



2017 Outlook For the Financial Markets

*We ask,
listen
and solve*

February 13, 2017

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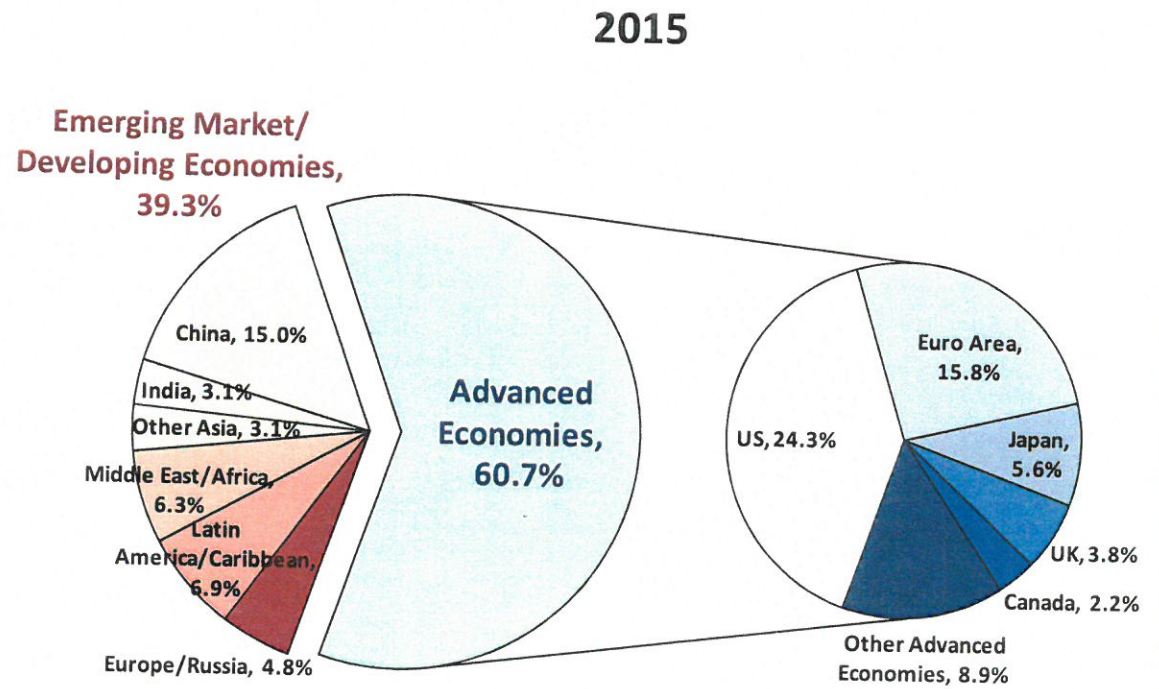
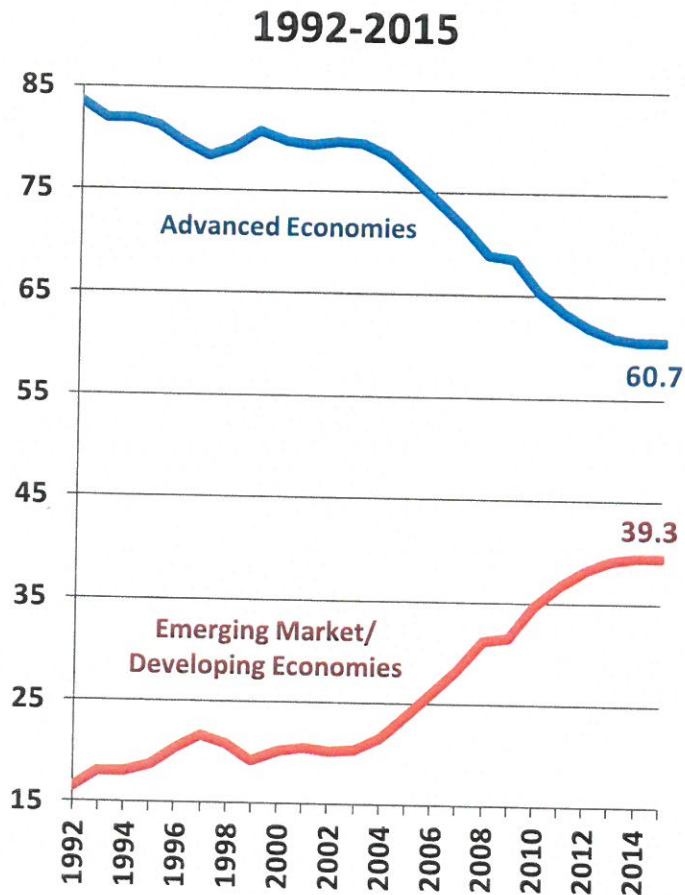
2017 Economic Themes

- The surprise “Trump” election has been received positively by the financial markets. At the margin, potential initiatives will likely focus on an infrastructure spend, healthcare reform, and regulatory/tax reductions. Risk assets particularly banks and finance have benefited as the expense of the lower volatility/interest rate sensitive sectors.
- Real GDP grew at 1.9% in Q4, following a rise of 3.5% in Q3, bringing GDP growth for 2016 to 1.9%. Personal consumption expenditures have risen, while capex has remained lackluster. These indicators reveal a mixed picture, but GDP growth will likely be capped at 2.0%-2.5% during the next six to nine months at least until more clarity appears on Trump’s pro-growth policies.
- The FOMC raised the Fed Funds rate target range to 0.50-0.75% at their December meeting, while maintaining their cautious stance. Going forward, the pace of rate hikes is expected to be gradual; with two increases projected for 2017.
- December nonfarm payroll employment added 156,000 jobs in the month, while the unemployment rate ticked up to 4.7%. The reported numbers were generally in line with expectations, indicating steady economic growth in the US. Job growth is averaging 167,000 over the past three months, a good trend but nothing spectacular.
- Corporate credit spreads have narrowed significantly this year as a result of improved economic data and oil prices, steady growth in employment and income, as well as favorable credit conditions. These positive fundamentals are projected to continue into 2017.
- Quantitative easing has pushed interest rates in developed markets to extremely low – in many cases negative – levels. While these lower foreign rates have kept our interest rates low, the US has started to decouple a bit. Higher, short term rates have increased the hedging costs for foreign buyers of our bonds and Trump’s republican sweep has been viewed as potentially inflationary.
- Broadly speaking, international financial conditions, especially China and Europe, are causing headwinds for growth. However, in the US, fundamentals of employment, wages, energy prices and wealth should continue to support sustained, but slow, growth heading toward year-end.



Economic Output – Where In the World Does It Come From?

Percentage Contribution to World GDP

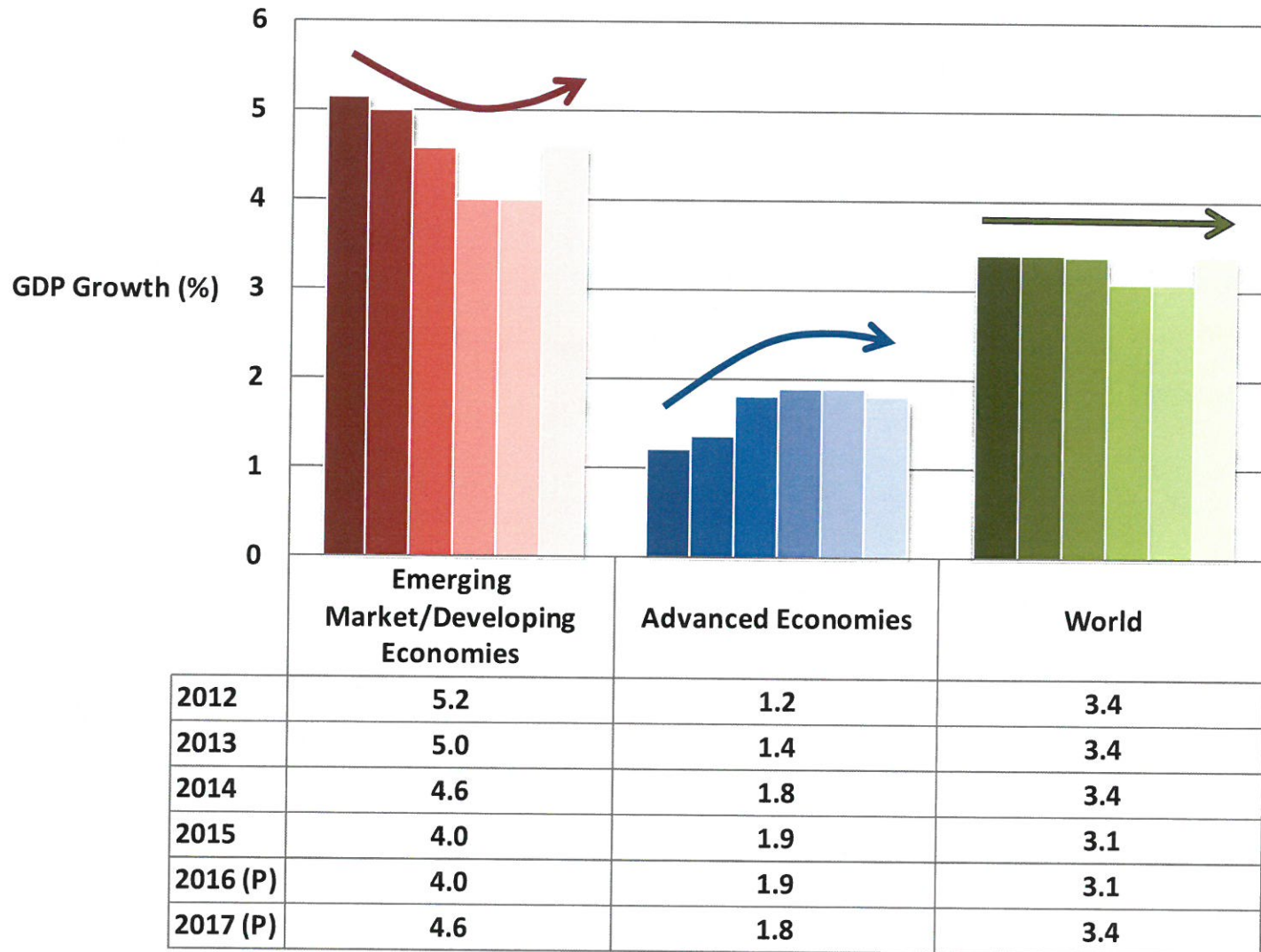


Source: International Monetary Fund



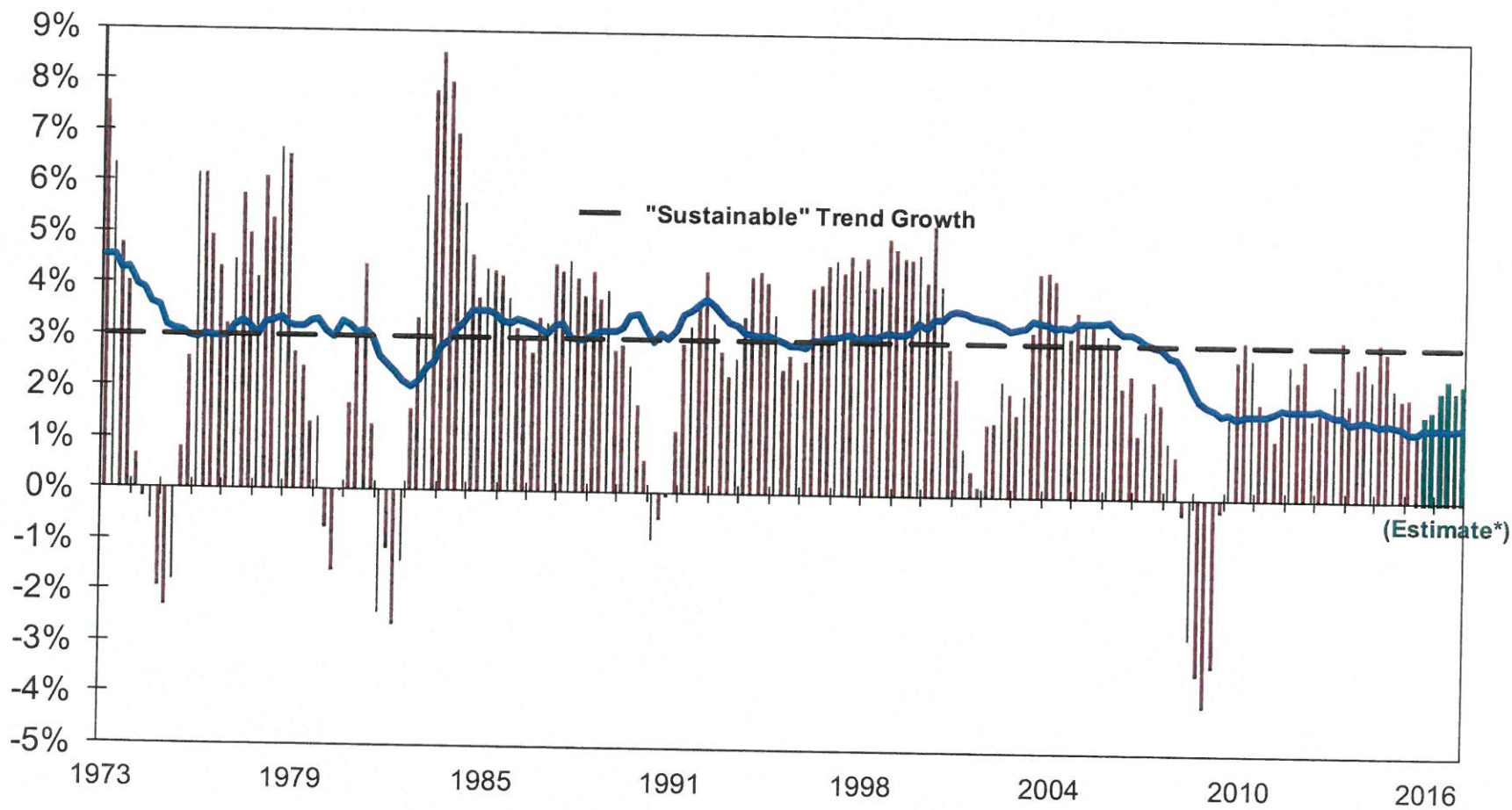
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Economic Output – Where in the World Will It Come From?

