MONTHLY UPDATE AND COMMENTARY
MARCH 2017

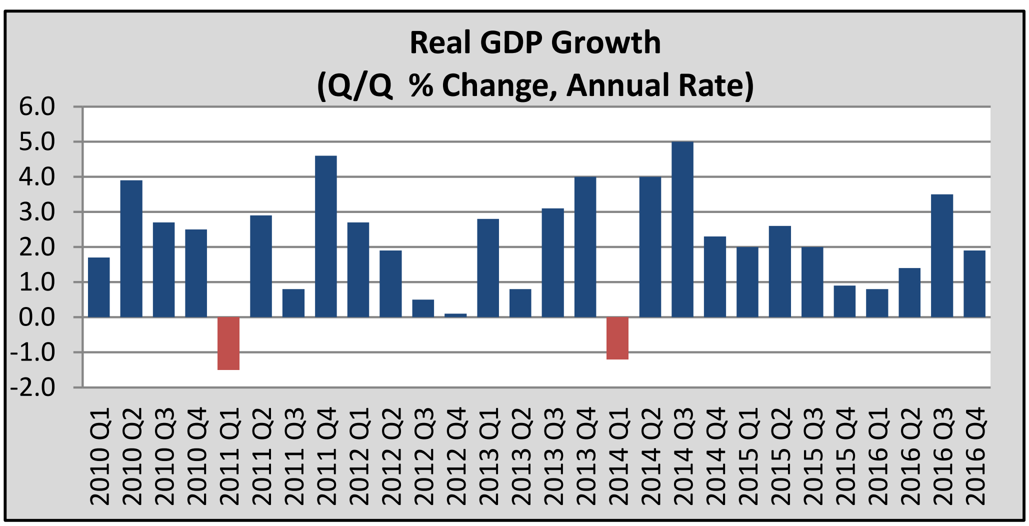
Recap: Recent robust consumer spending, an uptick in factory production and firming inflation, all point to a healthy start in 2017 for the U.S. economy. Stronger than expected retail sales, and an inflation rate that rose to its highest annual level in nearly five years are the latest signs that years of sluggish price growth could be coming to an end.

Together with Fed Chairwoman Janet Yellen's recent statement that the central bank may raise interest rates, the inflation rate uptick boosted the odds of a rate increase in mid-March. Both stocks and government-bond yields moved higher in February. The stock market jumped following the presidential election, along with surveys of consumer confidence and business sentiment, raising hopes for a pickup in overall economic growth. Still, it would be too soon to declare a clear breakout for the modest U.S. economic expansion now in its eighth year.

What really matters to economic growth however, are the fundamentals: jobs, income, etc. Rising sentiment in anticipation of tax cuts and other policy shifts from the new Administration could provide a boost but these policies would need to have a really sustained impact on growth.

President Trump has said he hopes to achieve 4% annual growth by overhauling the tax code, boosting infrastructure spending, rolling back federal regulations and negotiating new trade deals. That kind of growth could be difficult to achieve due to large scale demographic trends, including an aging population that has been putting downward pressure on the labor-force participation rate, and long-subdued gains in worker productivity.

GDP: The second estimate of U.S. real GDP growth for the fourth quarter of 2016 was unchanged at 1.9% (annualized). While GDP growth was unchanged, private domestic demand was revised up to 3.0% (from 2.8%), an acceleration from 2.4% in the third quarter. The downward revision to business investment was disappointing, but there should be ample scope for optimism over the year ahead.



