Winslow, Evans & Crocker, Inc.SM

June 2014 GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

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Overview

In this month's review we would like to take a step back and embrace a broader view of US economic data as we exit the damaging effects of what has been a difficult and prolonged winter. We believe that the economy is now on the cusp of an upward break-out for capital expenditures. The strength in US non-financial corporate free cash flow has been a signature corporate characteristic of this recovery as well as a target for investor activists to pressure management to distribute that cash to shareholders through dividends and share buybacks. Although this pressure still exists, US manufacturing companies are beginning to recognize that unless productivity focused capital expenditures are increased the US will once again lose ground to manufacturers in So. Korea, Japan and China.

CHART 1. First of all, it is clear on Chart #1 that US economic data has bottomed and is just now turning positive after having been in a virtual free fall since the beginning of this year as indicated by the US Economic Surprise Index

CHARTS 2-4. This bottoming process is corroborated by the very strong Markit/HSBC PMI indicators, in red for the US, on Chart #2. Also on this chart it is interesting to note that the PMI's for the Eurozone, blue, have been above 50, the expansionary phase, for several months as has the World PMI, in black. China, in yellow, which has been a major investor worry for a hard landing, had been in contraction mode below 50 for several months but has only now just moved up to 50 and is showing signs of having bottomed out.

In the US, initial weekly unemployment claims provide a good high frequency leading indicator of job growth and the economy. In Chart #3 it can be seen that the four week moving average has settled nicely into its -5.0% to -10.0% post-recession downward trend. More importantly, as shown on Chart #4, the Conference Board's Present Situations Annual Change correlates closely with and leads the annual change in private payrolls, again corroborating a strengthening in the labor market.

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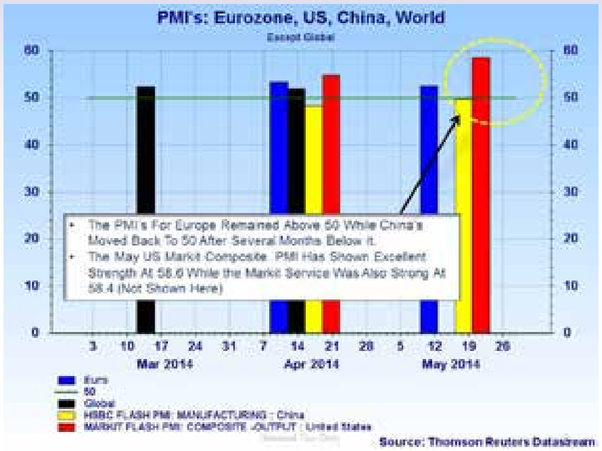

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CHARTS 5-6. The US housing market is finally beginning to show signs of life and, as can be seen in Chart #5, the gap between the Prospective Home Buyers Index and Private Housing Starts is finally beginning to narrow. This should help housing to become a larger contributor to GDP, Chart #6.

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CHARTS 7-9 Other indicators of a strengthening economy come from the transportation sector…specifically railroad carloads and intermodal volumes which, as you can see on Chart #7, have recently accelerated upwards. It should be no surprise that the strength in this sector of the economy has the Dow Jones Transportation Averages reaching new highs, Chart #8. If you study the correlation between the DJTA and Real GDP, Chart #9, you find a very high coefficient of determination, .72, with a one quarter lead time…further confirming that the US economy may be a break-out juncture.

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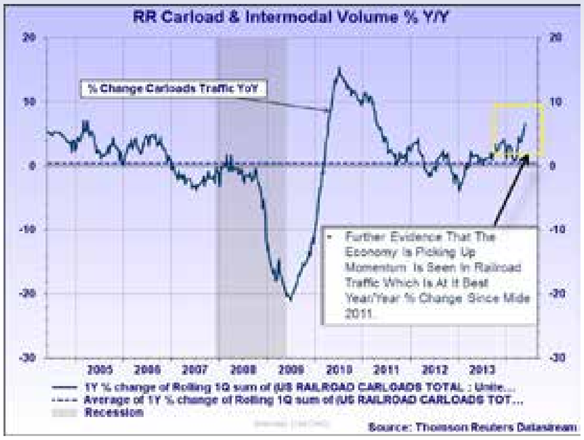

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CHARTS 10-13. The major beneficiary of a stronger economy should be corporate capital expenditures. Chart #10 shows Private Fixed Investment Less Depreciation as a Percentage of GDP. It is clear that despite a strong rebound since the recession, the absolute level is at the lowest it has been since the early 1980's. The private sector has a lot of catching up to do. Based on the ISM surveys it is clear, as shown on Chart #11, that corporations have strong intentions to increase capital expenditures over the next year. This is further confirmed in Chart #12 which shows the correlation between core capital goods orders and bank loans. Commercial loans, the blue line, have accelerated dramatically this year to the highest level of the cycle. Furthermore, the difference between the return on assets, the blue line on Chart #13 and the cost of Baa debt, the orange line, is the widest it has been since the early 1990's and is yet another incentive for corporations to increase their capital expenditures.

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CHART 14. The natural beneficiary of this improving economic data will be the cyclical stocks such as Industrials/Automation; IT Services; Software; Hotels; Employment Agencies; Advertising & Airlines. Although there was a bounce and retreat in the relative performance of cyclical stocks over defensive stocks in April, Chart #14, it now appears that the cyclicals are once again outperforming in line with the strengthening US economic data

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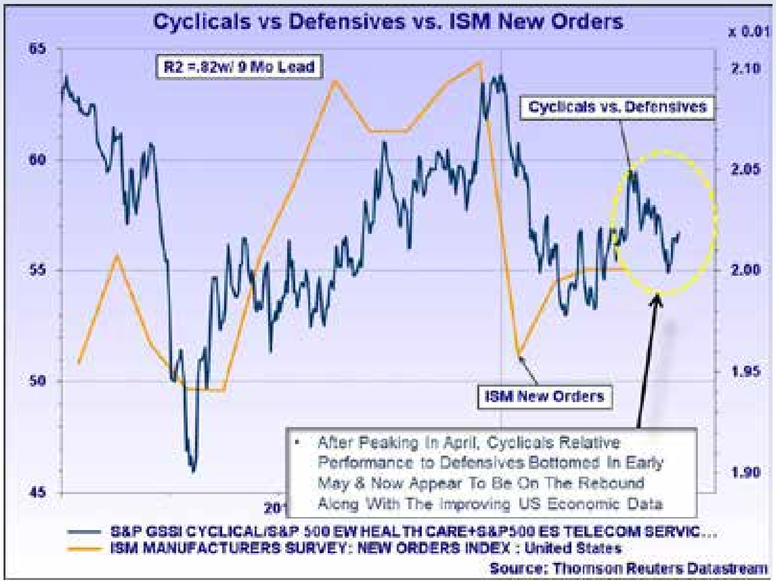

CHART 15. As we always do, we will finish with a final note on market valuation. As we have continuously observed since the recession, the earnings yield of the S&P500 has consistently remained at or above one standard deviation over its mean relationship to the Baa yield, as illustrated in Chart #15. Furthermore, this relationship spread is near historical levels when compared to the Kansas Fed Financial Stress Index, the dashed red line in Chart#15. With the market earnings yield this high in the face of narrow credit spreads; an historically low financial stress index; and, rising forward EPS estimates it is difficult to conclude that the market is anything but inexpensive relative to these alternative assets. The most likely scenario in which this yield relationship reverts closer to the mean will be if there is a general rise in interest rates caused by unexpectedly strong US economic data.

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