Market
Commentary
February 2018

BENCHMARK FINANCIAL

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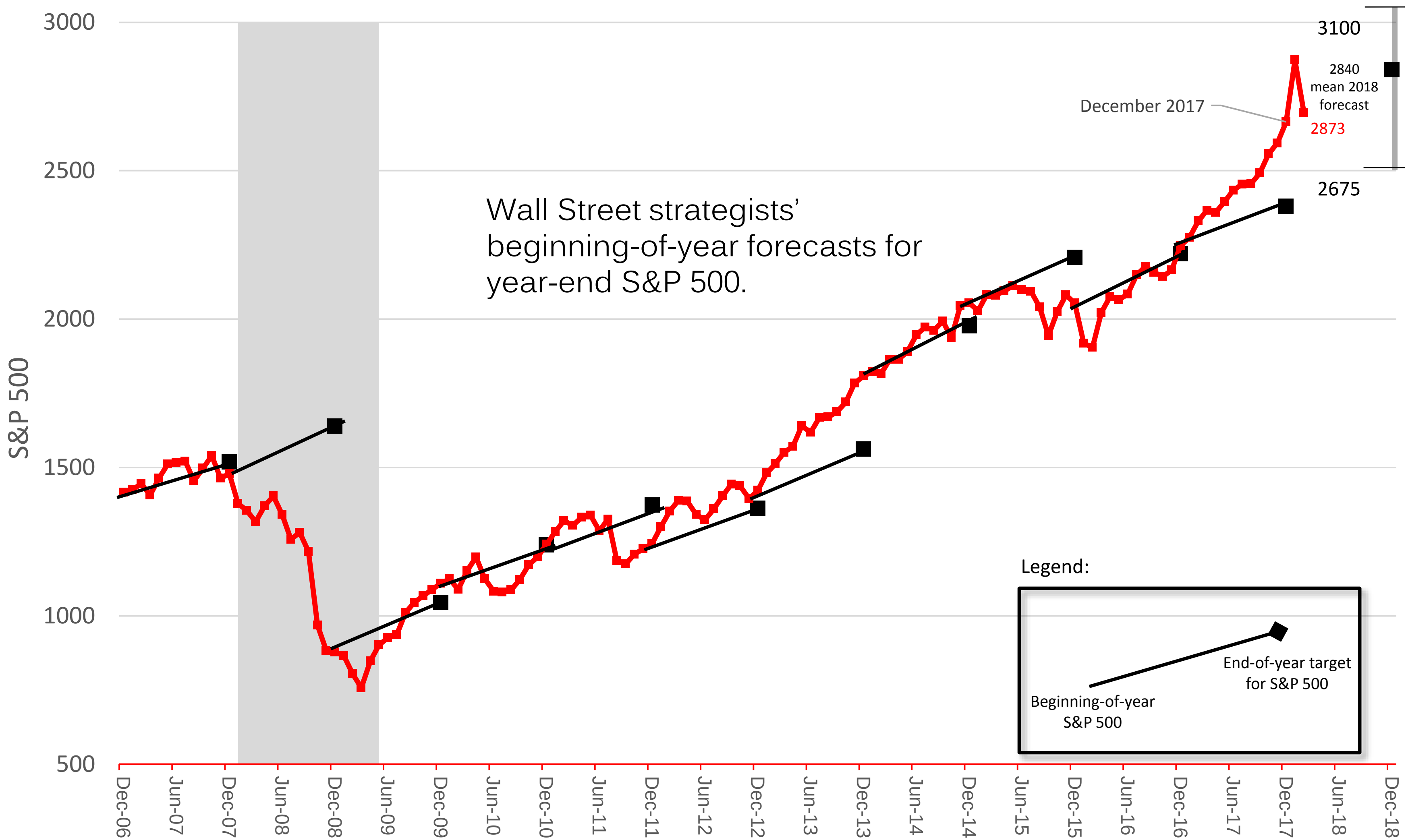
Stock Market

- still near record highs
- driven by global expansion and earnings surge
- lower $USD
- and cheap oil
- stocks are fully-, but not over-valued
- margins are likely sustainable
- Fed is still accommodative
- inflation is tame
- lack of irrational exuberance

