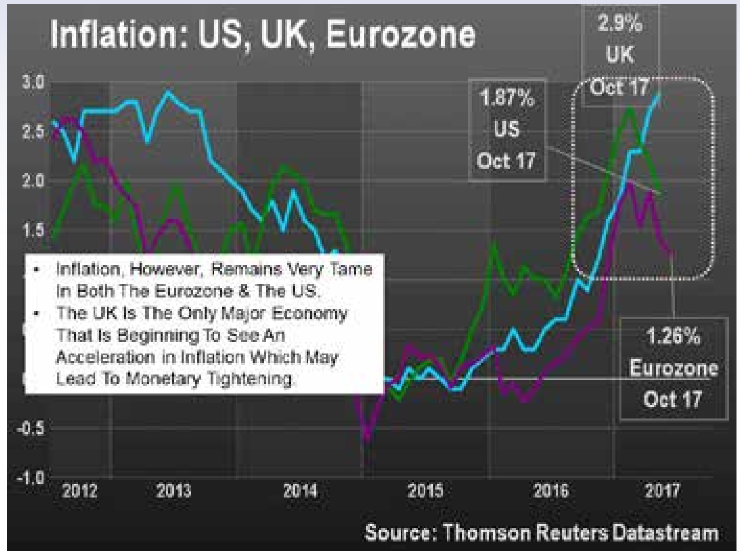
1



CHARTS 2-3

With the exception of the UK, however, there has been little indication of inflation getting out of hand as shown in Chart #2. It is therefore very likely that the rise in rates is an indication that domestic and global economies are returning to normal levels of growth and that fears of a deflationary spiral are quickly fading. This observation is supported by the fact that equity markets, although they fell somewhat, are still in a major uptrend with the German DAX having been the star performer since early 2016, Chart #3

2



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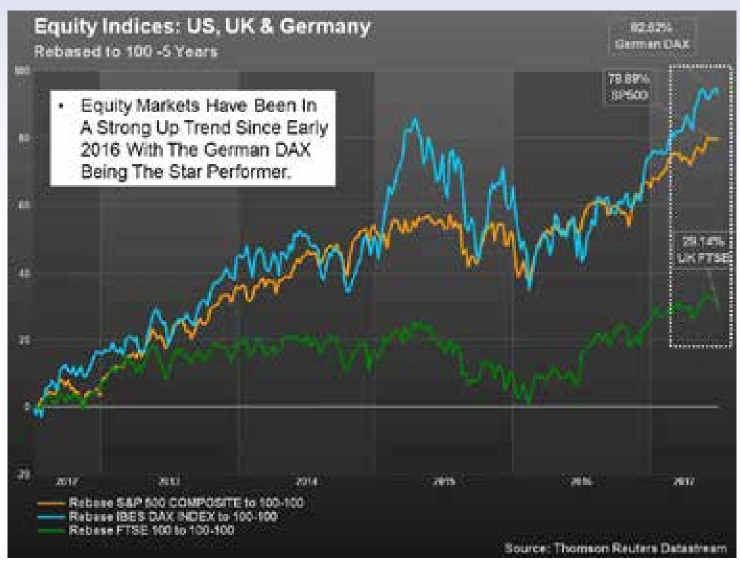

CHARTS 4-5

The positive economic backdrop is the primary reason that equity prices should hold up reasonably well even as bond yields continue to rise. As we pointed out last month the so called soft economic indicators such as consumer and business confidence surveys, Chart #4, were at cycle highs but, at that time, much of the hard economic data had yet to follow. This hard data is now improving and is the driving force behind rising interest rates and improving inflation expectations, Chart #5.

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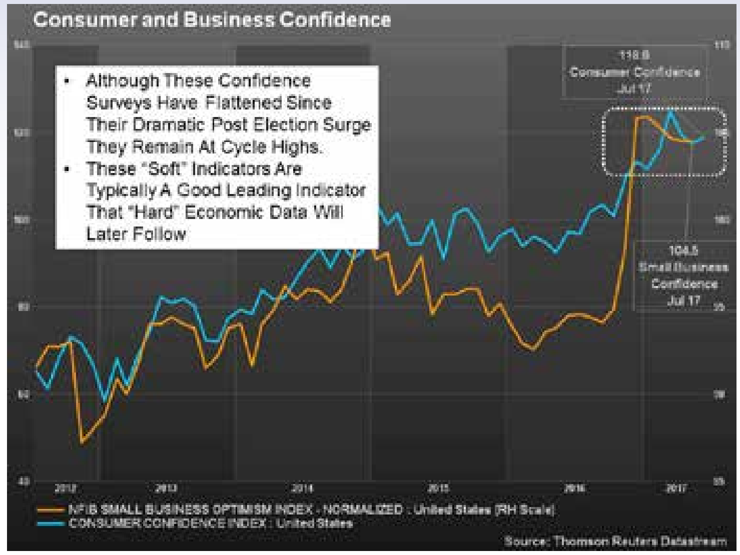