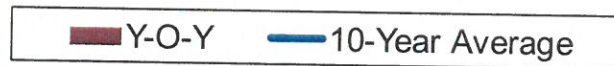


Source: International Monetary Fund

U.S. Real GDP (2% is the new 3%)

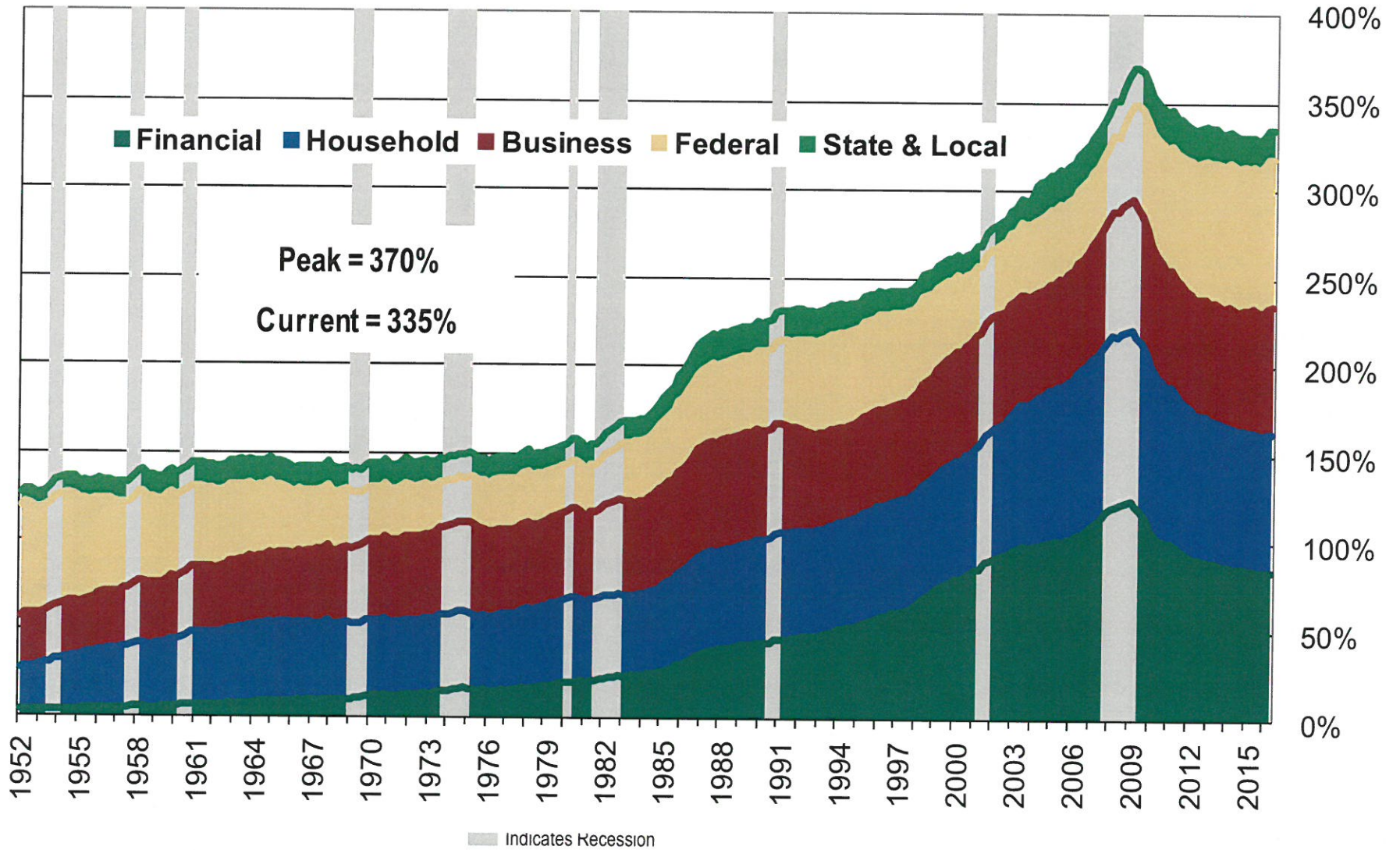


*Commerce Estimate: 2.3% for 2017



Source: Bloomberg, Bureau of Economic Analysis

U.S. Total Domestic Debt vs. GDP

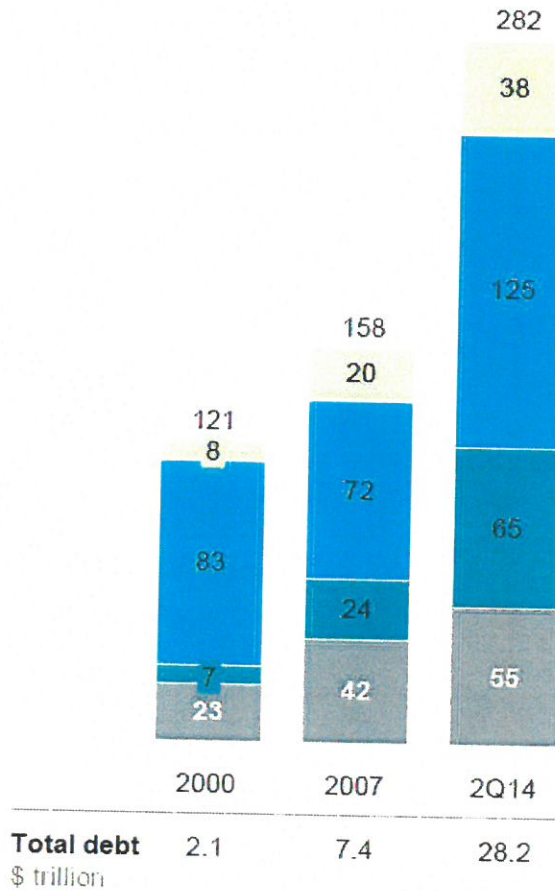


Source: Flow of Funds Accounts, Federal Reserve

China: Developing Country with Advanced Leverage

Debt-to-GDP ratio
%

China



Government
 Financial institutions
 Non-financial corporate
 Households

By country, 2Q14



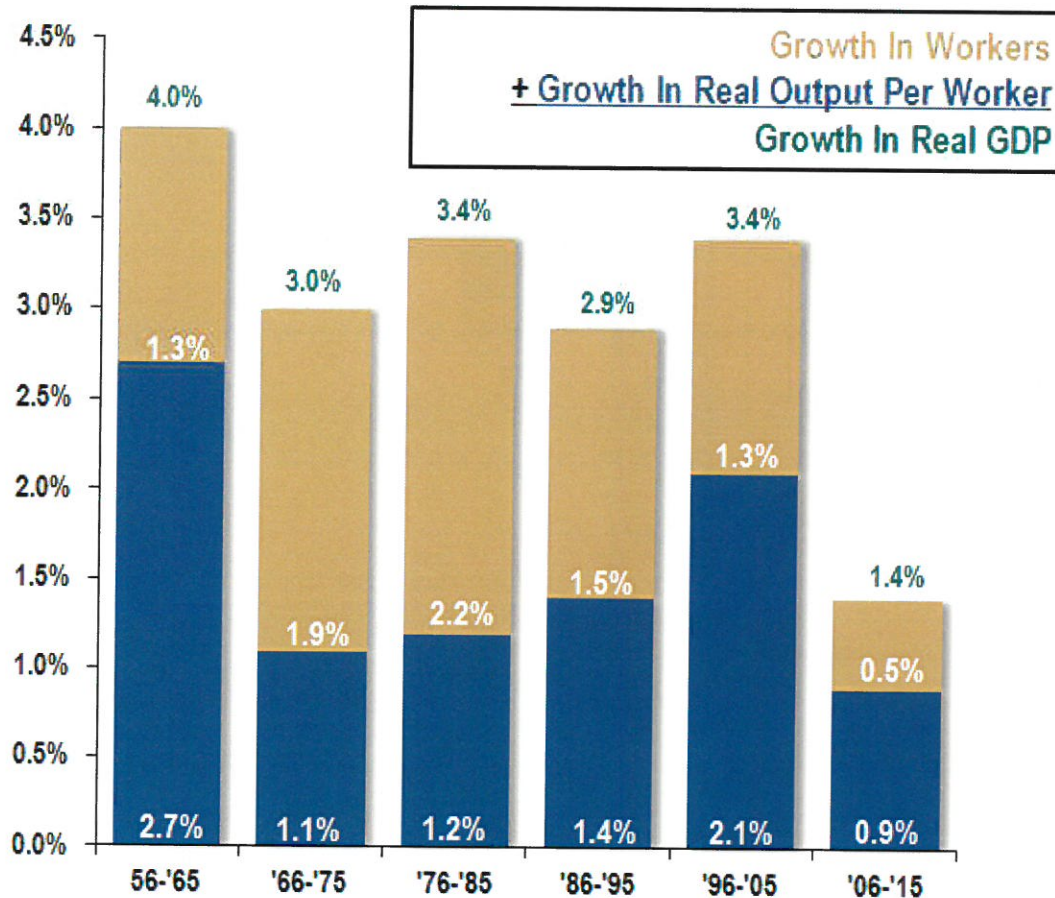
Source: McKinsey Global Institute, *Debt and (Not Much) Deleveraging*, February 2015



Long-Term Drivers of U.S. Economic Growth

Drivers of GDP Growth – U.S.

Average Year-Over-Year Percent Change



Labor Force Ages... and Exits

	<u>Median Age</u>	<u>Particip. Rate</u>
1994	37.7	62.7%
2004	40.3	65.9%
2014	41.9	62.7%
2024*	42.4	60.9%