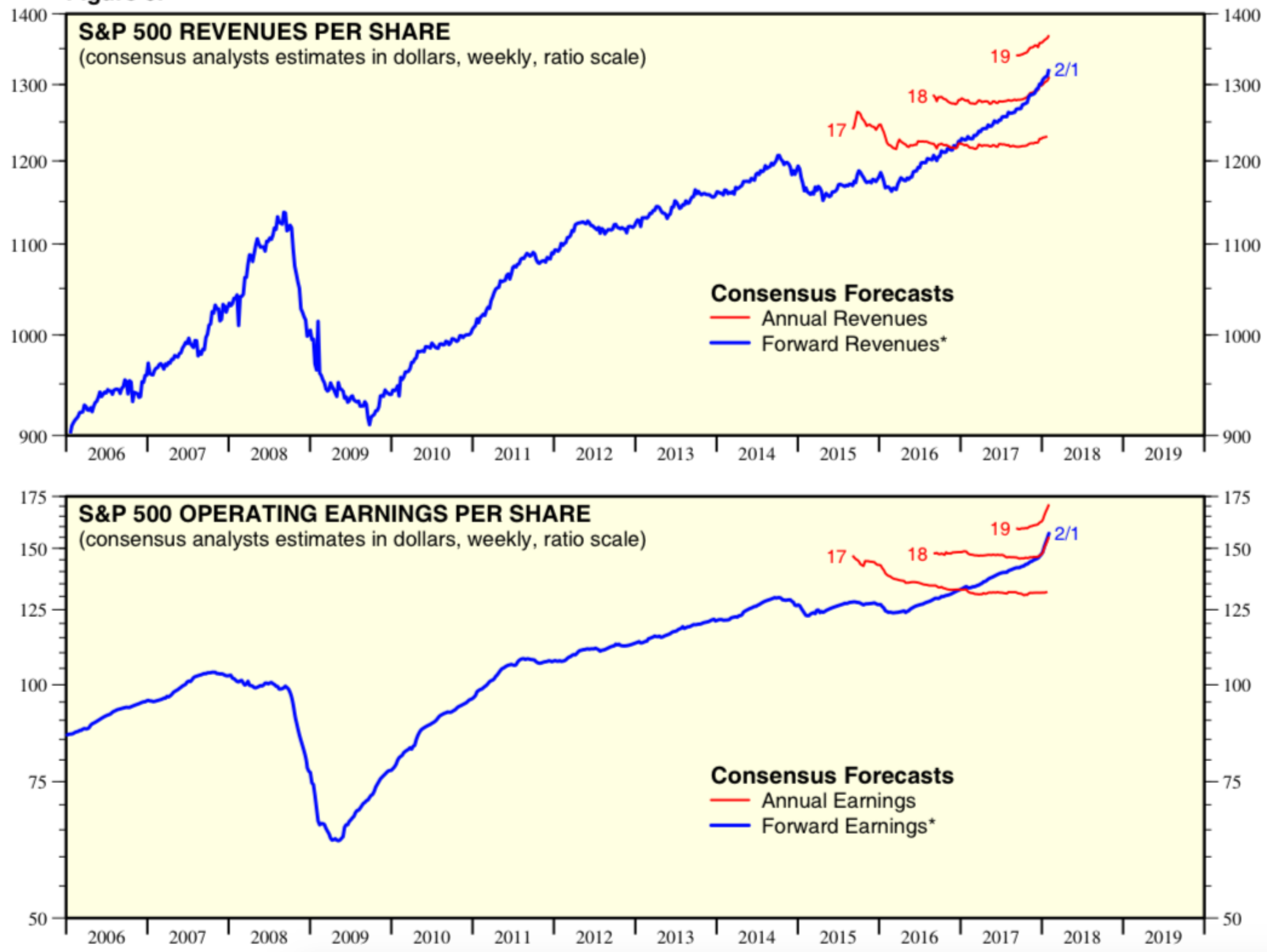
Stock Markey
S&P 500 Beginning-of-Year Forecasts



Source: Standard & Poor's, data through February 6, 2018. *Barron's* survey of 10 Wall Street strategists, December 11, 2017.

Stock Market
S&P 500 Forward Revenue and Earnings - Surging

Figure 6.

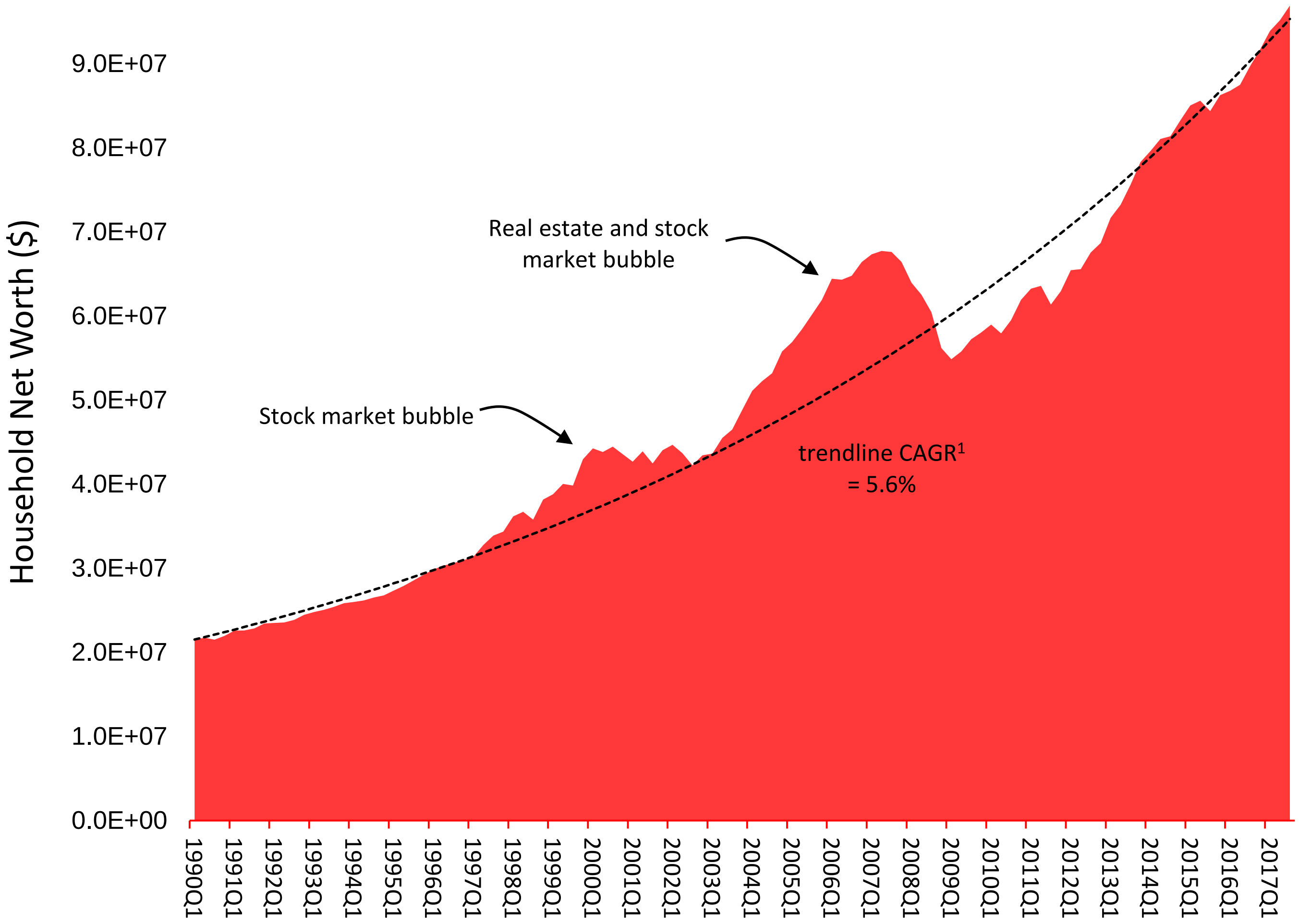


S&P 500 revenues are surging post- the earnings recession of 2014-2015.