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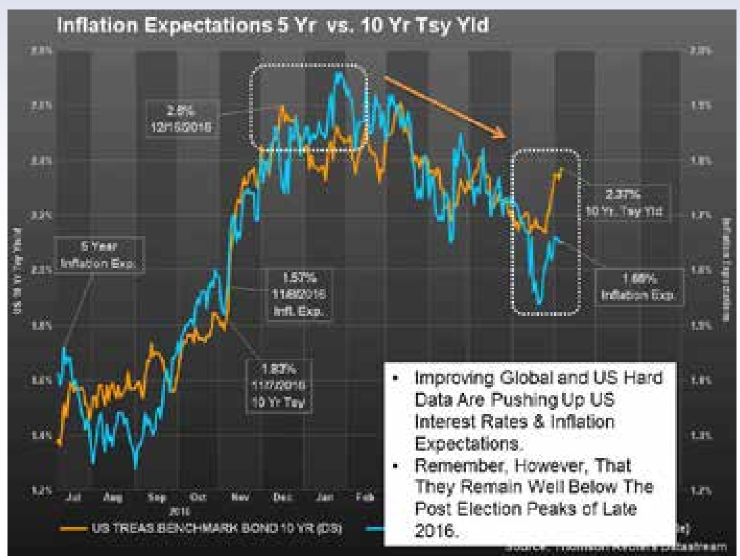

CHARTS 6-7

Evidence of the improving data is, on a global basis, seen in the continuing improvement in the OECD leading economic indicator along with a global ISM manufacturing index well into the expansion territory above 50, Chart #6. US data has also been improving. Corporate capital expenditures are raising in conjunction with an easing in bank Commercial and Industrial (C&I) lending standards, Chart #7. In this particular chart the C&I line is orange and is inverted which means as the line goes up banks are easing lending standards. This tends to correlate nicely with growing capital expenditures.

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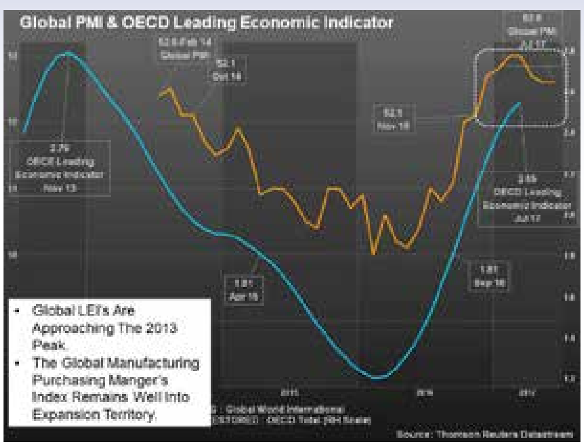

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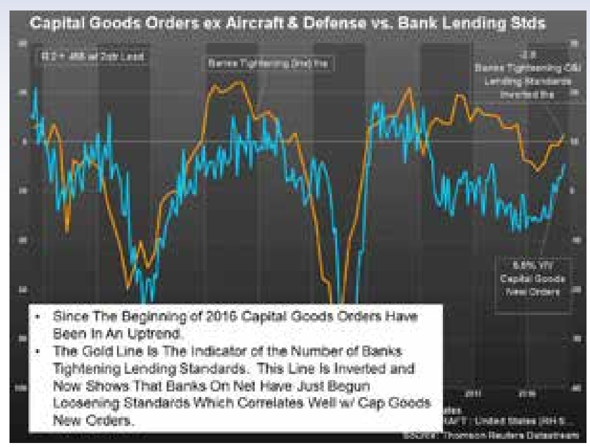

CHARTS 8-9

The ISM surveys for the manufacturing and non-manufacturing sectors have also been trending up and are near five year highs, Chart #8. One of the important components of the ISM manufacturing index is the New Orders survey because it is a leading indicator and has a strong correlation with S&P500 forward earnings growth as shown on Chart #9. Strong earnings and sales growth are the lynchpin for continuing strength in the equity markets during periods of rising interest rates.

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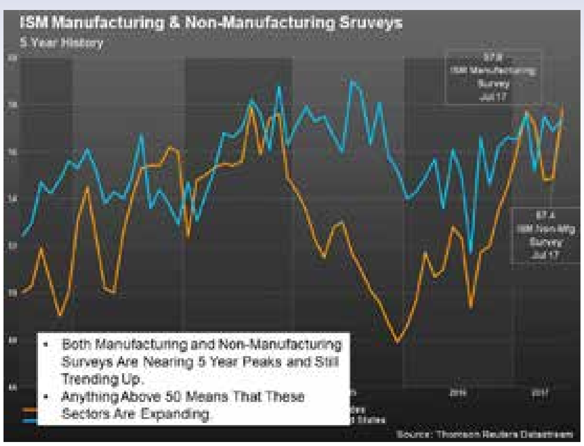