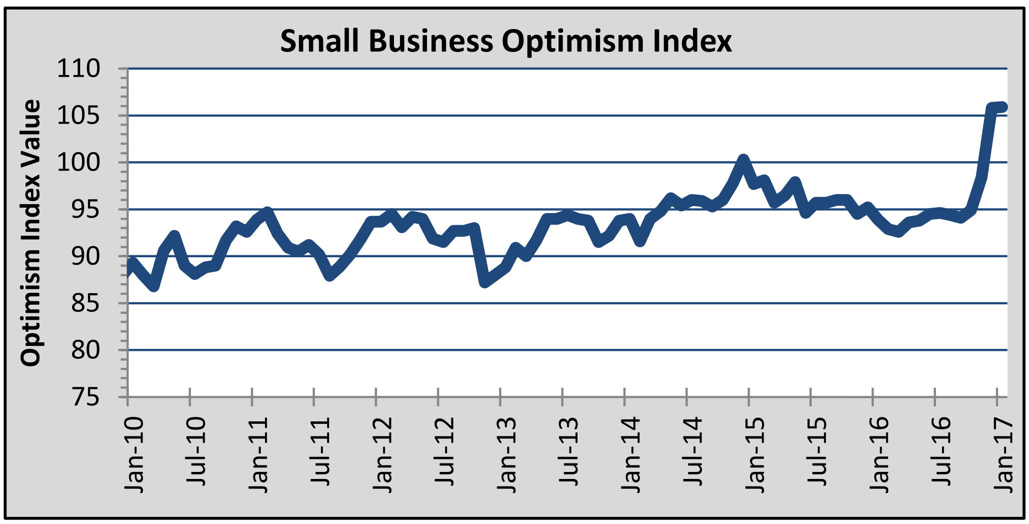
The latest figures were a marked deceleration from the third quarter's 3.5% pace, which had been the strongest reading in two years. They were, however, broadly in line with an economy that has, through ups and downs, settled at a roughly 2% growth pace since the recession ended. The current expansion has endured for more than seven years, longer than the historical average, but its rate of growth has been the weakest since at least 1949. Despite the low trajectory, GDP data from the end of 2016 and more recent indicators would suggest the economy remains on fairly solid footing.

Retail Sales: Retail sales rose by 0.4% in January. The rise followed December's upwardly revised 1.0% growth. Excluding autos and gasoline, sales were even stronger (0.7%). Gains were seen pretty much across the board, with the biggest gains coming from the sporting goods, electronics, and food services categories. Particularly encouraging was the fact that strong spending was seen in the discretionary spending categories. This would suggest that the gains in consumer confidence since the election were finally materializing.

Personal Income: Personal income rose 0.4% in January. Controlling for inflation and removing taxes, however, real disposable personal income actually fell 0.2%. In real terms, spending fell 0.3%. The decline in spending was broad based. Durable goods led the way while non-durable goods spending was virtually flat. Consumer prices rose 0.4% in the month, pushing year-over-year inflation to 1.9% (from 1.6% in December). Core prices (ex-food & energy) held steady at 1.7% (annualized). The personal saving rate edged up to 5.5% in January from 5.4% in December.

The downside of rising inflation would be a decline in real purchasing power. This would put the onus for growth on stronger wage gains to drive increases in income and therefore spending. Fortunately, with the labor market continuing to tighten, this should remain a strong possibility.

Small Business Optimism Index: The NFIB's small business optimism index rose 0.1 points to 105.9 in January. It has marked the fourth consecutive monthly gain – confirming that the surge in optimism post-election has remained intact. The recent upswing in confidence has been accompanied by significant improvements in three major subcomponents – expectations about the economy, projections of higher real sales and whether "now is a good time to expand." Most notably, the share of firms raising worker compensation rose to the highest level since 2007.

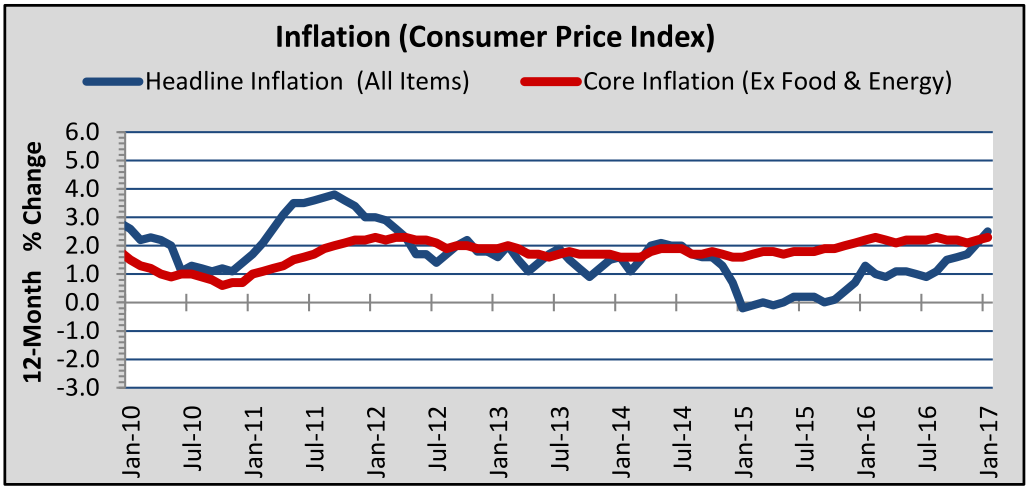


This report would suggest that the recent improvement in confidence will have some staying power should the sought-after Administration policies get implemented. Policy changes are expected to help boost confidence in the near-term. However, the extended lags in the political process have the potential to temper optimism in the coming months. For instance, work on a comprehensive tax bill – an important contributor to the recent boost in optimism – would be unlikely to start before the second half of the year.

