Winslow, Evans & Crocker, Inc.SM

APR. 2017 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

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

Climbing A Wall of Worry: The Big Picture Positives We See For The Balance of 2017

As we exit the first quarter of 2017 and examine the domestic and global environment we continue to see evidence that keeps us bullish through at least the end of the year. As you can see from Chart #1, our stylized depiction of our economic/interest rate environment, we continue to trend up into the Goldilocks sector as incoming economic data remains strong and interest rates stay tame. Also, as we pointed out last month, a similar scenario is unfolding globally thus putting us in a synchronized recovery mode.

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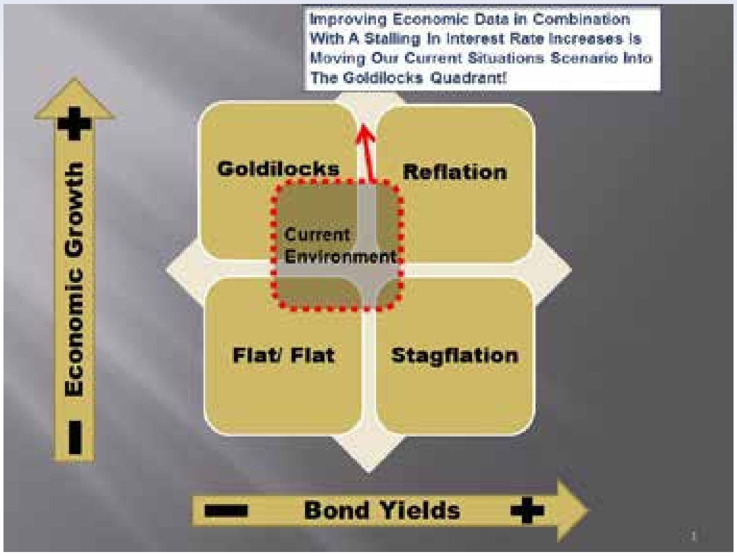

CHARTS 2-3

Chart #2 shows the economic surprise indices for the US, Eurozone, China and the Emerging Markets. It is clear from this chart that the economic data has been handily exceeding expectations and in a positive trend since mid-2016. One of the first major positives that we see for the balance of the year is that the improvements in domestic economic data and employment trends has not caused a spike in inflation expectations or interest rates. After having a post-election surge, interest rates and inflation expectations have been moving within a narrow band, Chart #3. One of the reasons for these muted inflation expectations is that labor costs have not accelerated in concert with the improvements in the jobs market.

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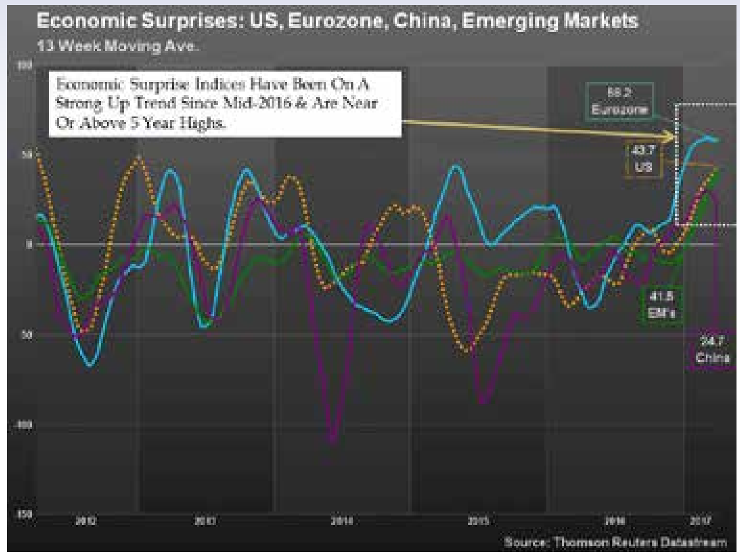

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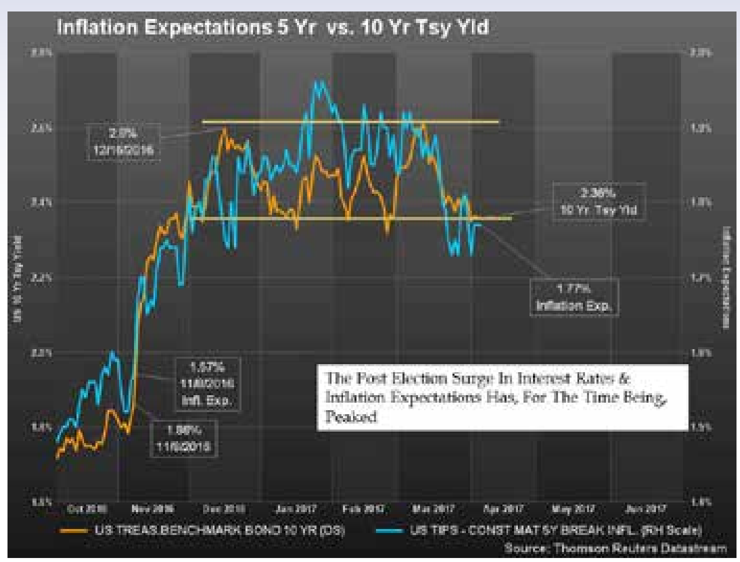