*BLS Estimate

BLS Estimates

Avg Annual Growth 2014-24

Labor Force	0.4%
Real GDP	2.2%

Source: JP Morgan, Bureau of Labor Statistics

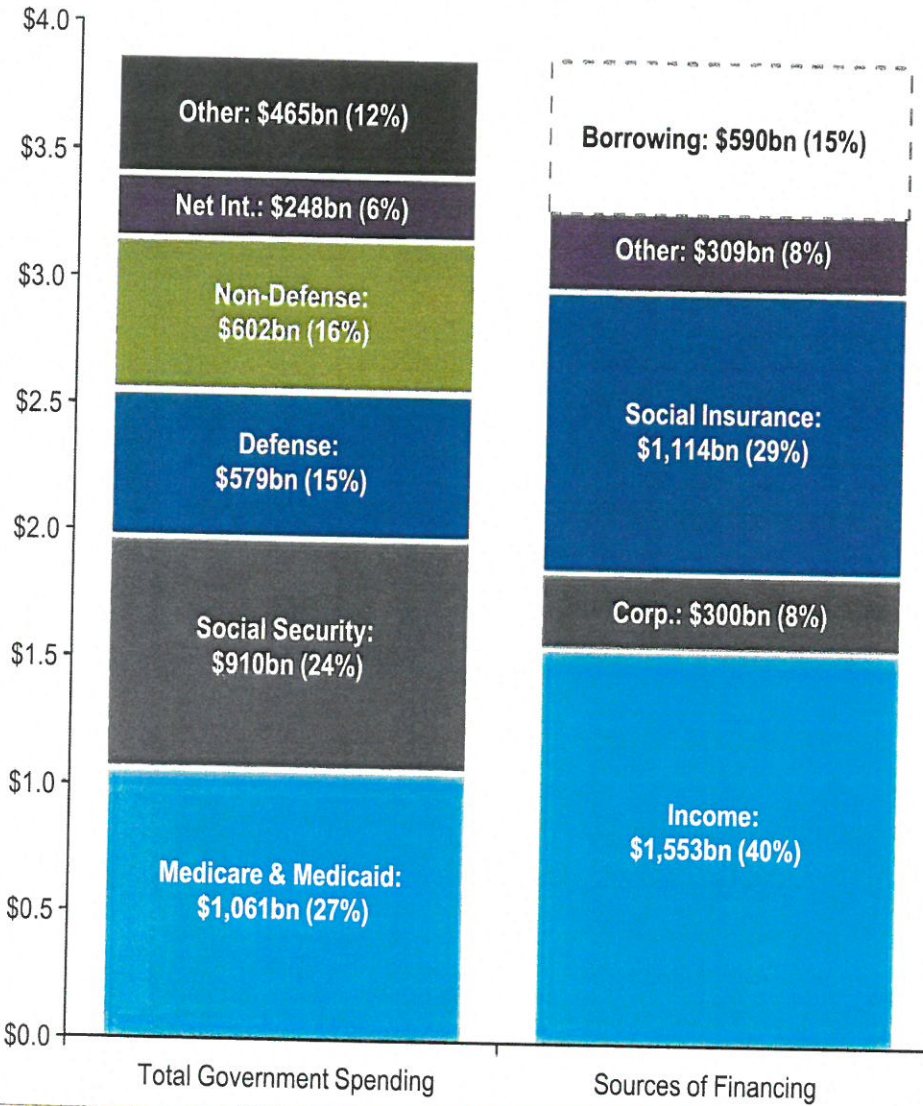


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Federal Finances

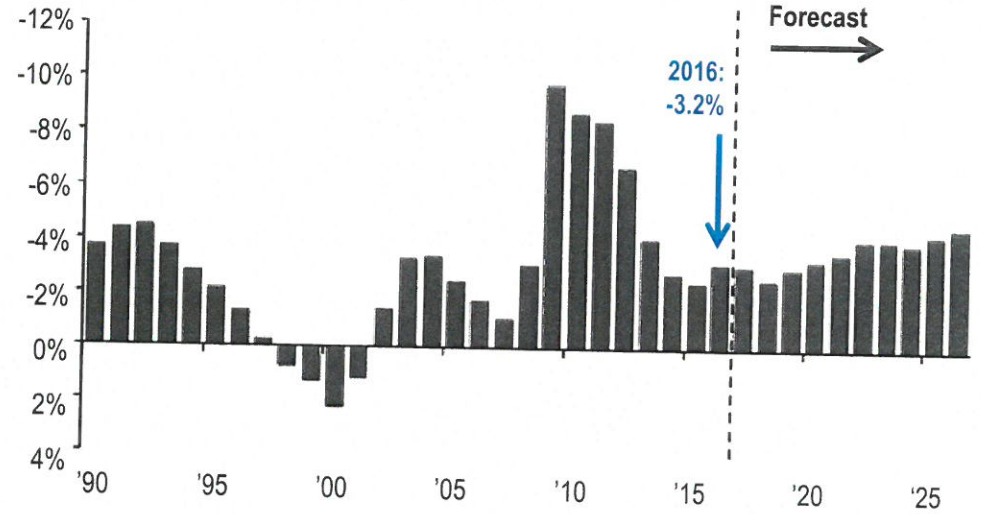
The 2016 Federal Budget

CBO Baseline Forecast, USD Trillions



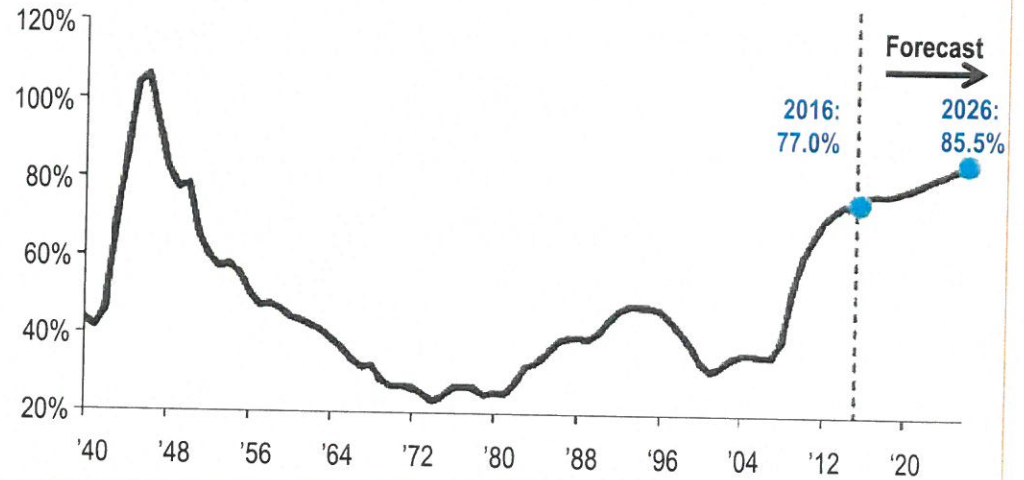
Federal Budget Surplus/Deficit

% of GDP, 1990-2026, 2016 CBO Baseline



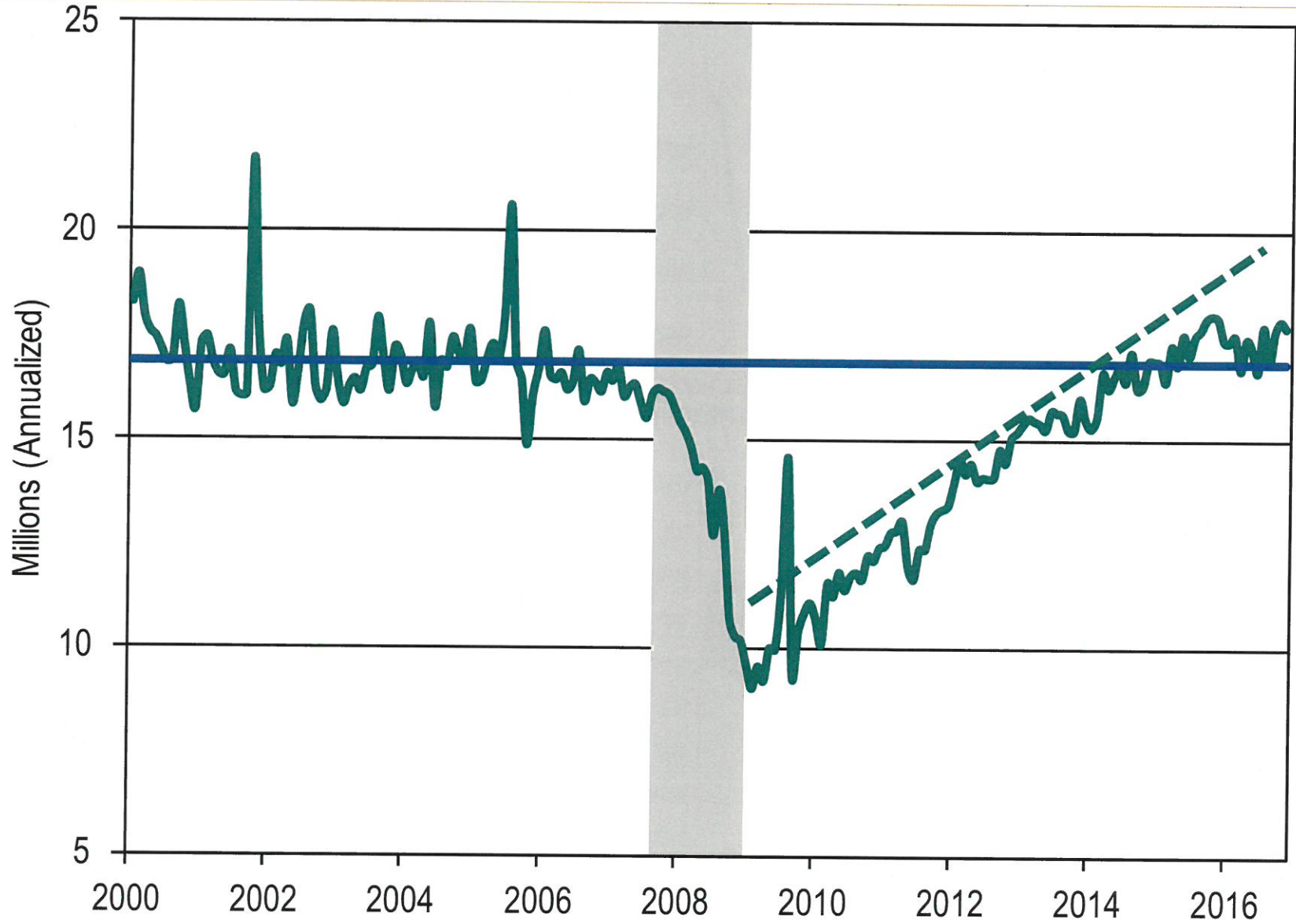
Federal Net Debt (accumulated deficits)

% of GDP, 1940-2026, 2016 CBO Baseline, end of Fiscal Year



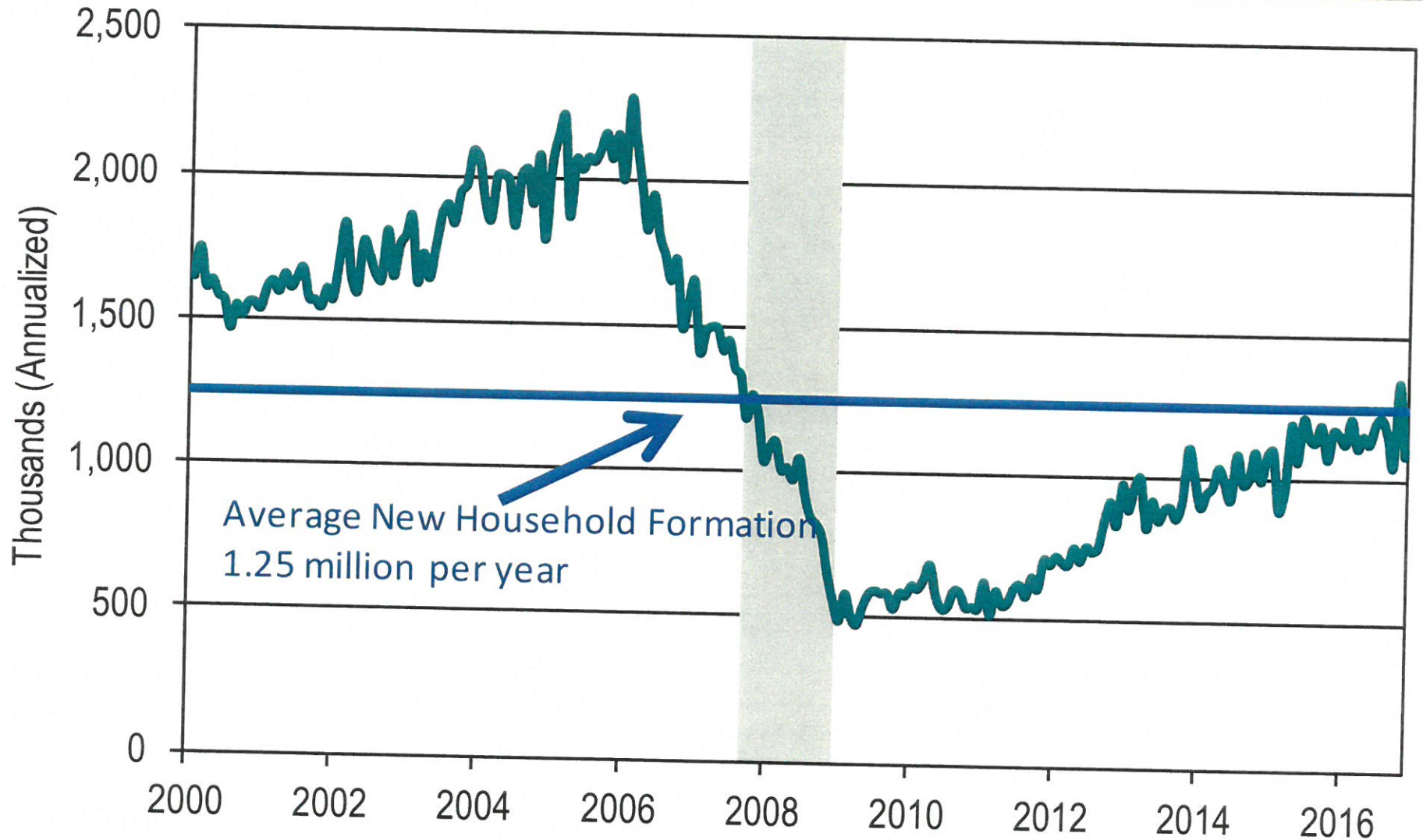
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Total U.S. Auto Sales - Recovered



