Winslow, Evans & Crocker, Inc.℠

APR. 2016 GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

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Overview

During the month of March the S&P500 rose 6.81% as credit spreads narrowed, financial stress indicators receded and fears of a US recession abated. For the first one and a half months of 2016, while recession fears were the greatest, it was the traditional defensive sectors of Utilities and Telecoms that dominated the returns. Since the market bottom of February 11th the leadership has been taken over by cyclical sectors such as Technology, Consumer Discretionary, Financials and Materials. This reversal of market leadership was driven by a more dovish monetary stance by the European Central Bank and, more importantly, by the US Federal Reserve. As we maintained in November of last year, the impending increase in the fed funds rate was coming at a bad time because of already tightening domestic financial conditions, a rapidly strengthening US$, weakening US economic indicators and slowing global economic momentum. It is now apparent from Yellen's testimony on March 23rd that the Fed has become more sensitive to international conditions in their consideration of monetary policy.

CHARTS 1-3

Although the US equity market is now in positive territory for 2016 we remain concerned that the easy monetary conditions behind this move may have reached the limit of their effectiveness in boosting market values. Future increases in valuation must come from stronger corporate sales and earnings growth. At the moment there is little evidence that this is happening.

In Charts #1 and #2 you can clearly see how credit spreads along with the more comprehensive financial stress indicators published by the St. Louis and Cleveland Feds have both receded substantially from their mid-February peaks. It is worth noting that much of the spread widening in the high yield market was a result of the collapse in oil prices and the subsequent fear of high levels of default in the Oil & Gas producer sector. As shown in Chart #3 there has been a tight correlation between the price of oil and high yield credit spreads. The price of oil in this chart, the blue line, is inverted and it comes as no surprise that the narrowing in credit spreads has followed the recent rise in oil prices.

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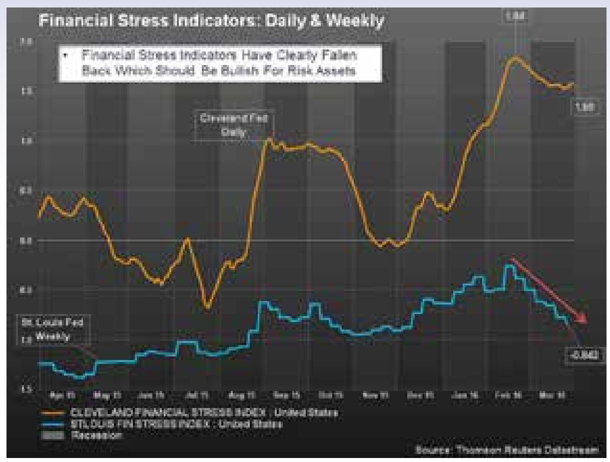

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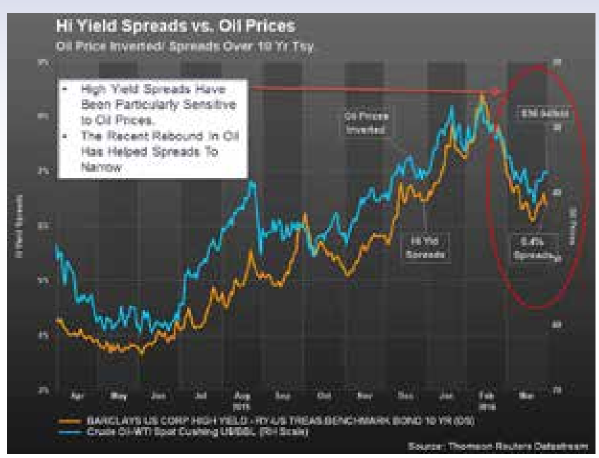

CHARTS 4-7

Until the market bottomed on February 11th the leading sectors were classically defensive: Utilities and Telecommunication while the traditional cyclical groups, Energy, Consumer Discretionary and Technology, were the worst performers, Chart #4. Since then, however, the leadership has reversed so that Technology, Materials, Consumer Discretionary and Financials are at the top, Chart #5. This rotation in leadership is not surprising given the easy monetary stance from central banks, the firming in oil prices, the weakening US dollar and the fall in emerging market bond yields However, it is important to note in Chart #5 that the defensive sectors of Utilities and Telecommunications continued to do well and, per Chart #6, still lead in performance on a year-to-date basis. This signals that the markets remained worried about the earnings outlook. Another indicator of continued market uncertainty can be seen in Chart #7. Here you can see that the other traditional flight to safety assets such as gold, the Swiss franc and the Japanese yen have continued to remain in positive territory during the March market rally.