CHARTS 4-5

In Chart #4 we show the jobs openings data (JOLTS) as the orange line. It has clearly exceeded the peak of the last cycle in 2007. Yet the growth in various labor cost indicators such as Average Hourly Earnings (AHE) and the Employment Cost Index (ECI), as shown on the chart, remain well below the last cycle. The causes for this divergence are likely due to hidden slack in the labor markets and the increasing use of automation. There is also an argument to be made that actual productivity is higher than that captured by the official statistics. More importantly, however, is the implication that the full employment level that the Federal Reserve should target, the so called NAIRU (Non-Accelerating Inflation Rate of Unemployment) has probably dropped from 5.0%, the level that the Fed has traditionally targeted, to around 4.2%. Unemployment is currently around 4.7% which means that the Fed will raise rates very gradually and inflation will likely remain tame. This will be bullish for equities until such time that unemployment drops below the 4.2% rate, probably sometime in mid-2018. One way of determining whether or not the Fed is in a tightening or easing mode is to subtract the core PCE deflator, the Fed's favorite measure of inflation, from the effective funds rate as shown in Chart #5.

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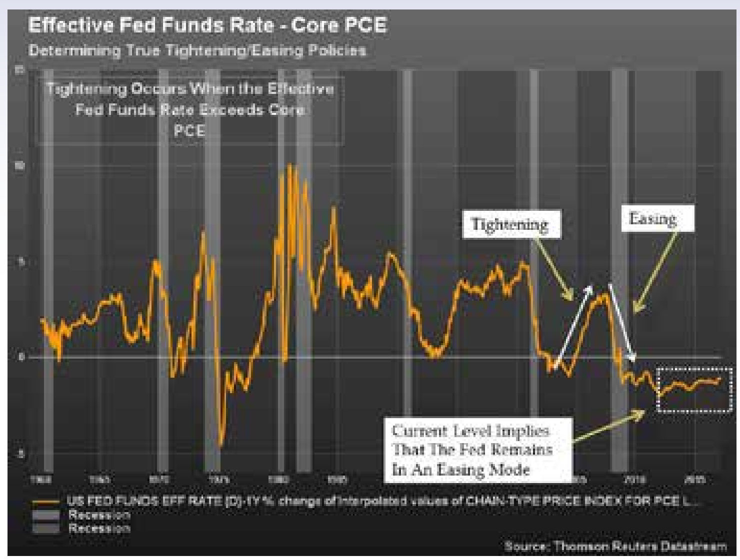

CHARTS 6-8

The white arrows indicate periods of tightening and easing. Despite the recent Fed's recent rate increases this chart implies that we remain in an easing mode. Coupled with the positive news about inflation is the evidence that we are currently enjoying a synchronized global recovery which is being reflected in strong earnings growth worldwide. Chart #6 provides this evidence. The global Purchasing Manager's Index is above its 2014 peak and the OECD's index of leading economic indicators has risen to its July 2014 level. This global economic momentum is helping to reduce fears of "tail risks". This is evidenced by the divergence between two macro indicators: the value of the US$ and the global equity index, shown in Chart #7. Within the white square box you can see that as the US$ increased in value (gold line, inverted) the global equity index also declined. This was a flight to safety. Since that time, however, the global equity markets have rebounded sharply even as the US$ continued to appreciate. This is indicative of a fading of "tail risk" fears. This will be positive for equities. US economic data continues, on the whole, to be positive. The ISM Manufacturer's Survey, shown in Chart #8, remains elevated and is at about the highs of late 2014.