Source: Bloomberg

New Housing Starts

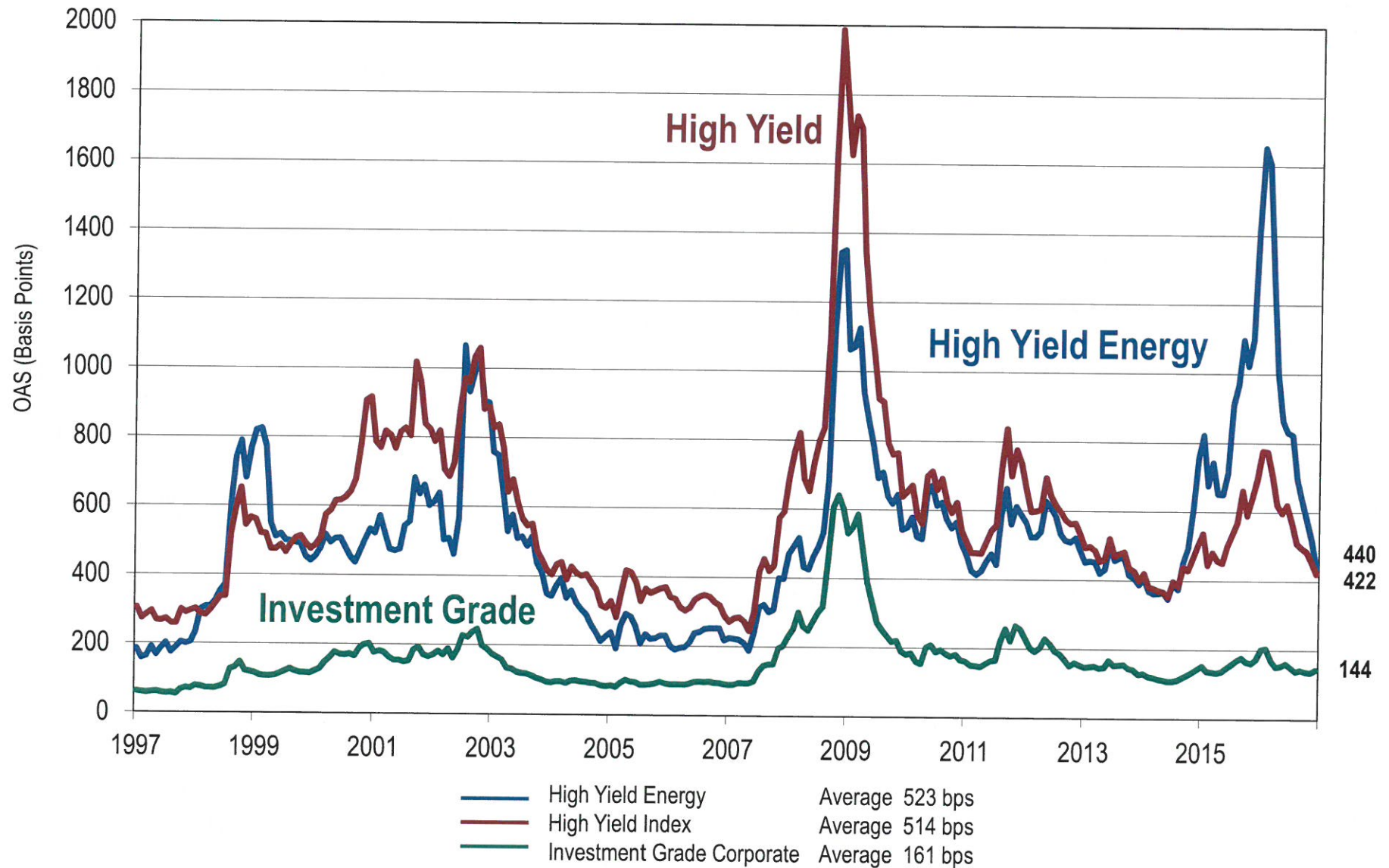


Source: Bloomberg



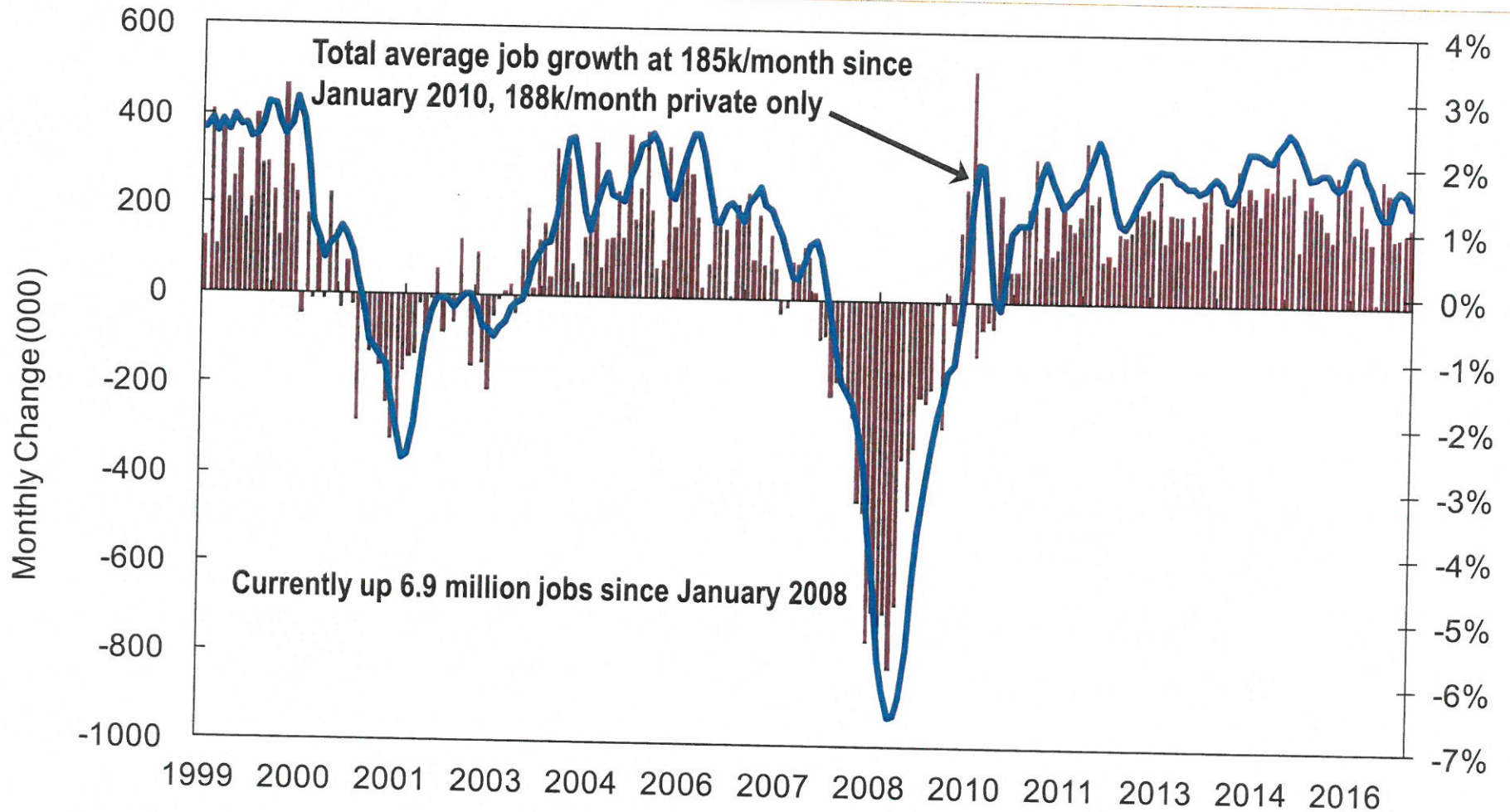
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Corporate Credit Spreads (Relative to Treasury Bonds)



Source: Bloomberg, Barclays

Employment – Steady and Better Than It Feels



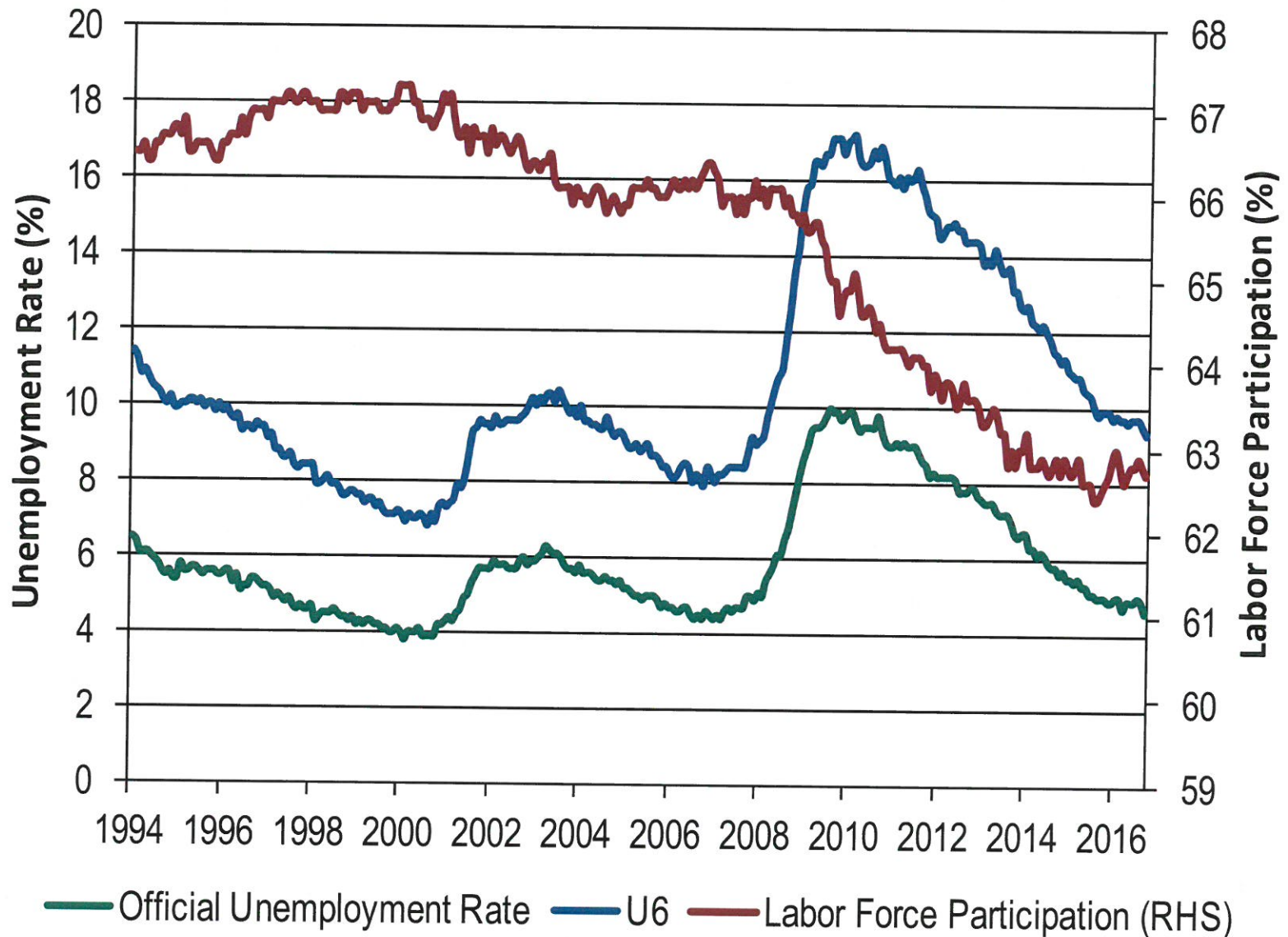
Monthly Increase (Left Axis)
 3 Month Change (Right Axis)

Source: Bureau of Labor Statistics



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Unemployment Falling but also Participation

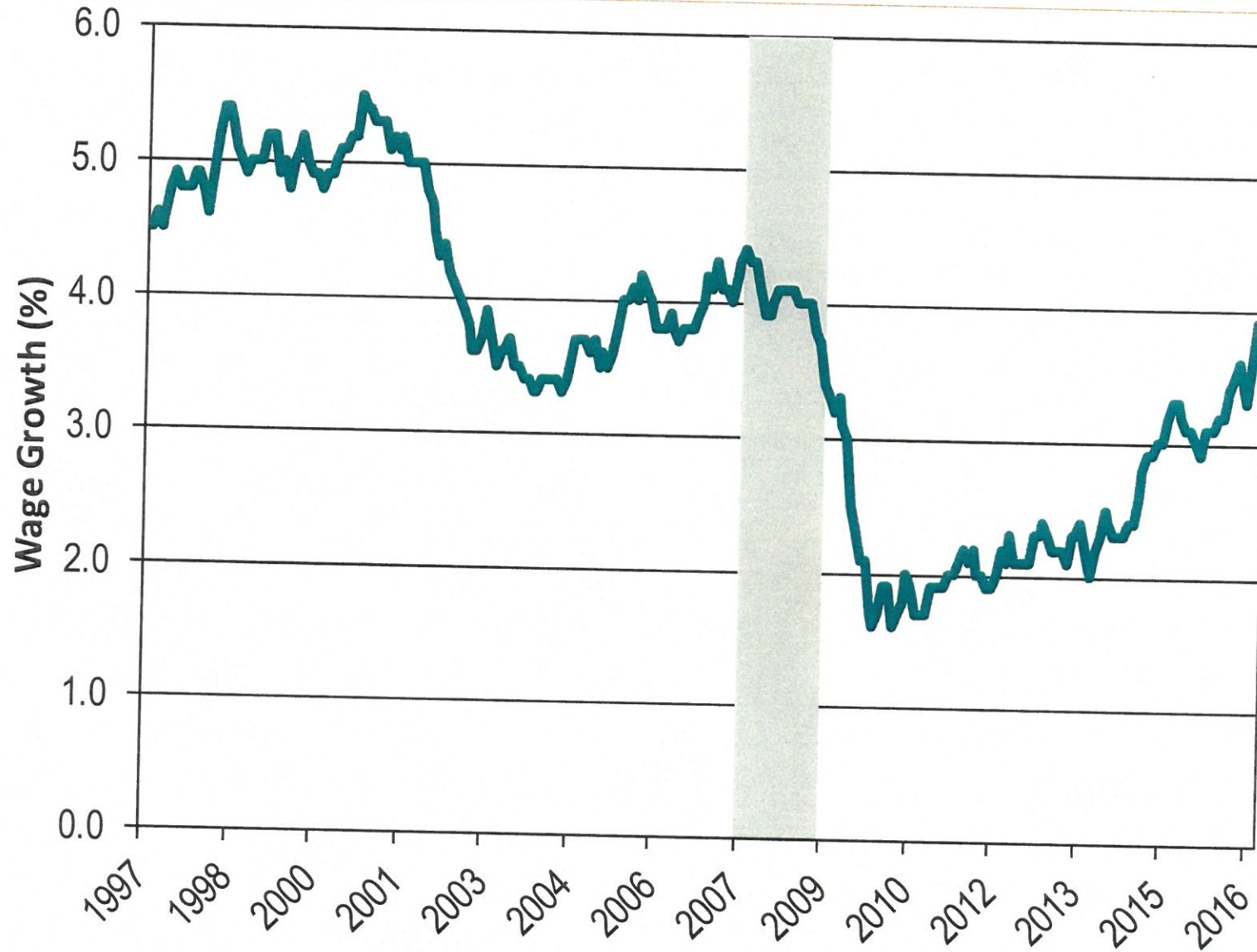


Source: Bureau of Labor Statistics



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Atlanta Federal Reserve Wage Growth

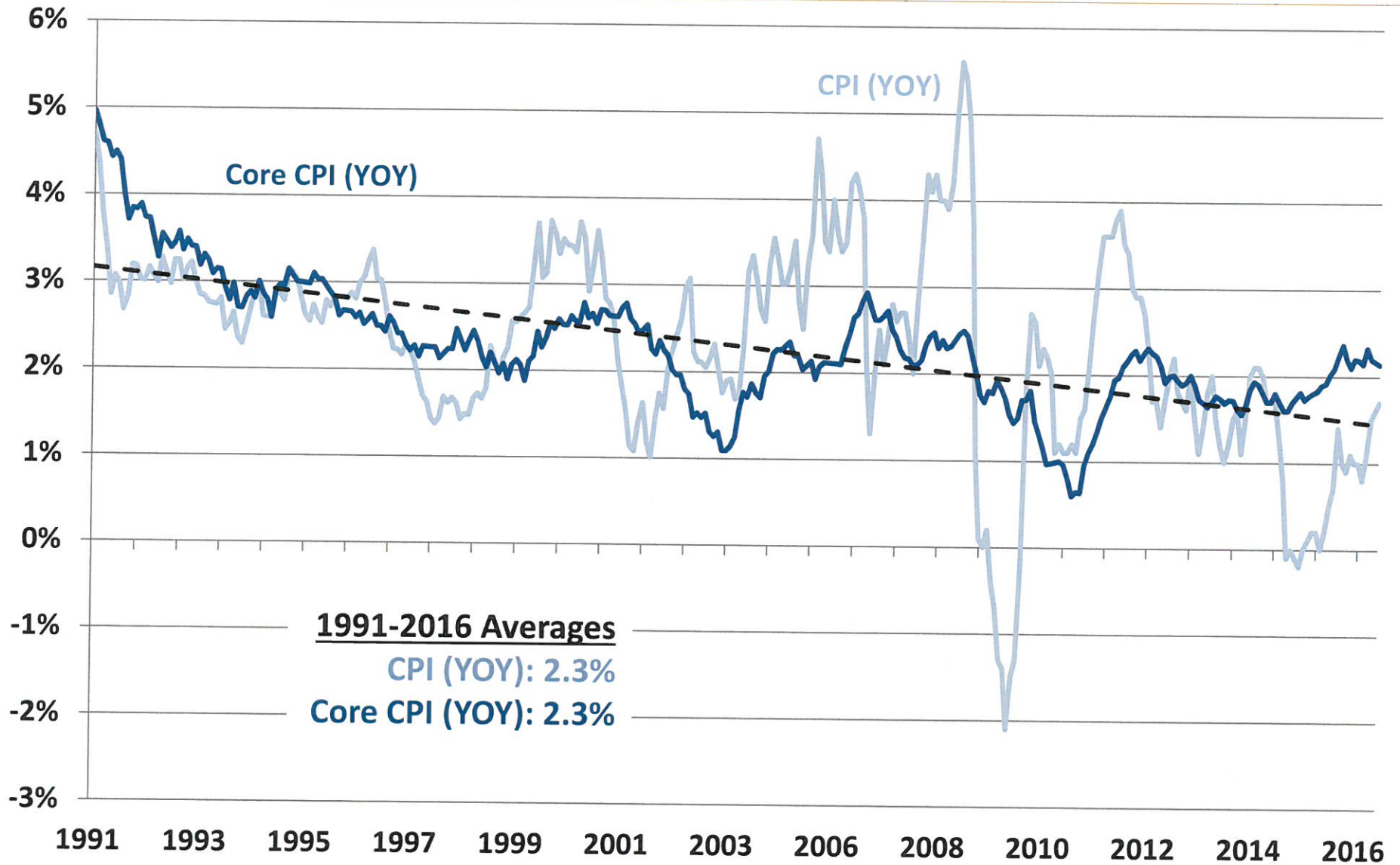


Source: Bloomberg



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Inflation – Benign but Turning Up