With 50% of S&P 500 revenues sourced overseas, strong global expansion is helping to drive strong U.S. companies' sales and earnings.

Note how 2018 revenue estimates have been rising.

Source: Yardeni Research, Inc., with permission.



Household net worth has fully recovered …

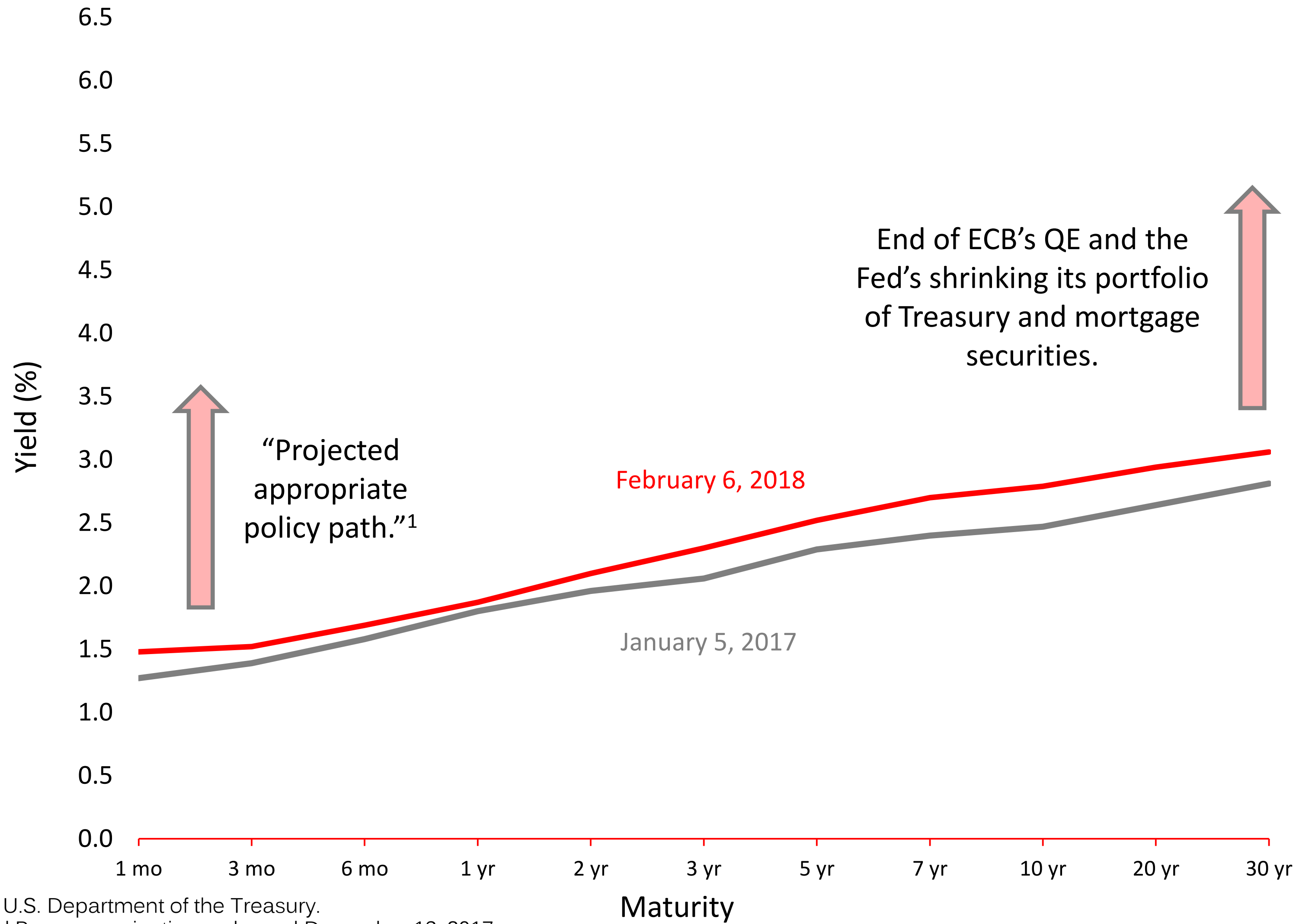
… but, not into bubble territory.

Source: Federal Reserve. Data through September 2017, released December 7, 2017. [1]Compound annual growth rate.
$9.0E+07 = $90 trillion.

Fed policy

- on a path of steady hikes to 3% fed funds rate
- inflation has lagged Fed's forecast
- the Fed manages the yield curve
- the Fed has created every recession since the 1950s
- first rate hikes have signaled stock market lift-off
- the Great Unwinding: bond yields set to start rising

Federal Reserve Policy
Policy Normalization Means Guiding the Entire Yield Curve Higher