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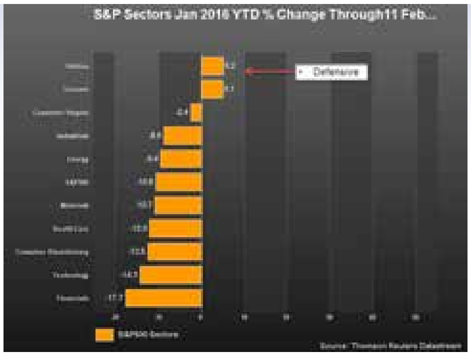

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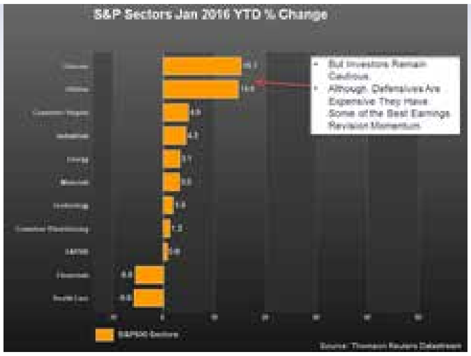

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CHARTS 8-9

The major concern overhanging the market is the future of corporate earnings and sales growth. As shown in Chart #8 the twelve month forward estimated S&P500 earnings and sales growth forecast is negative. This forecasted growth rate normally correlates fairly well with the ISM new orders survey, the green dashed line on the chart. This ISM survey is at 55.36 and, at above 50, implies that new orders are expanding. Historically this has been bullish for future earnings estimates. The explanation for the divergence may be related to the downward trend in ISM new orders beginning in May of 2014. Once again the culprit was very likely the rapid contraction in the Oil & Gas sector. This should annualize out later in 2016 and help the new orders survey to rebound and begin trending back up again. Evidence that this may be starting to happen is shown in Chart #9 where we have found a very tight correlation of R2 = .69 of the combined regional manufacturing surveys with the ISM new orders surveys. You'll notice the recent, sharp rebound in this indicator (gold line) thus implying an improvement in new orders.

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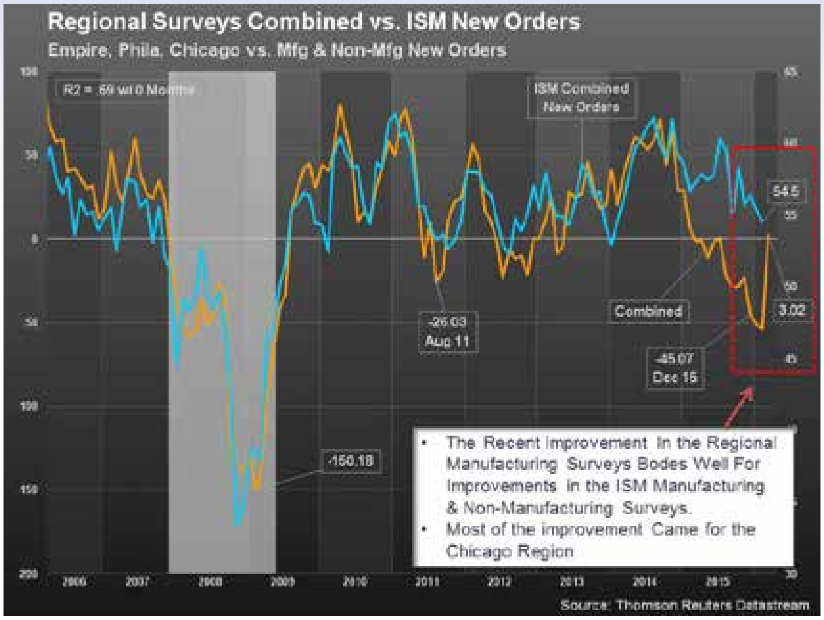

CHARTS 10-11

The forward 12 month price/earnings ratio of the S&P500 is currently near the high end of its recent range at around 16.5x as shown in Chart #10. This looks particularly expensive when compared to the declining earnings estimates as evidenced by the gold line. If, however, we look at the level that the market's earnings yield exceeds the yield on corporate BAA bonds it appears that the market is about one standard deviation cheap relative to its long term history, Chart #11. Therefore, on an absolute basis the market is expensive but on a relative basis it is cheap. This contradiction is best explained by the fact that the markets see bond yields as being kept artificially low by the Fed while, at the same time, the earnings picture remains very cloudy.

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In summary, any further increases in the market level and/or market valuations will depend most heavily on future earnings growth. Our view is that the headwinds from the collapse in oil prices will diminish by the second half of this year and, when combined with the strength in employment and housing, should allow for earnings momentum to resume to the upside. In the interim, however, the market is likely to trend sideways and successful portfolios will depend upon good sector and stock selection.

Please consult with your advisor if you would like to discuss any of these comments in further depth.