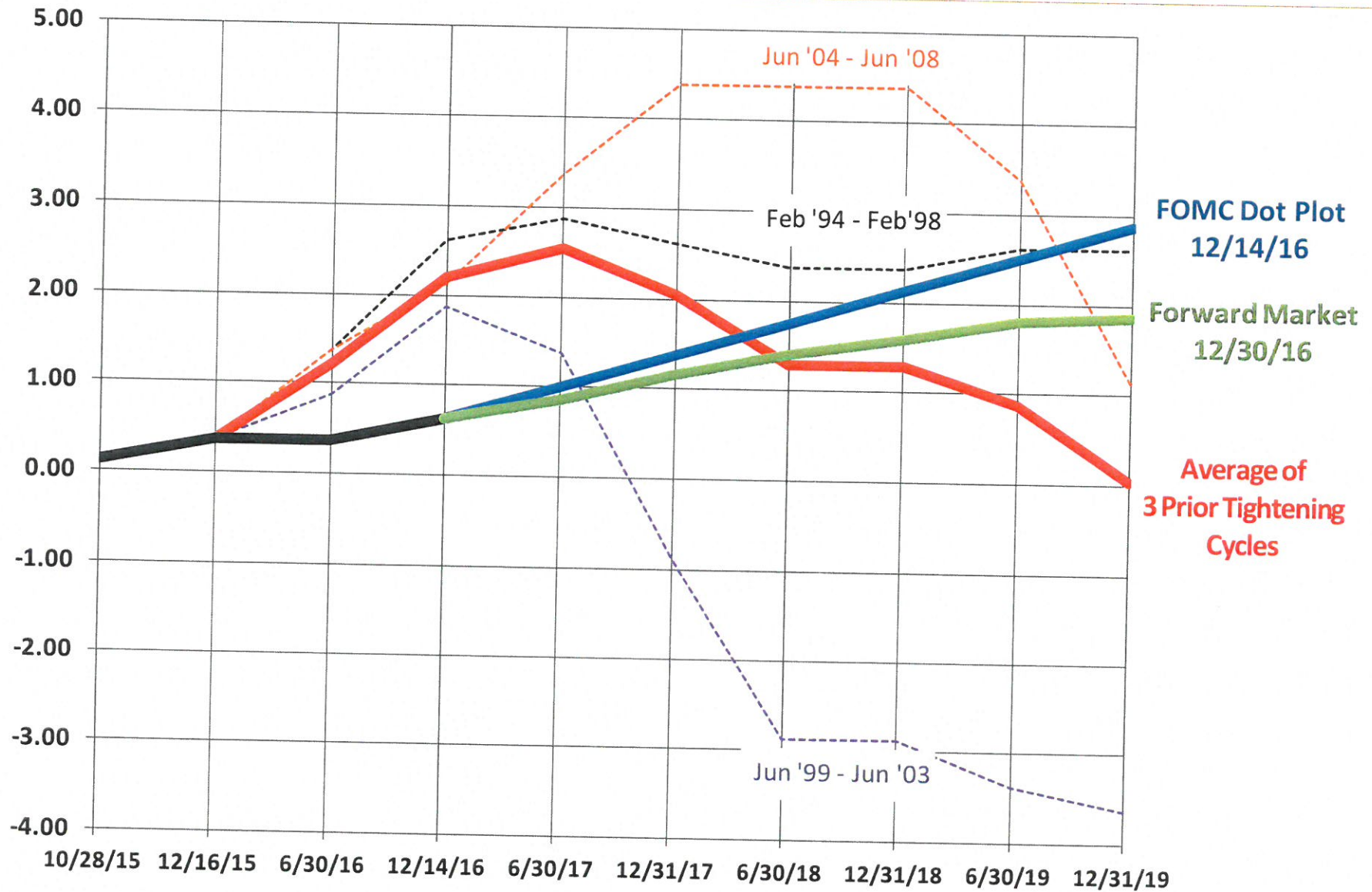


Source: Bloomberg



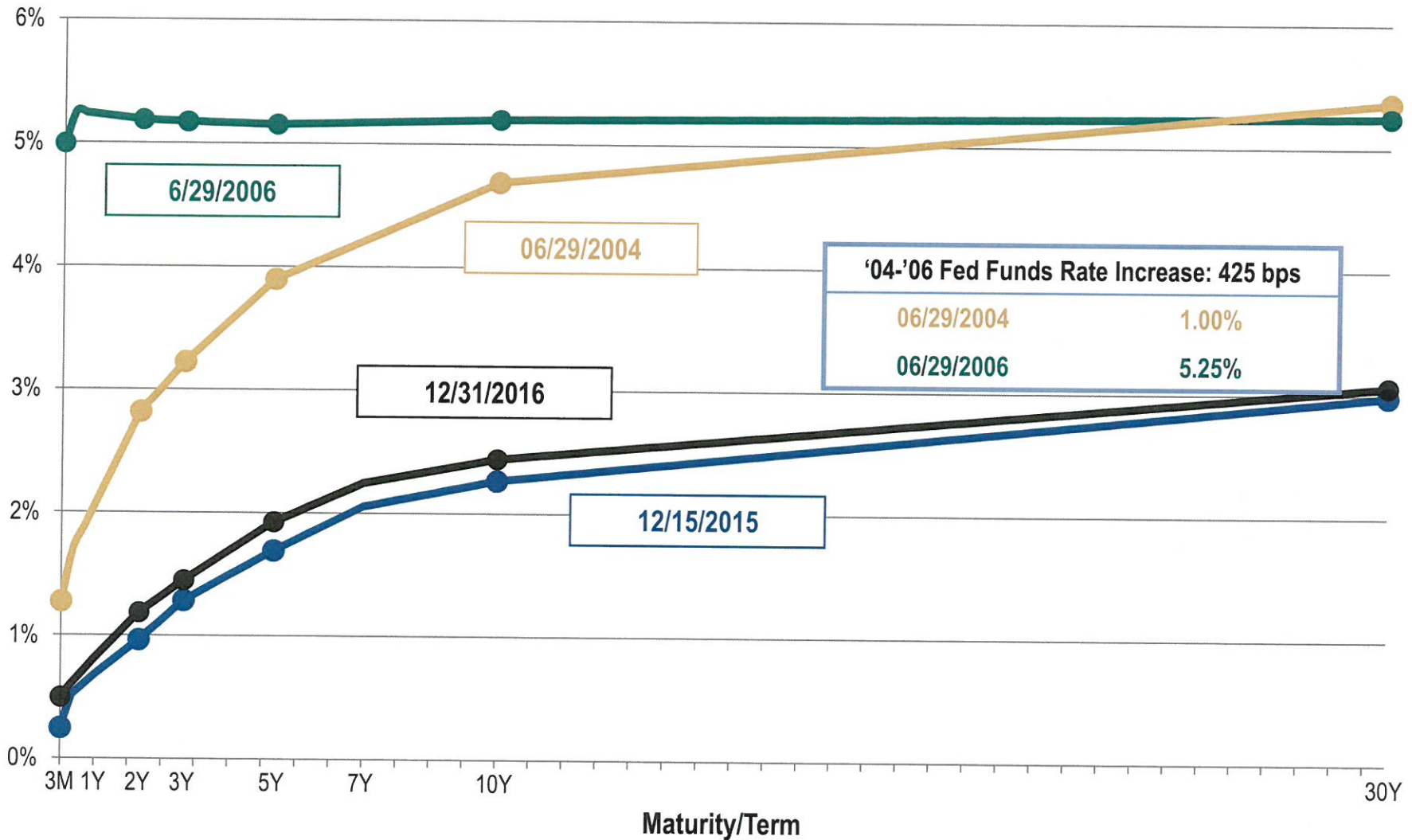
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3 Prior Fed Hikes vs. Current FOMC vs. Market Expectations



Source: Bloomberg, BofA/Merrill Lynch

Treasury Yield Curve Changes - Last Fed Tightening Cycle vs. Today's Cycle

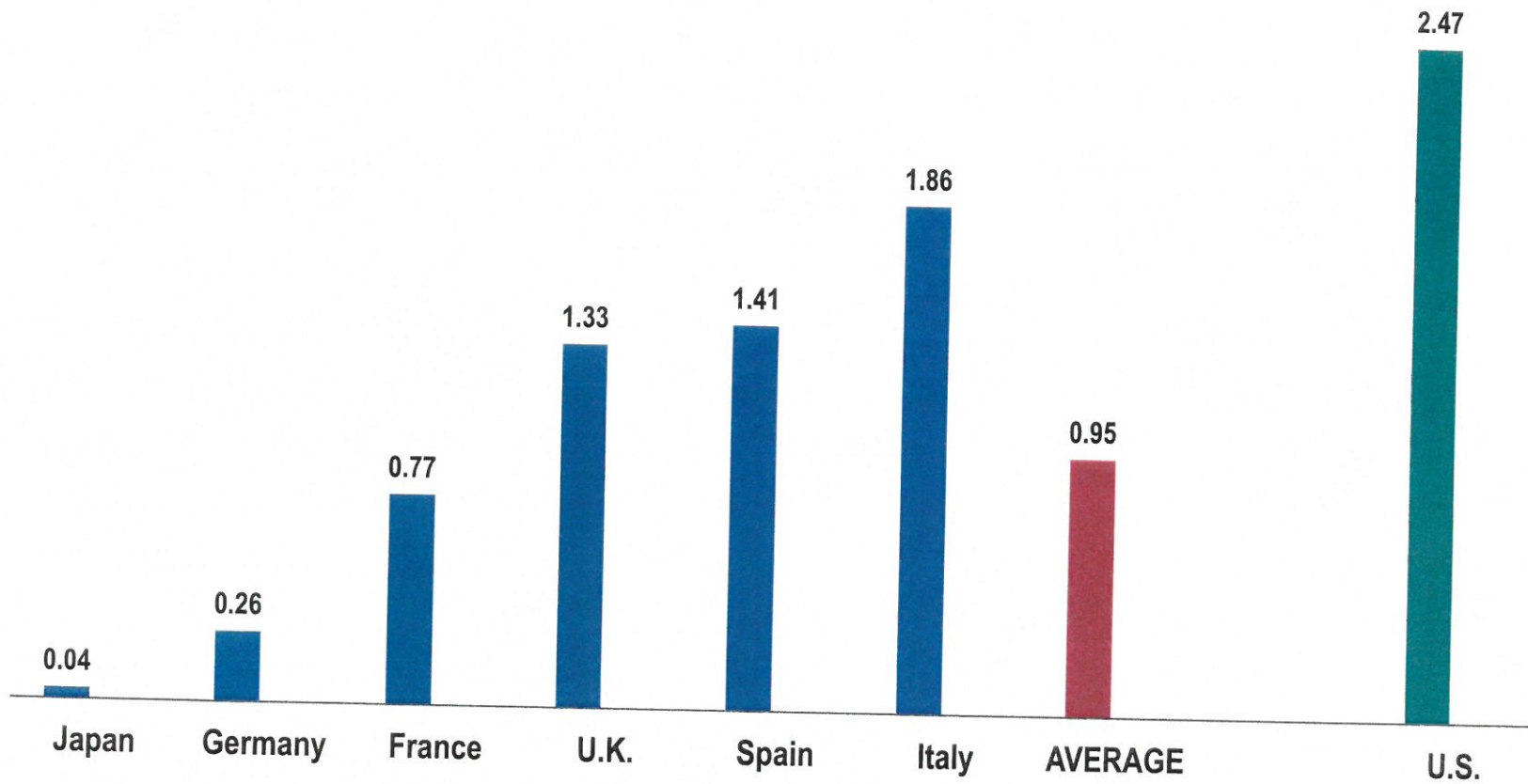


Source: Bloomberg

You Think Our Rates Are Low?

10-Year Government Bond Yields (%)

■ 12/31/2016

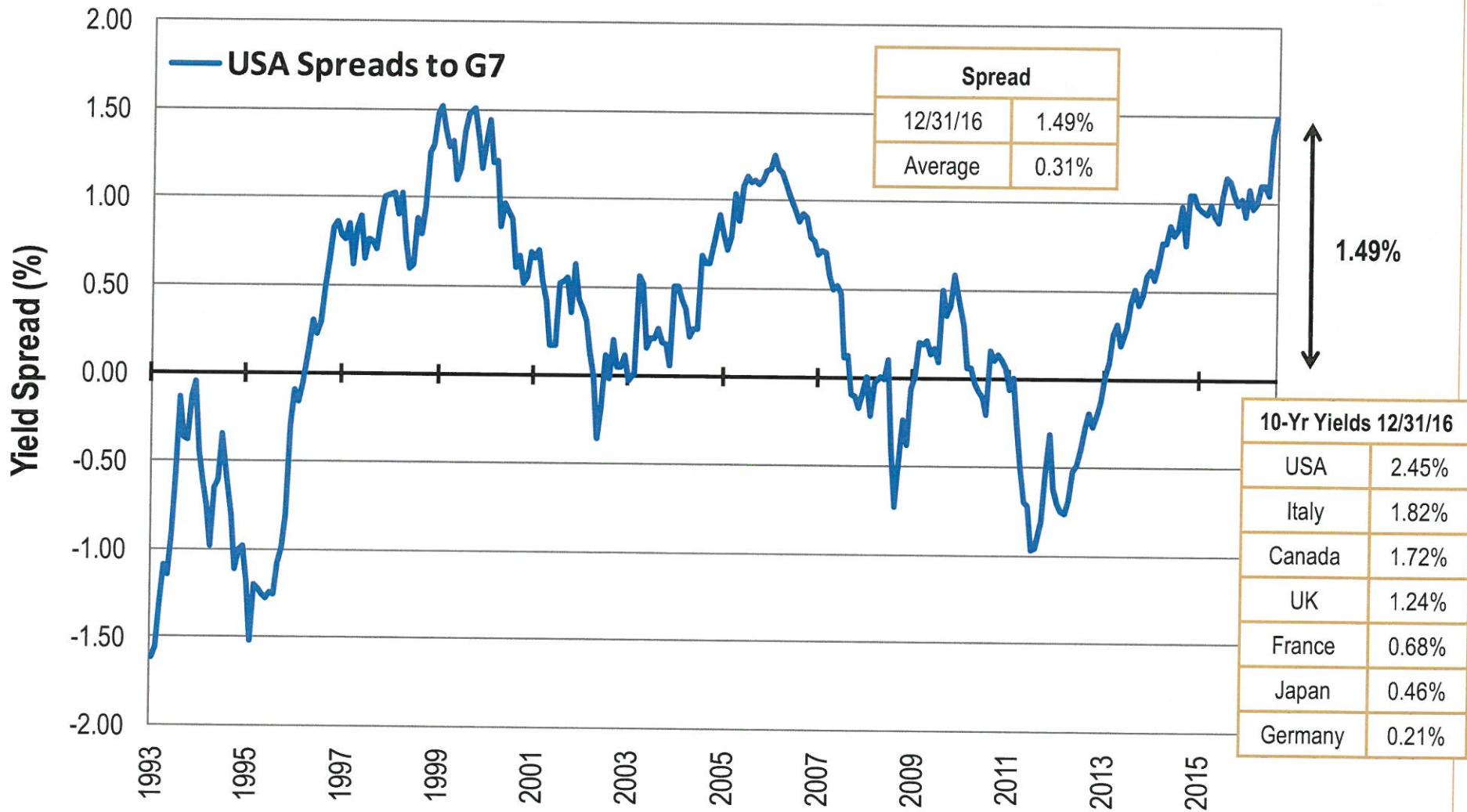


Source: Bloomberg



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10-Year Government Bond Yields: U.S. vs. G7