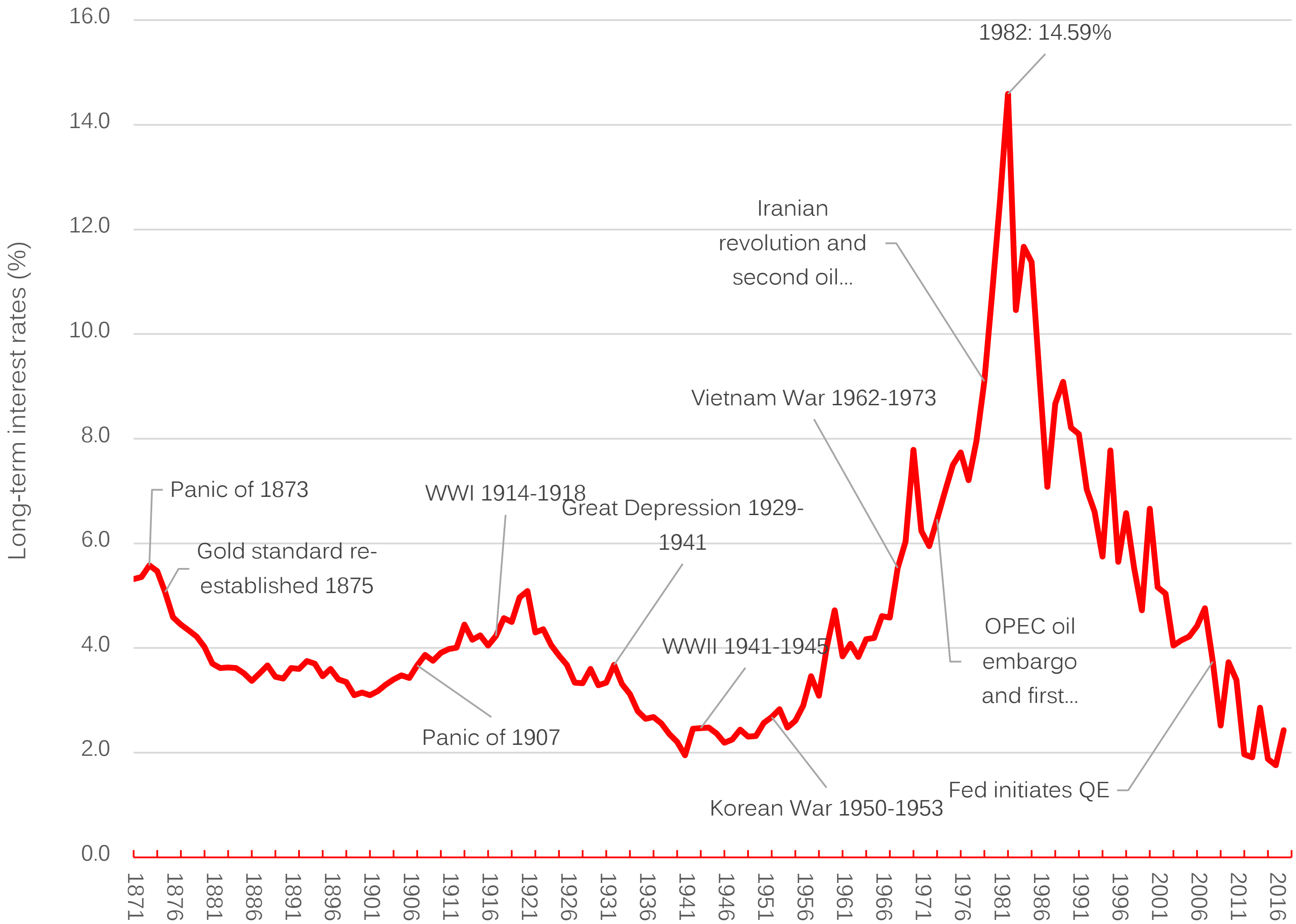
The Fed is allowing its bond portfolio to gradually run off; and the ECB is planning to taper its QE program. Those two actions will probably result in gradually higher bond yields such that the shape of the yield curve could remain sloped, as is presently the case, as the entire curve shifts higher.

Source: U.S. Department of the Treasury.
[1] Federal Reserve projections released December 13, 2017.

Bond Yields

- recent lowest yields in history
- yields don't make sense fundamentally
- yields held down until the ECB's QE taper