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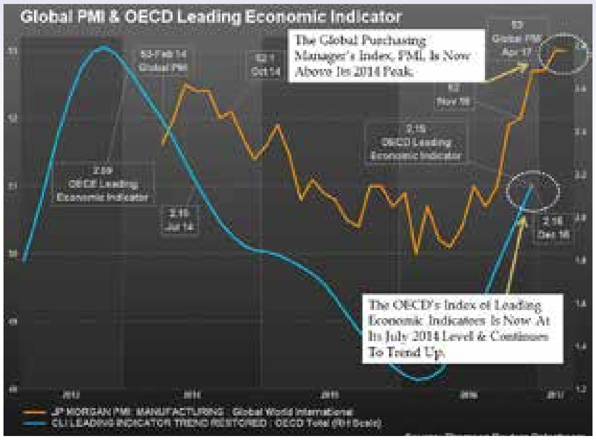

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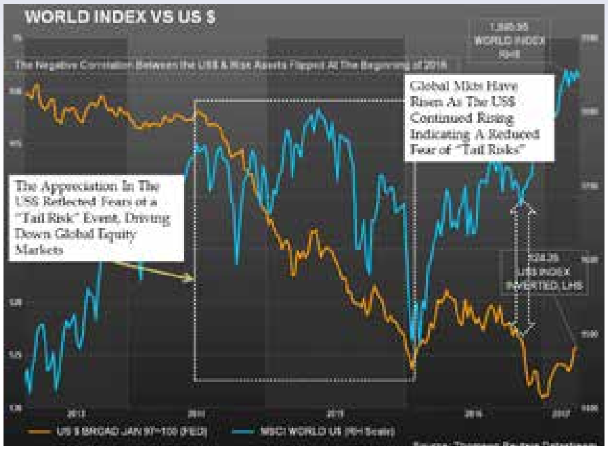

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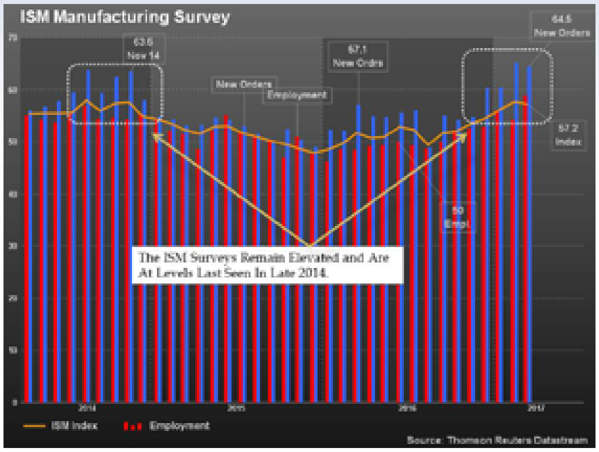

CHARTS 9-10

You'll notice that the blue bar, which represents new orders, is at a three year high. This is important because it is a good leading indicator of forward earnings growth for the S&P500. Chart #9 illustrates how this relationship has a very high correlation of .64 and leads the earnings growth rate by about five months. As can be clearly seen in this chart these ISM New Orders are very bullish for continued appreciation in earnings estimates. Another bullish factor for the US economy is the housing market. The strength in the labor markets and the gradual improvement in earnings should continue to increase the rate of home ownership. As you can see in Chart #10 there has recently been an increase in the labor participation rate, the gold line, which will pull up the level of home ownership, clearly benefiting the housing industry.

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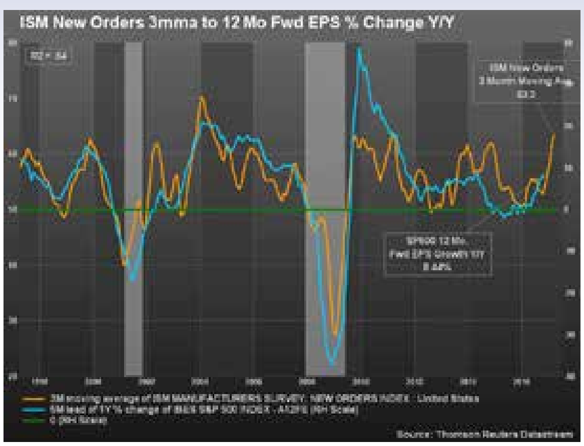

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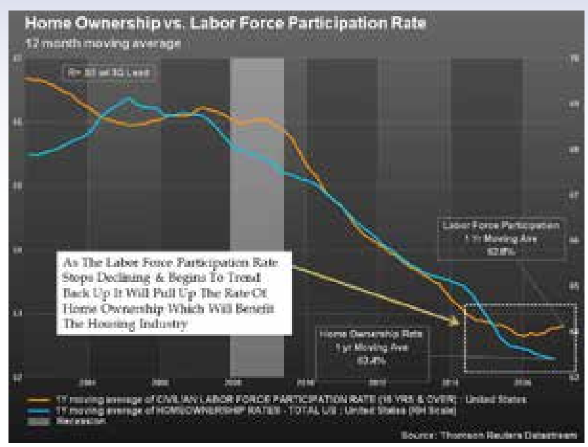

CHART 11

In conclusion, we see several positive domestic and global factors which point to reduced fears of a “tail risk” event and which will help drive down the Equity Risk Premium as illustrated in Chart #11. Please consult with your investment advisor if you would like to discuss this report in reference to your portfolio.

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