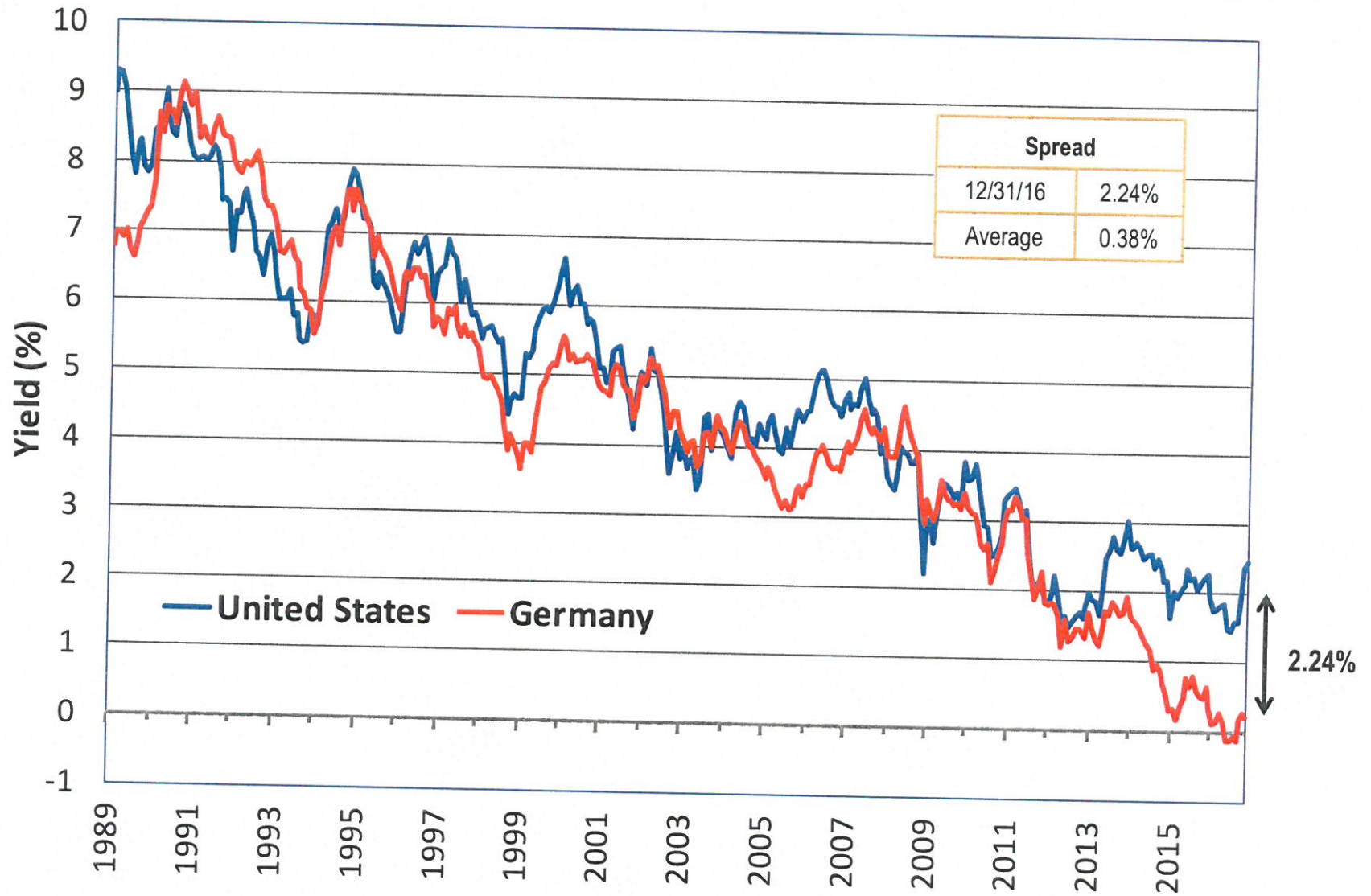


Source: Bloomberg



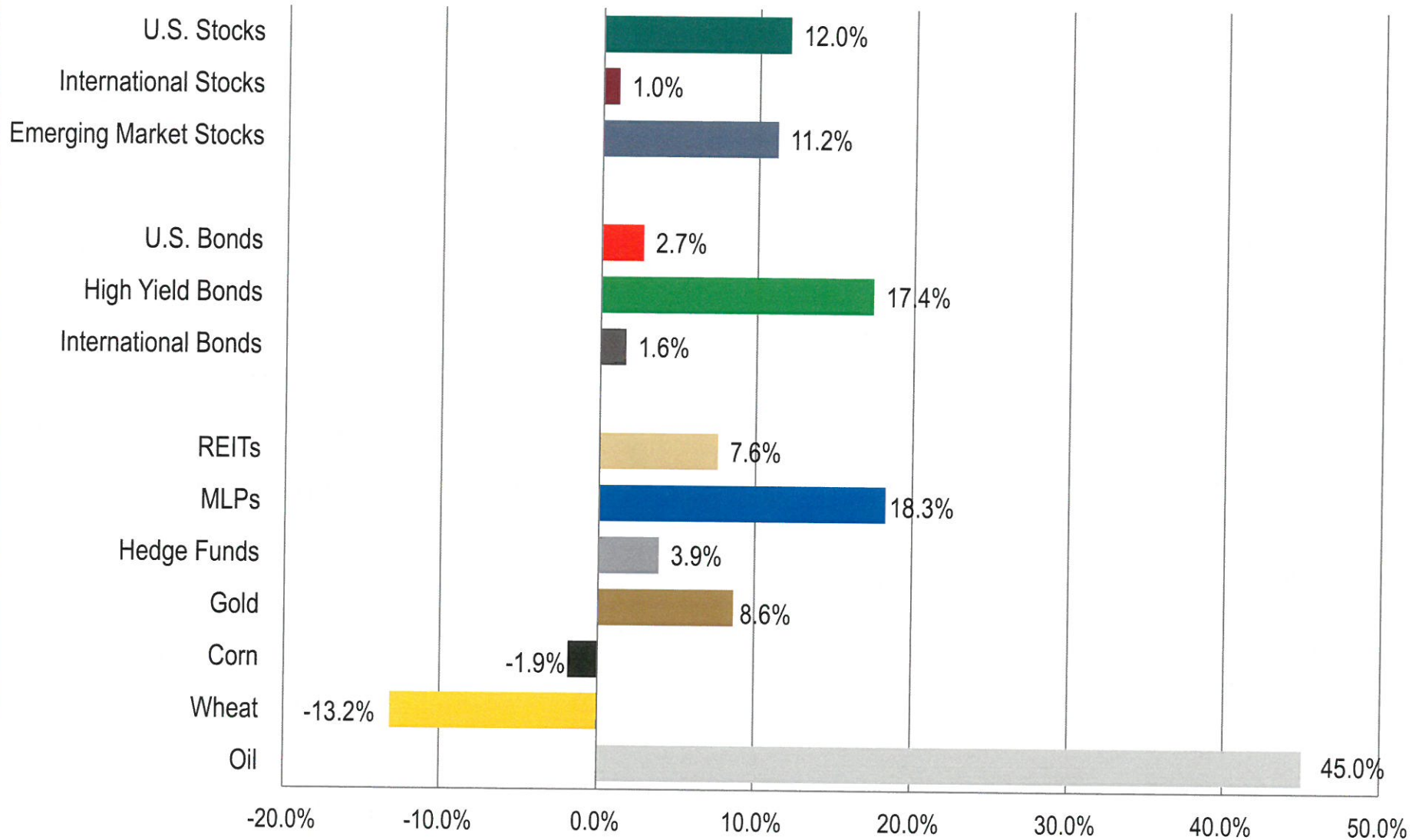
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10-Year Government Bond Yields: U.S. vs. Germany

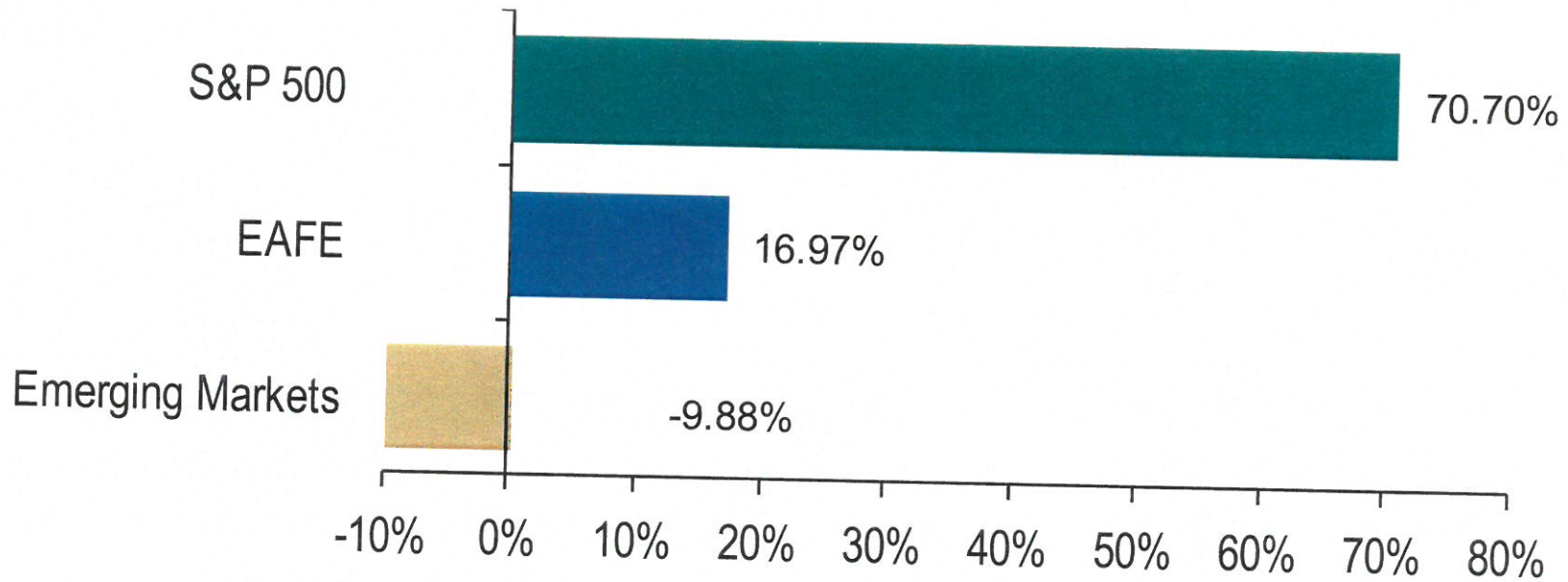


Source: Bloomberg

2016 Index Returns



Domestic vs. International Equity Returns – 12/30/12 to 12/31/16



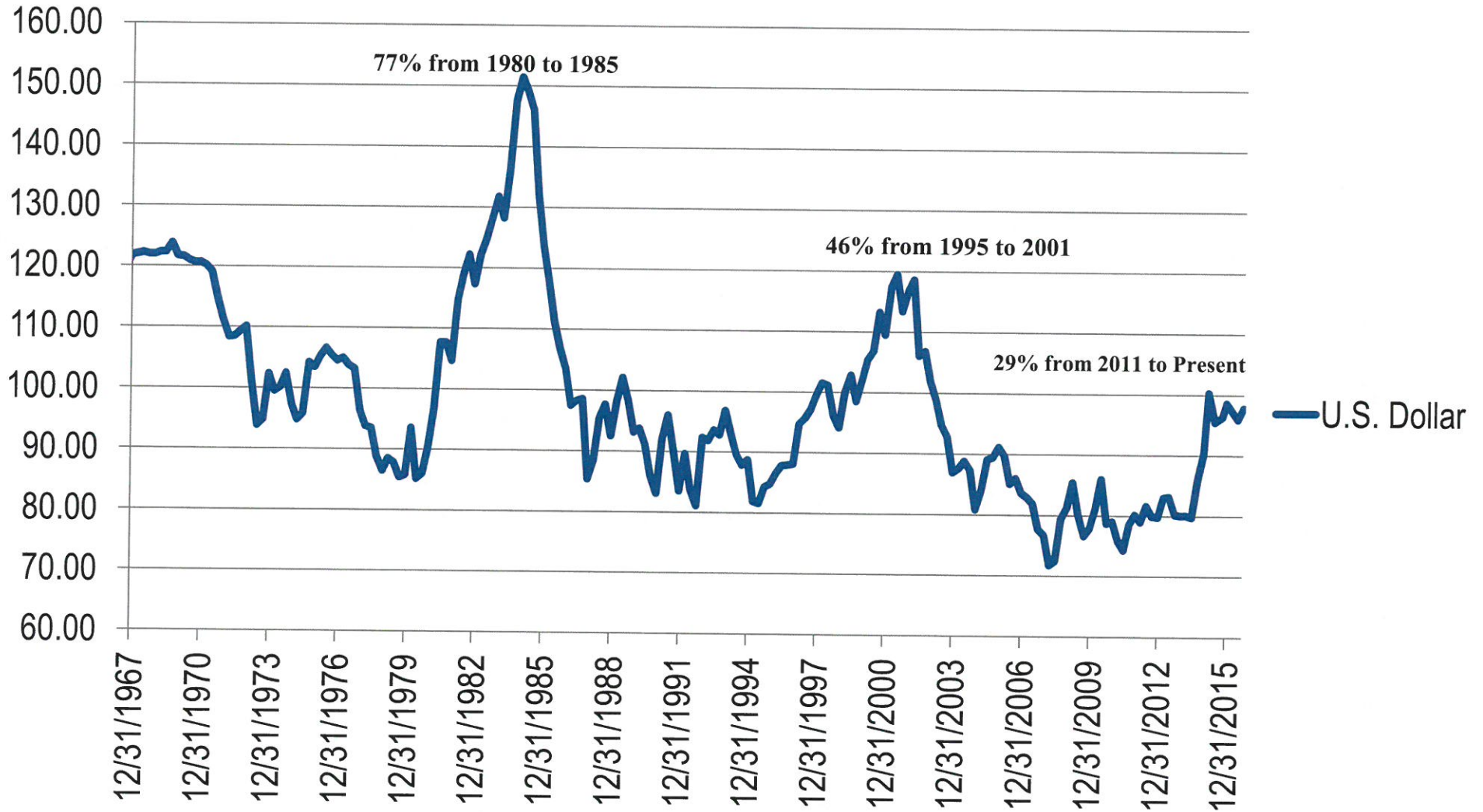
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Source: Bloomberg