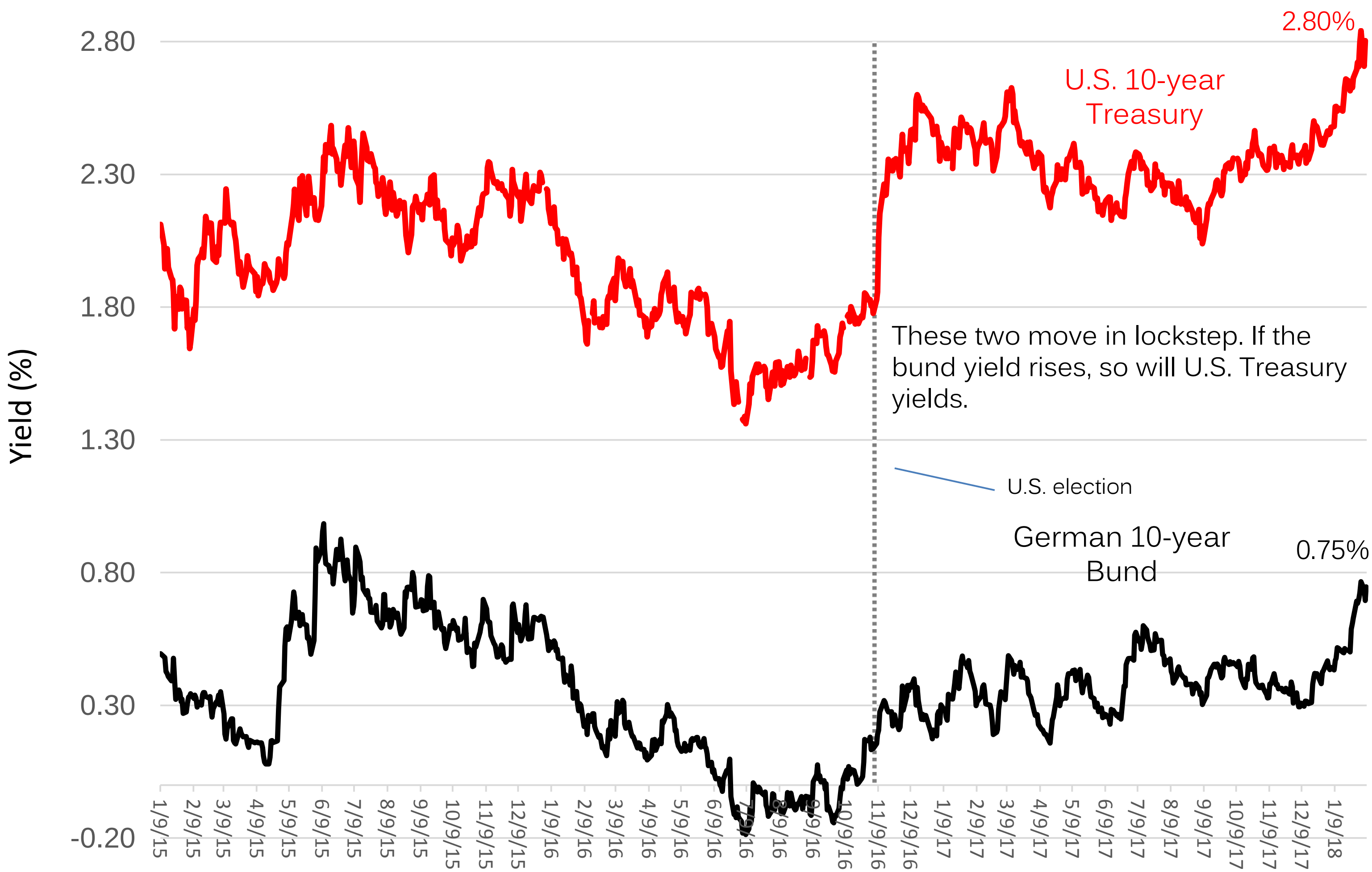
Bond Yields
All-time low Bond Yields



Lowest long-term interest rates in U.S. history.

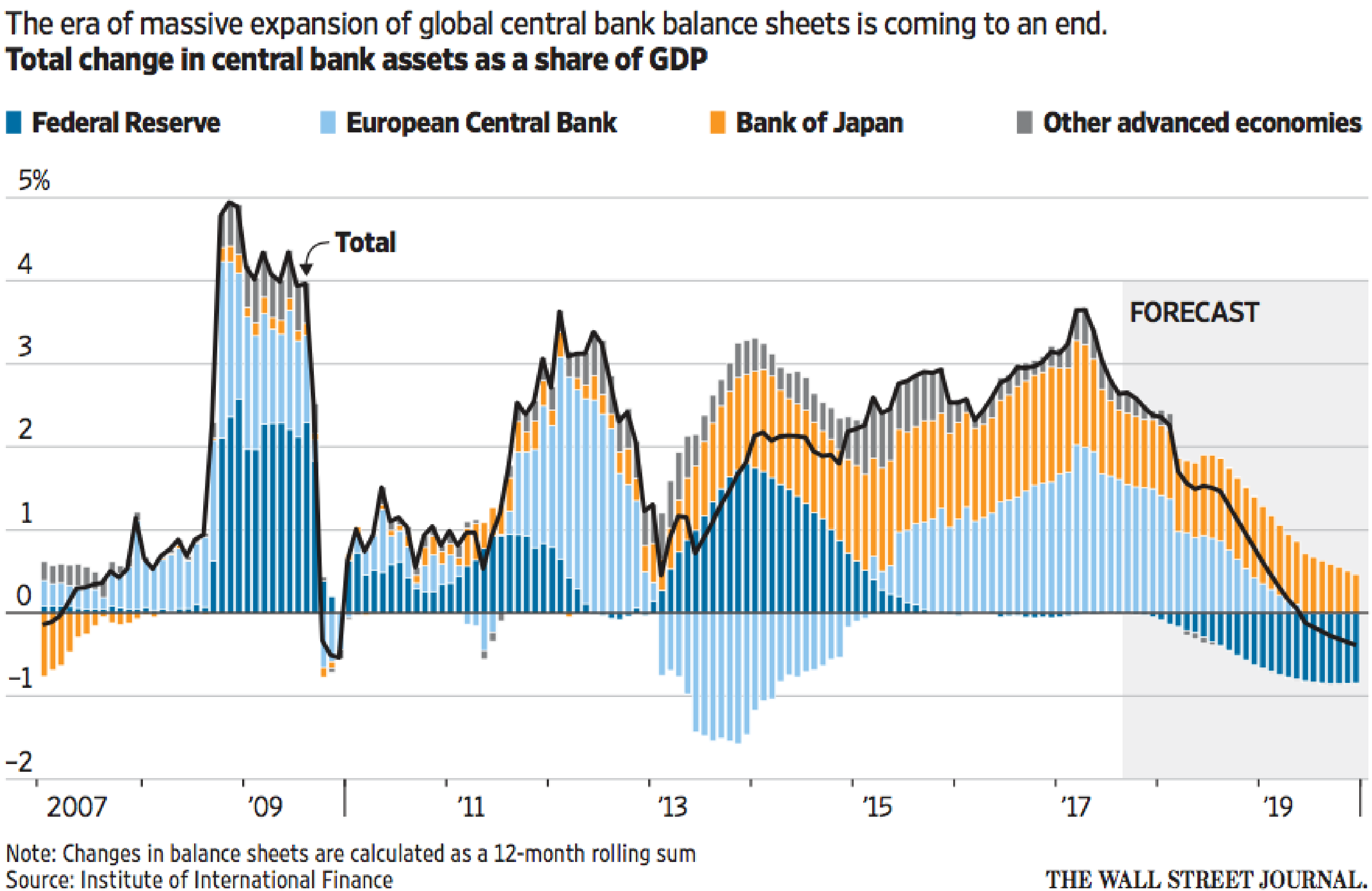
Source: Online Data Robert Shiller. Data through December 2017.

