Economic Update

March 5, 2018

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This weekly update provides a snapshot of changes in the economy and markets and their implications for investors.

Growth

Economic growth was adjusted one-tenth of a percentage lower to 2.5% q/q in the fourth quarter according to the second estimate. Consumer spending was unchanged at a healthy 3.8%. Residential investment was adjusted higher to 13.1% from 11.6%, while slowing inventory build and nonresidential investment dragged on growth. We expect economic growth to pick up in the first half of 2018, supported by fiscal stimulus, before a second-half slowdown.

Jobs

The January employment report was as expected, showing 200,000 jobs last month compared to consensus estimates of 175,000. However, downward revisions of 24,000 to the prior two months almost exactly offset the slight upside surprise on the January number. The unemployment rate and participation rate remained at 4.1% and 62.7%, respectively. Wage growth increased 0.3% in the month for all private workers, and rose to 2.4% y/y for production and nonsupervisory workers as wage pressure begins to build. The bigger message from last month's report is that the U.S. is running out of workers, a reality that will likely limit U.S. economic growth past 2019.

Profits

With 485 companies having reported (98.8% of market cap), our current estimate for 4Q17 is $33.86 ($28.15 ex-financials). This represents a 21.4% y/y growth rate, with strength in energy, materials, technology and industrials, while telecom and real estate have struggled. So far 75% of companies have beat on earnings and 67% have beat on revenue. 2018 earnings estimates have risen from $149.70 to $158.00 since the beginning of the quarter. Although analyst estimates have historically been optimistic, strong economic fundamentals and the impact of tax reform should support double-digit earnings growth this year.

Inflation

Personal consumption data showed signs of gradually firming inflation with the month-over-month headline and core measures both up 0.4% and 0.3%, respectively. However, it still wasn't enough to move the year-over-year readings, which stayed steady at 1.7% and 1.5%, respectively. These results are in line with the Fed's outlook that inflation should gradually move upward toward its 2% target this year. We believe this will keep the Fed on track for 3-4 rate hikes in 2018.

Rates

As largely expected, the Fed left rates unchanged at its meeting in January, the last with Chair Yellen at the helm. Economic projections were not updated at this meeting and still show real GDP at 2.5% and unemployment at 3.9% for 2018. Fed funds rate projections indicate three rate hikes this year, in line with expectations, as well as the continuation of the gradual reduction of the balance sheet. As outlined at the September conference, the cap increased to $20 billion from $10 billion this quarter. Investors should note that there will be a changing of the guard this year with several voting members rotating out and a new chair. We believe the composition of this new committee may be slightly more hawkish than the current Board.

Risks

- Danger of extensive fiscal stimulus in a full employment economy could lead to overheating.
- Elevated asset prices and valuations are pressured if rates move materially higher.
- Weak demographics could negatively impact labor force growth in the future.

Investment Themes

- Increasing earnings growth, coupled with slowly rising interest rates, still make stocks look attractive in relative terms.
- High yield bonds look more attractive than Treasuries, but a diversified approach to fixed income investing seems appropriate given Fed tightening.
- International exposure is warranted given growth prospects abroad, and a weaker dollar can enhance foreign returns.

■ Denotes updated information

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Asset Management

Data are as of March 5, 2018

Past performance does not guarantee future results.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

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