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U.S. Dollar Index



Source: Bloomberg

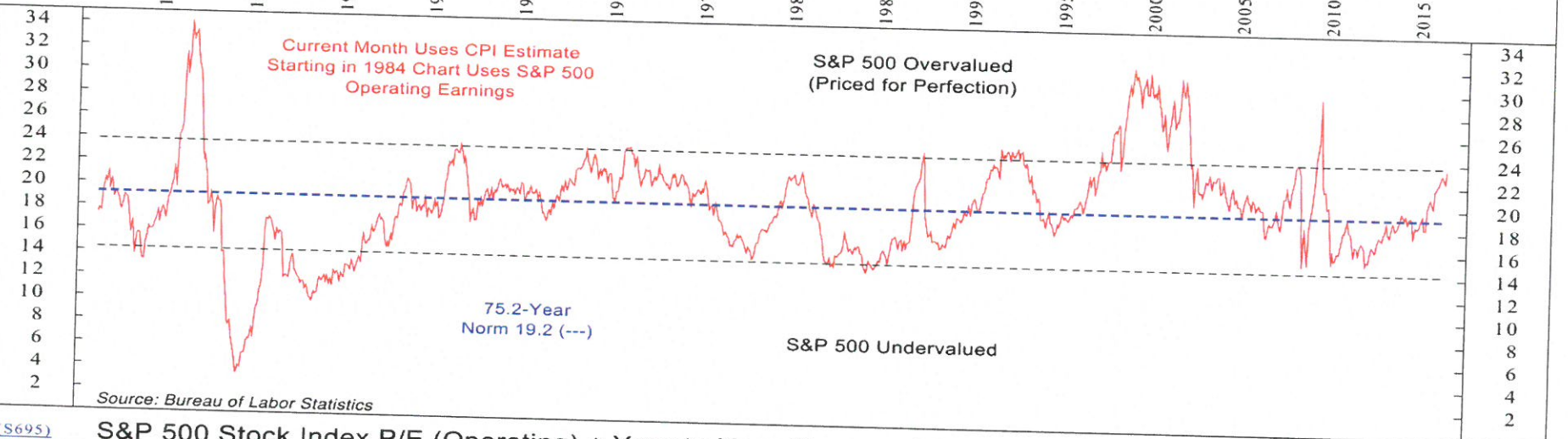
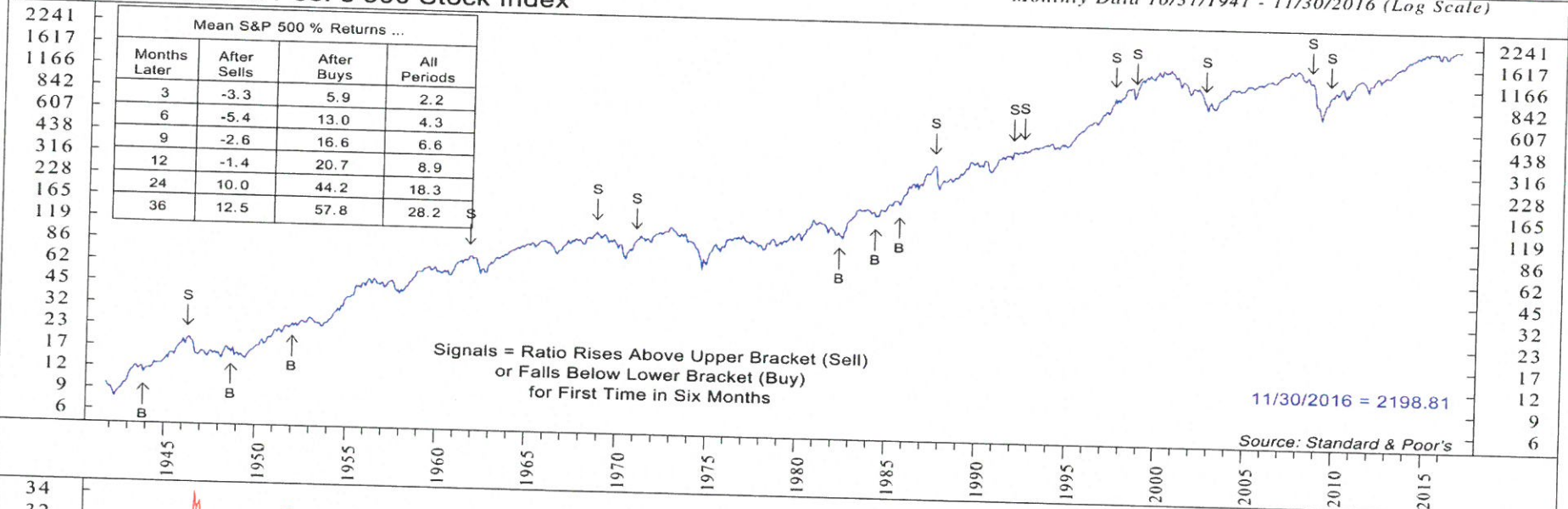


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S&P 500 P/E and Inflation Ratio

Standard & Poor's 500 Stock Index

Monthly Data 10/31/1941 - 11/30/2016 (Log Scale)



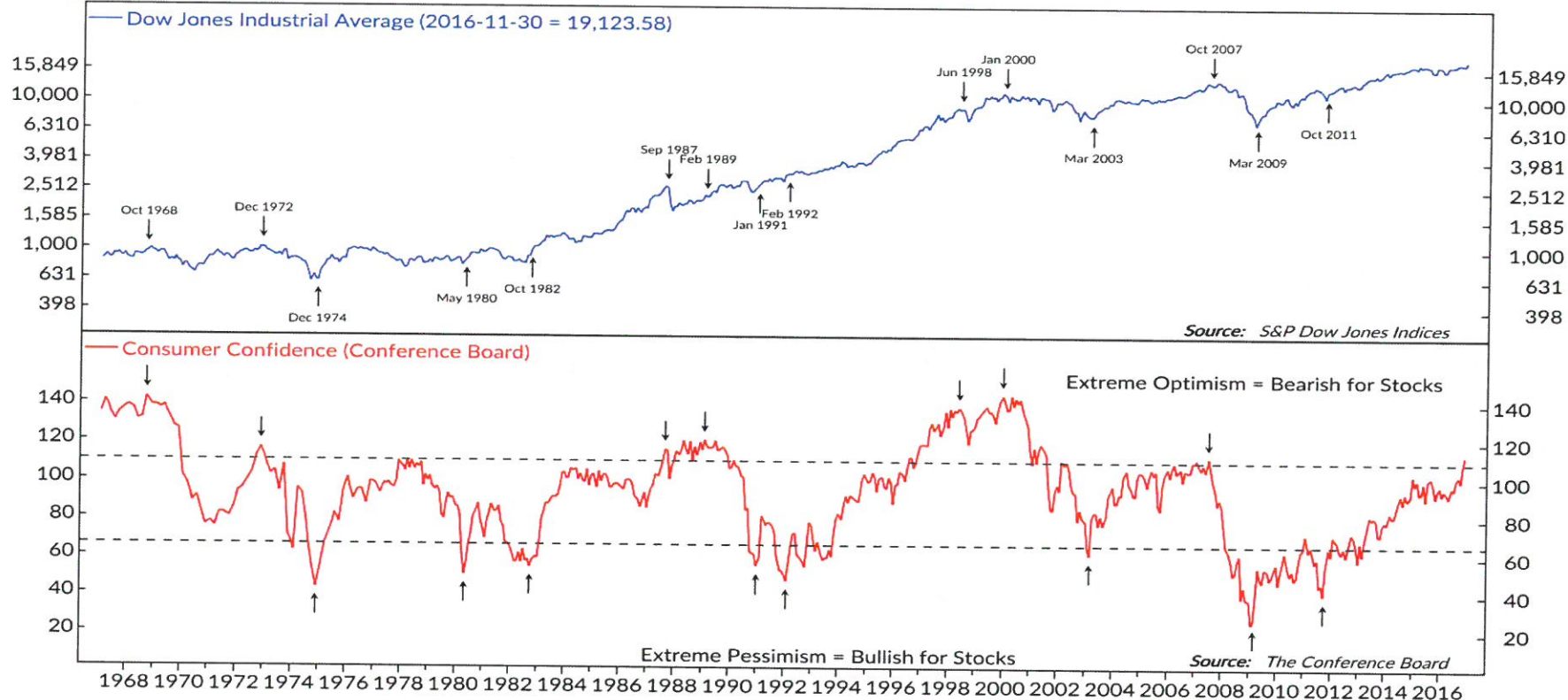
(S695) S&P 500 Stock Index P/E (Operating) + Year-to-Year Change of CPI

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Stock Returns vs. Consumer Confidence

Dow Jones Industrial Average vs. Consumer Confidence Index

Monthly Data 1967-02-28 to 2016-12-31



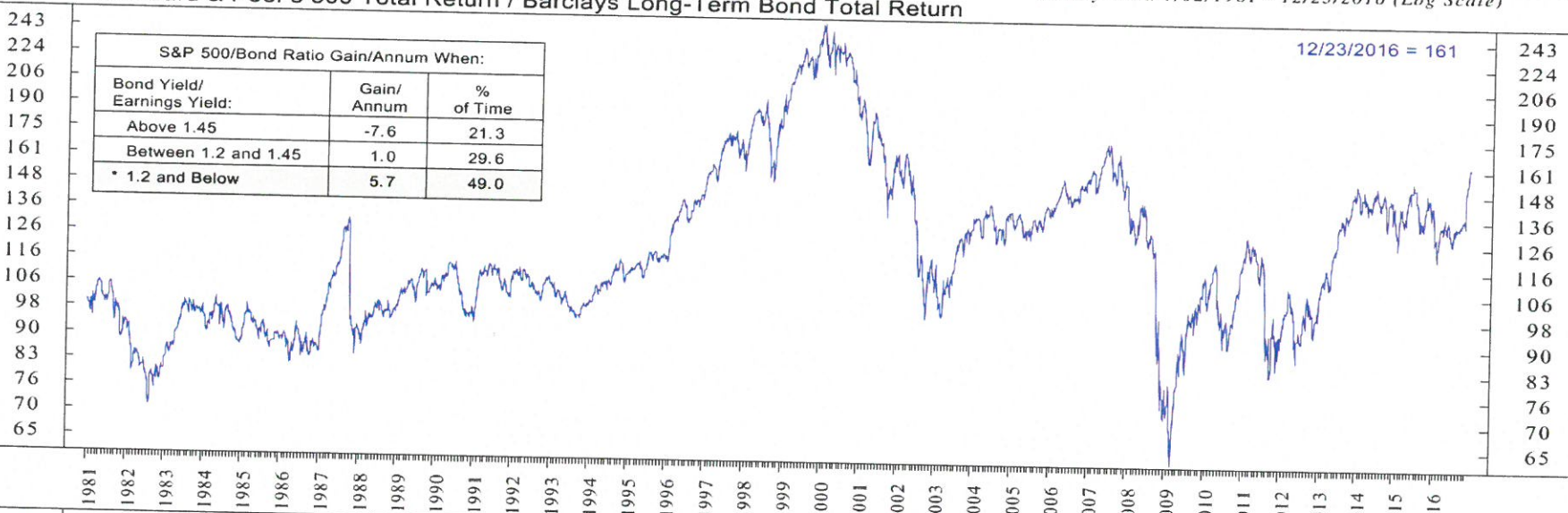
DJIA Performance		
Full History: 1967-02-28 to 2016-11-30		
Consumer Confidence Is	% Gain/Annum	% of Time
Above 110.0	0.51	21.75
66.0 - 110.0	6.40	61.03
Below 66.0	14.82	17.22
Buy/Hold = 6.48% Gain/Annum		

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Relative Value Stocks vs. Bonds

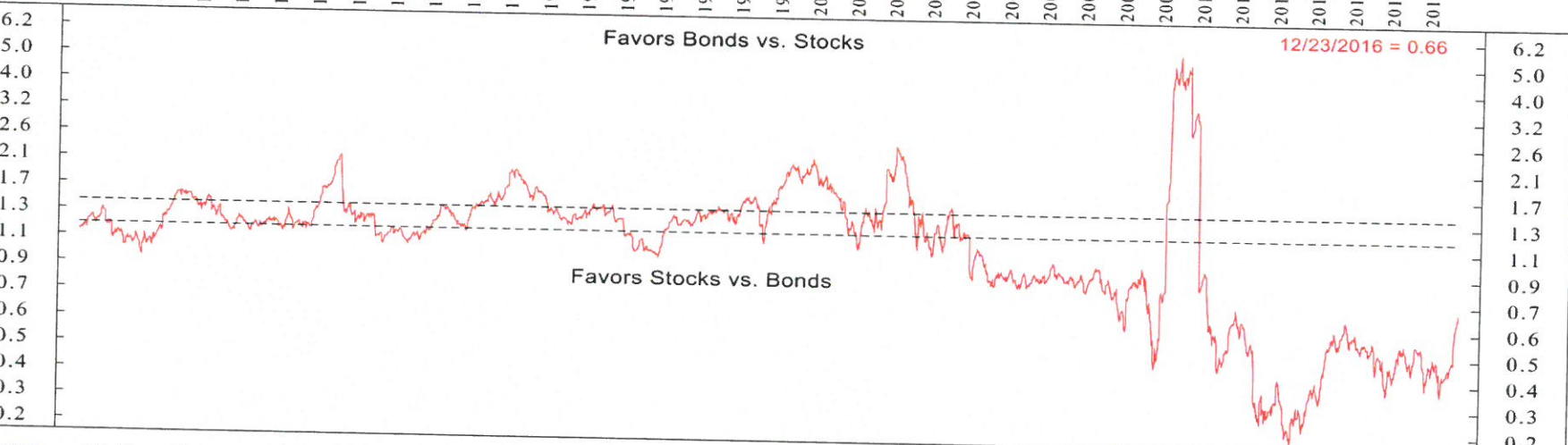
Standard & Poor's 500 Total Return / Barclays Long-Term Bond Total Return

Weekly Data 1/02/1981 - 12/23/2016 (Log Scale)



S&P 500/Bond Ratio Gain/Annum When:		
Bond Yield/ Earnings Yield:	Gain/ Annum	% of Time
Above 1.45	-7.6	21.3
Between 1.2 and 1.45	1.0	29.6
* 1.2 and Below	5.7	49.0