Bond Yields
When ECB Wings Down its QE Bond Yields Likely to Rise



Source: *The Wall Street Journal* for data through February 6, 2018.

Federal Reserve Policy
The Great Unwinding Begins – all Central Banks



Source: *The Wall Street Journal*, October 9, 2017.

Inflation

- headline PCED +1.7%, +1.5% core
- headline CPI +2.2%, +1.8% core
- employment cost inflation rising
- productivity drives declining unit labor costs
- recent strong productivity drove unit labor costs *negative*
- inflation expectations are gradually rising

Economy

full-employment economy operating at full potential

+2.5% Q4 GDP growth compared to +2.2% post-recession average
+2.7% GDP growth forecast

surge in LEI, small business optimism index, recovery in business investment
healthy growth in personal income, real DPI, strong retail sales
strong household balance sheets, savings rate, FICO scores and record low household financial obligations ratio
record high PMIs, strong hiring, record high job openings, new low unemployment rate, record low weekly unemployment claims, strong vehicle sales, rising housing starts

inflation expectations are rising

Optimism, Momentum
Global Economies are Booming

J.P.Morgan

PMI™ By IHS Markit

News Release

MARKET SENSITIVE INFORMATION
EMBARGOED UNTIL: 1100 (New York) / 1600 (UTC) February 5th 2018

J.P.Morgan Global Manufacturing & Services PMI™

Produced by J.P.Morgan and IHS Markit in association with ISM and IFPSM

Global economic growth at 40-month high in January

The start of 2018 saw a further solid and broad-based expansion of global economic activity, with growth rising to a 40-month high. Output increased across the six categories of manufacturing and service sector activity tracked and in almost all of the national PMI surveys available at the time of publication.

The J.P.Morgan Global All-Industry Output Index[1,2] – which is produced by J.P.Morgan and IHS Markit in association with ISM and IFPSM – posted 54.6 in January,

Commenting on the survey, David Hensley, Director of Global Economic Coordination at J.P.Morgan, said:

"The world economy sustained its strong upturns in output and new business at the start of 2018, as manufacturers and service providers benefitted from a synchronised upswing in global market conditions and growth. Forward-looking indicators such as new orders, backlogs of work and business confidence also suggest that this solid phase of expansion will be maintained in coming months."

Source: IHS Markit Ltd., February 5, 2018.

Optimism, Momentum
IMF's forecast – Upward Revisions to Accelerating Growth Forecast

Table 1. Overview of the *World Economic Outlook* Projections

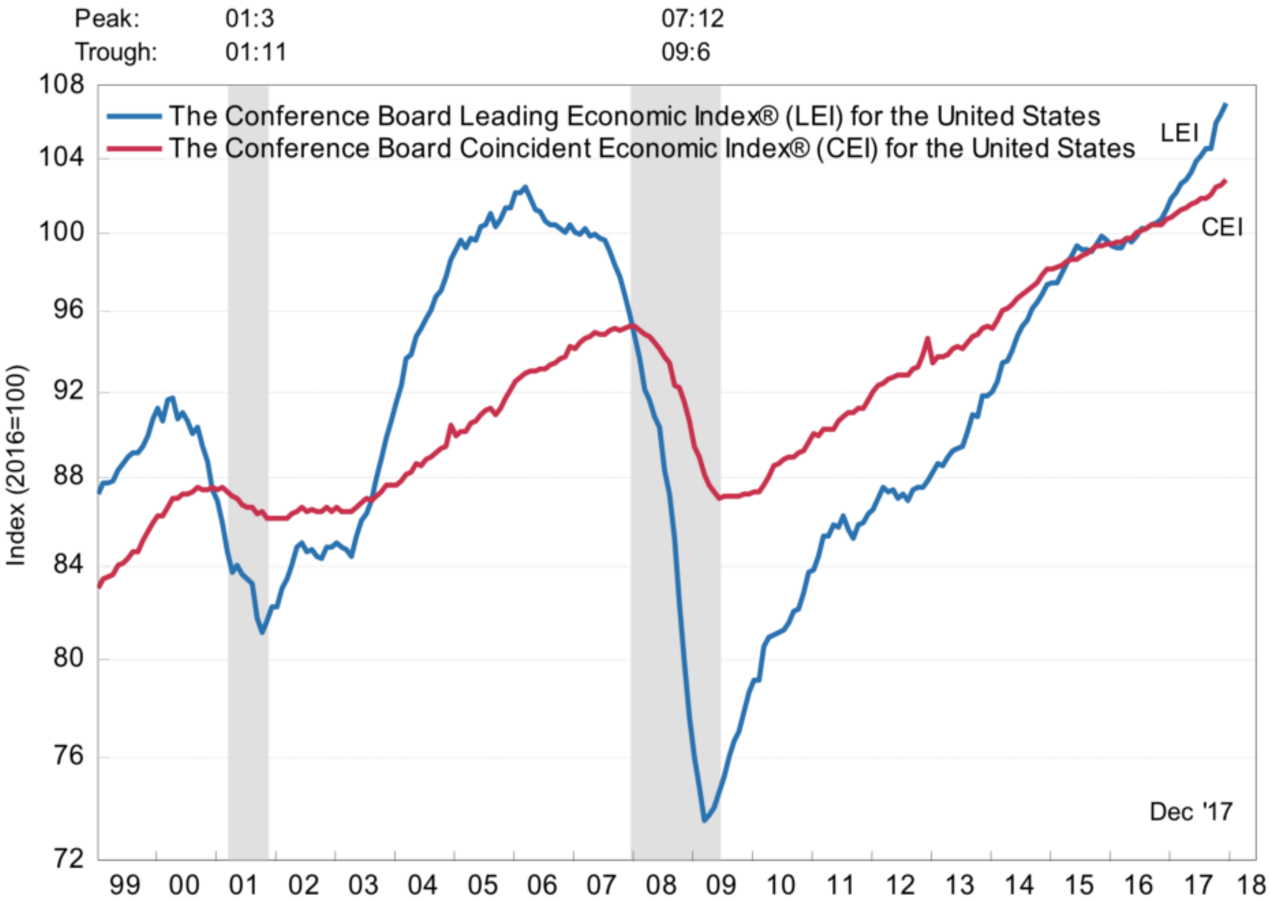
(Percent change unless noted otherwise)