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CHARTS 10-11

As mentioned above the levels of inflation in the US have been surprisingly low. Some of the forces responsible for keeping a check on inflation are the strengthening of the US$ over the past year; the dramatic globalization of the economy that has taken place over the past decade; and, the low level of wage growth in a very low unemployment environment. This latter factor has been a surprise to nearly everyone but, given the strong jobs environment, is not expected to stay depressed for long. On Chart #10 you can see that the current level of weekly initial unemployment claims is the lowest in forty years and that the unemployment rate is also hovering near forty year lows. In Chart #11 we show the relationship between job openings, the JOLTS monthly numbers, and the growth in Average Hourly Earnings (AHE) and the Atlanta Fed Wage Tracker. You can clearly see that the number of job openings has surpassed the peaks of the prior two economic cycles but the growth in wages remains well below those of the past two cycles. This condition is not likely to last for very long.

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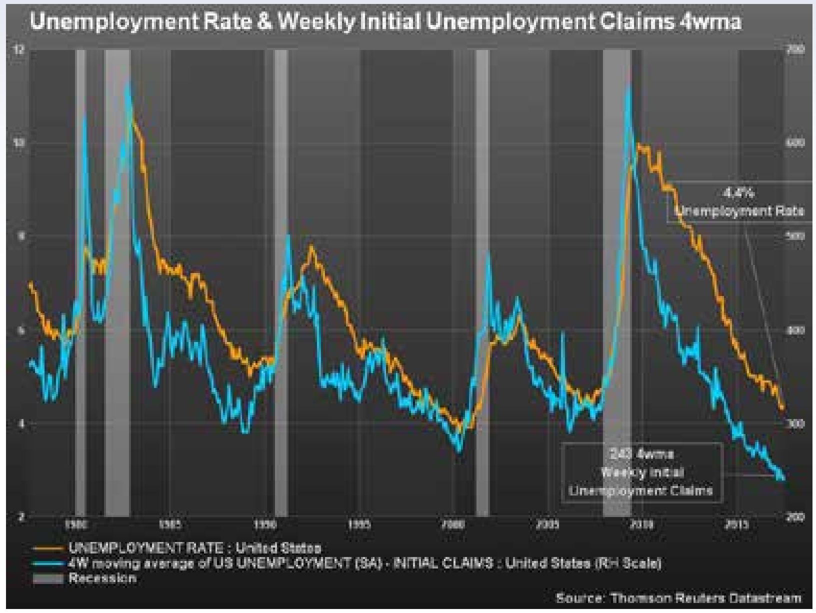

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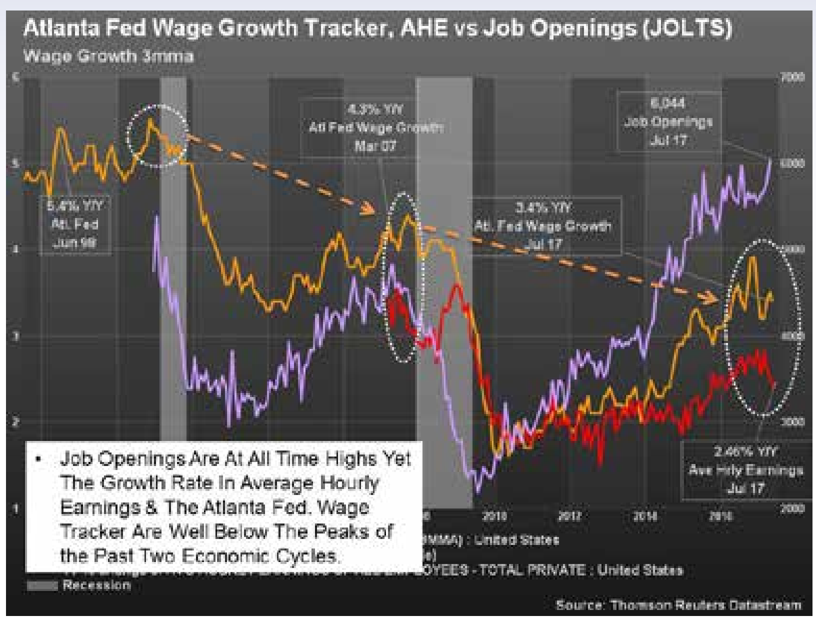

CHART 12

The number of companies planning on raising employee compensation is once again on the rise and, according to the Conference Board's Employment Trend Index, this will continue for the next six months. This is shown on Chart #12.

Interest rates will likely continuing going up for the balance of the year as economic data continues to strengthen. So long as earnings and sales continue to grow this should not have an adverse impact on equity markets but it will influence which sectors within the market will over or under perform. For example, in a rising interest rate environment traditional defensive sectors such as consumer staples and utilities will underperform cyclical sectors such as industrial, consumer discretionary and information technology. Within all of these sectors stock selection will always be the key to a properly constructed portfolio.

For more information about how these comments might influence your portfolio please contact your investment advisor.

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