12/23/2016 = 161

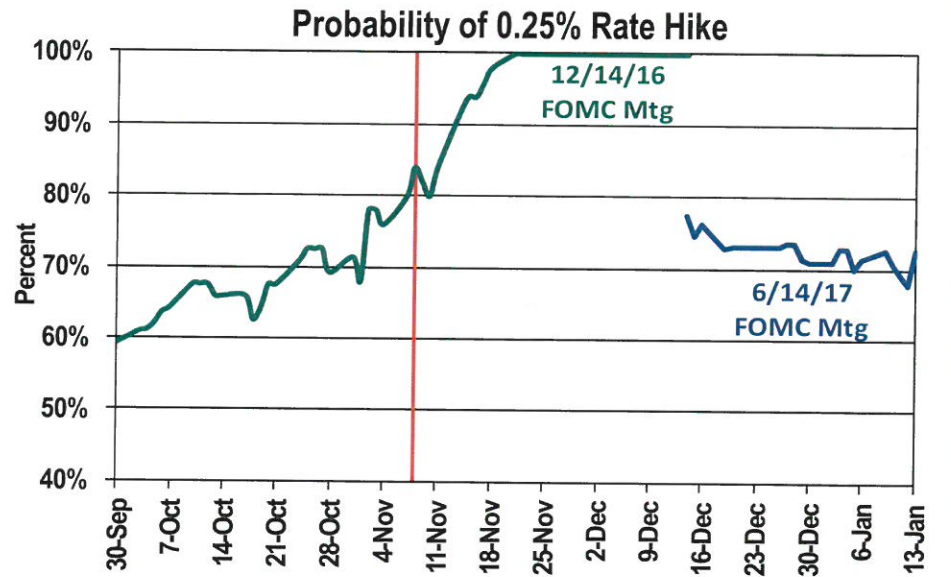
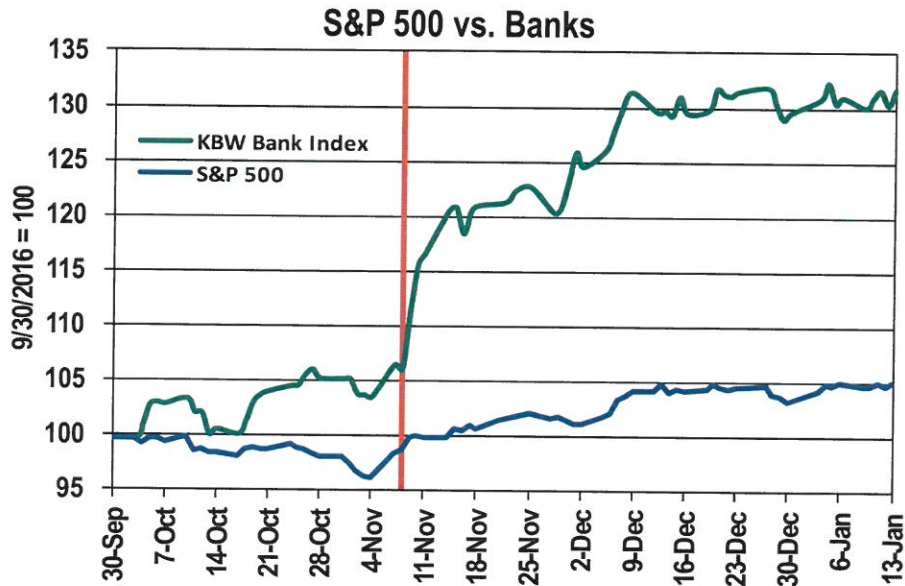
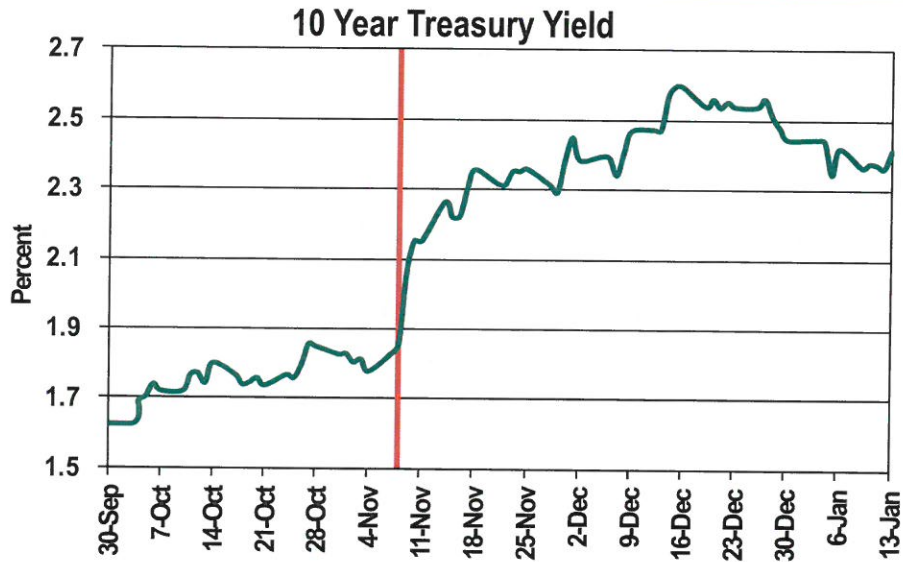


12/23/2016 = 0.66

(AA45) 10-Year Treasury Yields / Standard & Poor's 500 GAAP Earnings Yields

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Trump Effect – Will It Last?



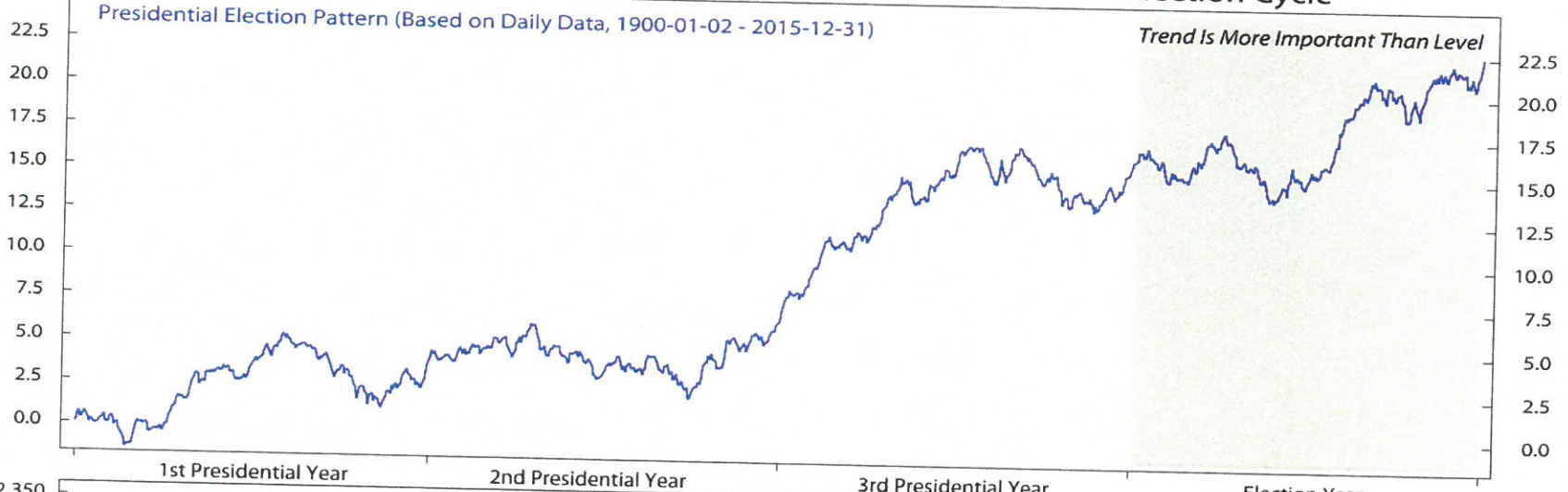
Source: Bloomberg



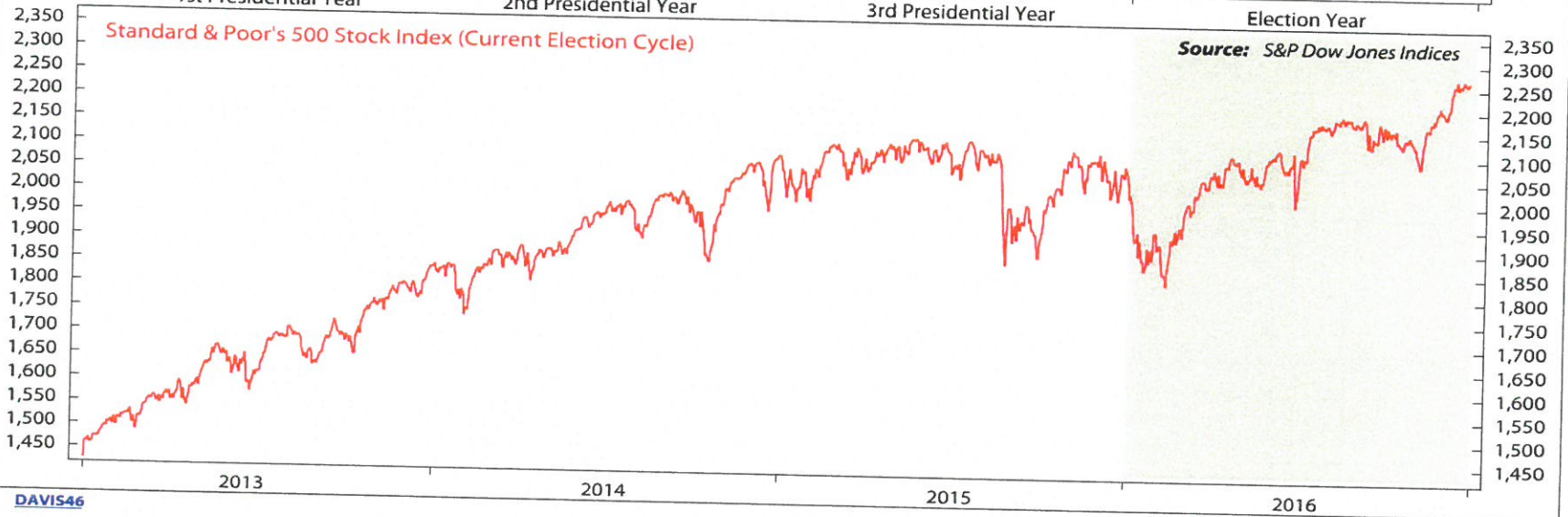
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Presidential Stock Cycle

Dow Industrials Four-Year Presidential Cycle vs S&P 500 Index Current Election Cycle



Standard & Poor's 500 Stock Index (Current Election Cycle)



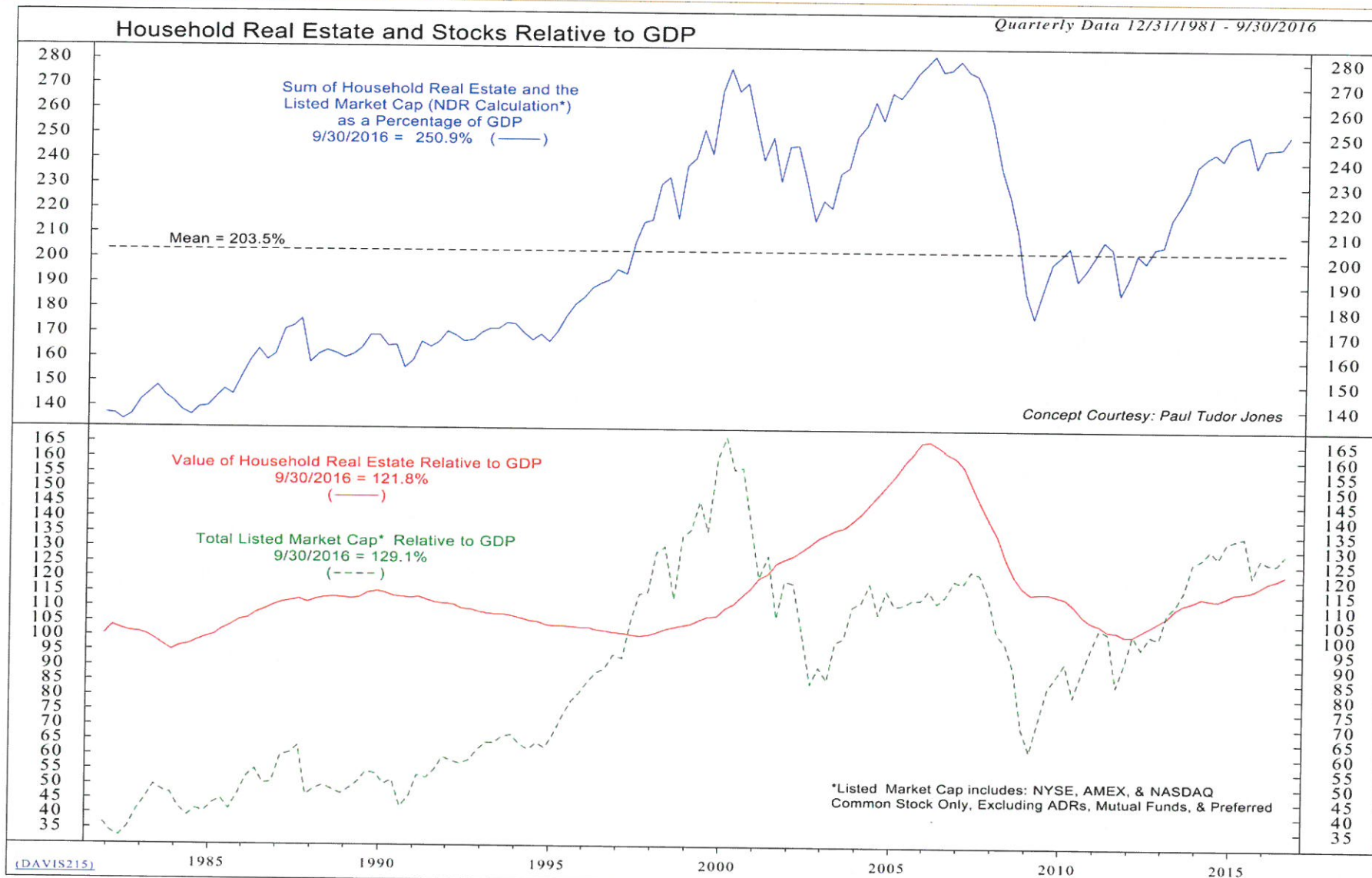
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Housing and Stocks vs. GDP (Expensive)



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