	Year over Year					
		Estimate	Projections		Difference from October 2017 WEO Projections 1/	
	2016	2017	2018	2019	2018	2019
World Output	**3.2**	**3.7**	**3.9**	**3.9**	**0.2**	**0.2**
Advanced Economies	**1.7**	**2.3**	**2.3**	**2.2**	**0.3**	**0.4**
United States	1.5	2.3	2.7	2.5	0.4	0.6
Euro Area	1.8	2.4	2.2	2.0	0.3	0.3
Germany	1.9	2.5	2.3	2.0	0.5	0.5
France	1.2	1.8	1.9	1.9	0.1	0.0
Italy	0.9	1.6	1.4	1.1	0.3	0.2
Spain	3.3	3.1	2.4	2.1	–0.1	0.1
Japan	0.9	1.8	1.2	0.9	0.5	0.1
United Kingdom	1.9	1.7	1.5	1.5	0.0	–0.1
Canada	1.4	3.0	2.3	2.0	0.2	0.3
Other Advanced Economies 3/	2.3	2.7	2.6	2.6	0.1	0.1

Global economic activity continues to firm up. Global output is estimated to have grown by 3.7 percent in 2017, which is 0.1 percentage point faster than projected in the fall and ½ percentage point higher than in 2016. The pickup in growth has been broad based, with notable upside surprises in Europe and Asia. Global growth forecasts for 2018 and 2019 have been revised upward by 0.2 percentage point to 3.9 percent. The revision reflects increased global growth momentum and the expected impact of the recently approved U.S. tax policy changes.

Source: IMF, *World Economic Outlook*, January 22, 2018.

Economic Data
U.S. Index of Leading Economic Indicators – Surge in 2017

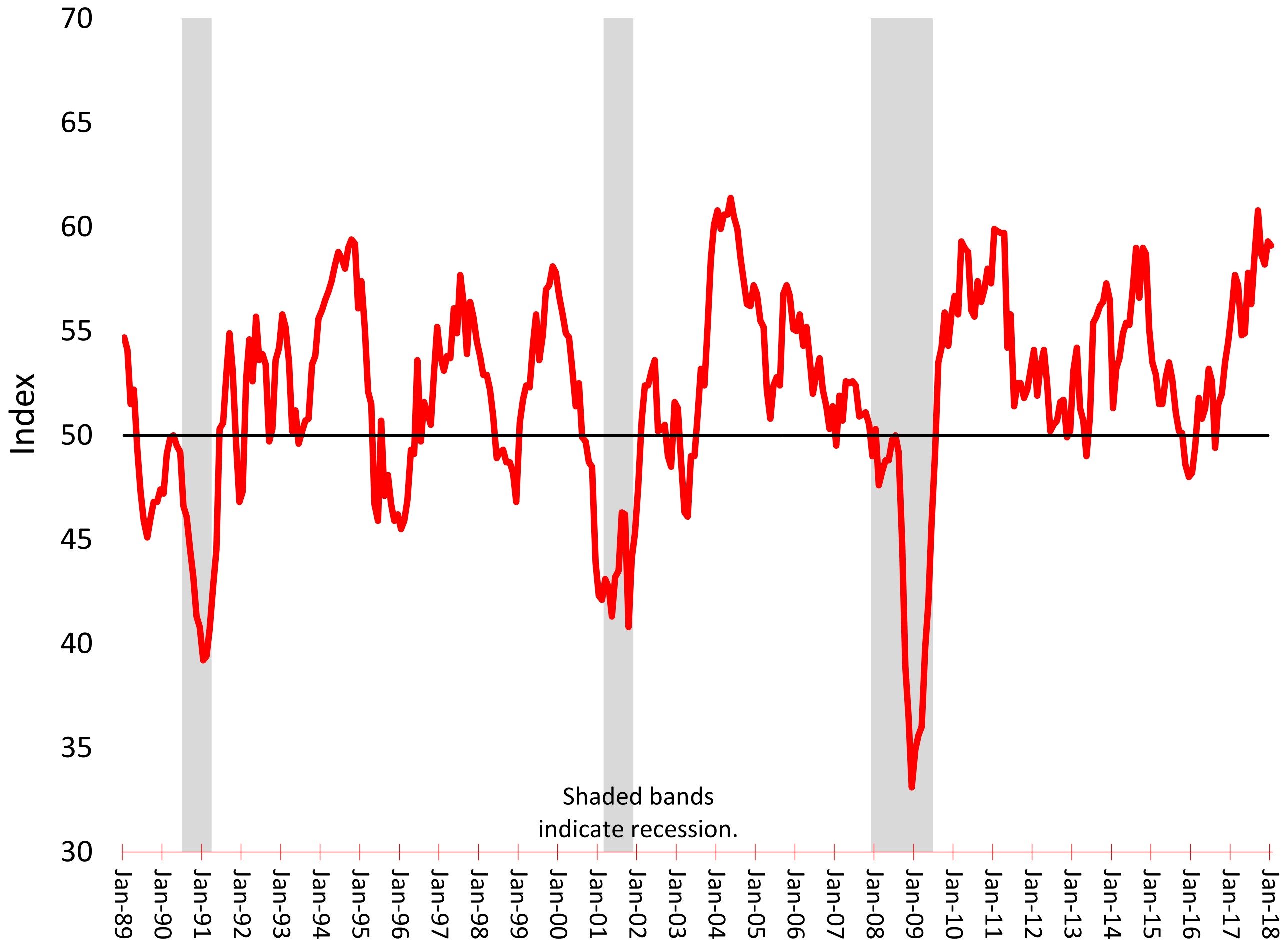


"The U.S. LEI continued rising rapidly in December, pointing to a continuation of strong economic growth in the first half of 2018. The passing of the tax plan is likely to provide even more tailwind to the current expansion. The gains among the leading indicators have been widespread, with most of the strength concentrated in new orders in manufacturing, consumers' outlook on the economy, improving stock markets and financial conditions."

This chart shows how the LEI has definitively rolled over well in advance of the last two recessions.

The Conference Board Leading Economic Index® (LEI) components: 1) average weekly hours worked, manufacturing; 2) average weekly initial unemployment claims; 3) manufacturers' new orders – consumer goods and materials; 4) ISM index of new orders; 5) manufacturers' new orders, nondefense capital goods; 6) building permits – new private housing units; 7) stock prices, S&P 500; 8) Leading Credit Index™; 9) interest rate spread; 10-year Treasury less fed funds; 10) index of consumer expectations., Source: ©The Conference Board. Data through December, released January 25, 2018.

Economic Data
ISM Manufacturing Purchasing Managers Index



60.8 in September was the highest in 13 years. January 2018 at 59.1 is still very strong.

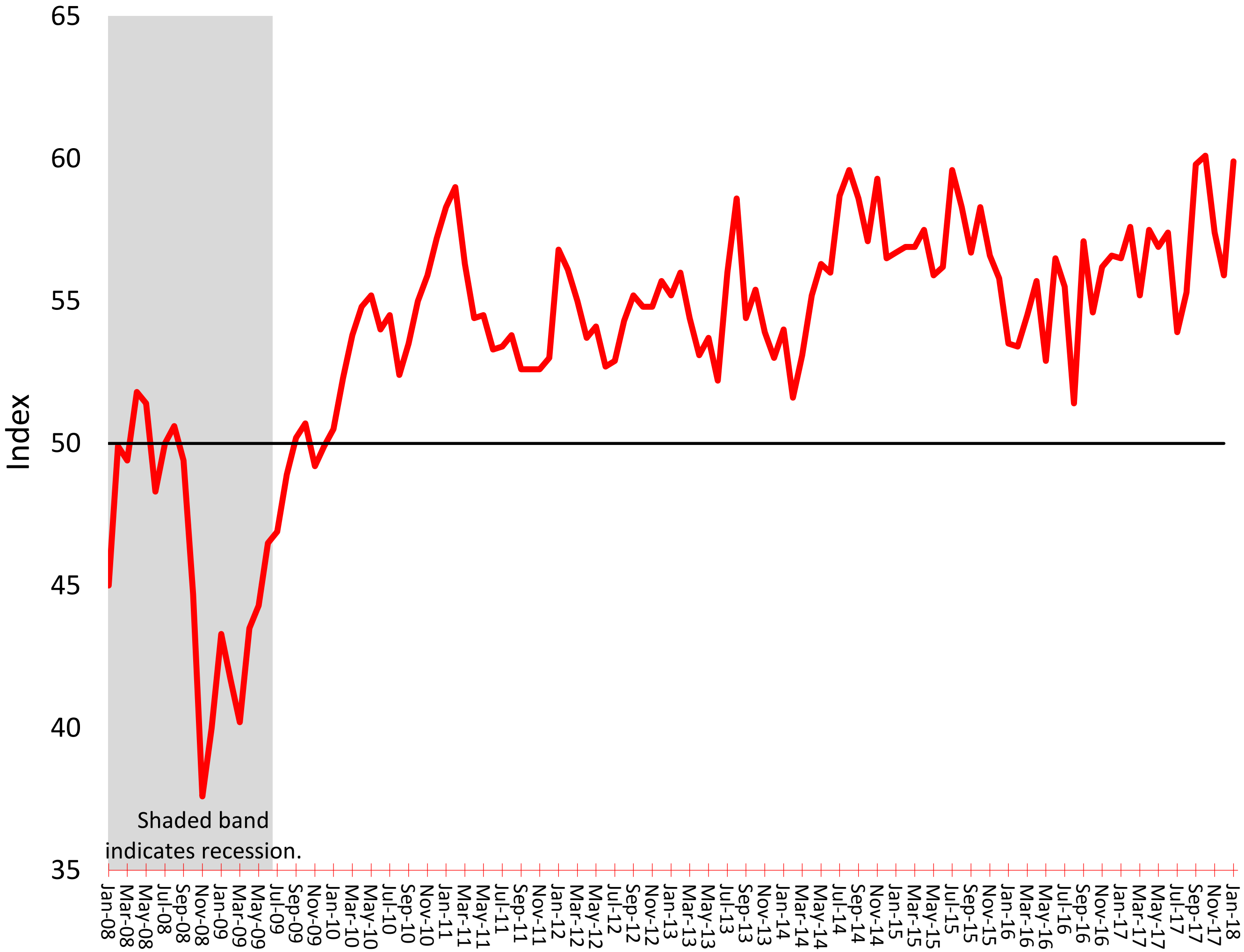
January new orders at 65.4 is very strong.

Note the historic volatility in the manufacturing PMI.

Note how this indicator has slumped well below 50 even during periods of strong economic expansion, eg. 1995, 1999, 2003, 2013.

Source: Copyright 2018, Institute for Supply Management; data through January 2018.
ISM: "A reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting. A PMI in excess of 43.1 percent, over a period of time, generally indicates an expansion of the overall economy."

Economic Data
ISM Non-Manufacturing Purchasing managers Index



January at 59.9, the second highest reading on record.

New orders surge to 62.7.

Non-manufacturing captures the vast majority of the U.S. economy.

Source: Copyright 2018, Institute for Supply Management; data through January 2018. This data series was created in 2008. ISM: “A reading above 50 percent indicates that the non-manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting.”

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