Household Debt: The total amount of debt held by American households climbed in 2016 by the most in a decade, driven by broad and steady increases in credit card debt, auto and student loans, and a fourth-quarter surge to the highest amount of mortgage originations since before the financial crisis. Total household debts are now $12.6 trillion. This would underscore the incredibly long-lingering effects of the financial crisis that began nearly a decade ago and showed that households in many ways are beginning to move past it.

Households shed nearly $1.5 trillion in housing debt between 2008 and 2013, through a combination of foreclosures and the grindingly slow pay down of debt. But the biggest force driving household debts higher over the past decade has come from the rise of student loans and auto loans.

Inflation: Inflation rose to 2.5% year-over-year in January, marking the fastest pace in the headline index since March 2012. On a seasonally adjusted basis, prices rose 0.6% in the month from the previous month. Consumers paid more for gasoline, shelter, apparel, and new vehicles in January. The price of gasoline was responsible for about half of the 0.6% m/m advance in January reflecting the pass-through from higher price for crude oil.



Stripping away volatile food and energy prices, core CPI rose 2.3% y/y in January, with the index rising 0.3% in the month. Headline inflation in January was well above 2% for the second consecutive month, owing largely to an anticipated bump from rising energy prices. Higher energy prices should remain a key driver behind the rise of headline inflation in 2017.

Housing: Existing home sales rose to the highest level in a decade in January – despite a 70-basis point rise in mortgage rates since last September. Strong existing home sales further confirmed the progress the U.S. housing market has made since the crash over a decade ago. New home sales rose 3.7% in January after a 7.0% drop in December. Sales for November and October were revised down, possibly reflecting increased cancellations following the jump in mortgage rates. The January rebound was an indication that the new-construction market has remained on the path to recovery despite bumps along the way.

New-home sales should continue to increase this year as builders step up construction of single-family homes and more first-time buyers come into the starter-home market. The pent-up demand since 2009 may be starting to release, bringing more buyers into the market, especially in the move-up segment where rising home values are giving buyers more equity when they sell their homes to purchase more expensive homes.

The recent rise in mortgage rates has likely fueled some uptick in sales activity but does pose some downside risk for homebuilding. Still, solid fundamentals, including continued employment, wage gains, and rising household wealth will help keep housing demand on a moderately positive course.

Trade Deficit: The U.S. economy increased imports by about $3.5 billion in December, but exports have grown even faster, increasing just over $5 billion. The net result has been a bigger-than-expected narrowing in the trade deficit to $44.3 billion in December from a $45.7 billion deficit in November. Exports bounced back after two months of contraction. The increase was led by capital goods, but industrial supplies, automotive exports and consumer goods also saw gains. Imports rose with all major categories posting gains.

Both exports and imports picked up in the latter half of 2016, after a flat performance earlier in the year. That was in line with an acceleration in economic growth both at home and abroad. The U.S. dollar has given back most of its post-election gains on a trade-weighted basis, and is now only about a percent higher than its year-ago levels. A strong dollar has been exerting a considerable drag on goods inflation, but that affect will likely decrease in the coming months. This could help improve trade deficit in the second half of 2017 and provide less of a drag on GDP performance.

Euro Zone: The Euro zone's modest recovery gained some fresh momentum in February despite heightened uncertainty about future policies ahead of a series of key elections across the currency area. The pickup seemed set to continue over coming months, as new orders to firms flowed in at the fastest pace in six years, while businesses hired additional workers at a rate not seen since August 2007.

For the first time in almost four years, none of the Euro zone's 19 members were in deflation in January, an encouragement to the European Central Bank (ECB) in its long struggle to lift inflation to its target of 2.0% and keep it there. Consumer prices in the currency area were 1.8% higher than a year earlier, a jump from the 1.1% inflation rate recorded in December 2016 and within touching distance of the ECB's target. Nonetheless, there have remained wide divergences in inflation across Euro zone members. In January, the highest rate was the 3.1% recorded in Belgium while Ireland had an inflation rate of only 0.2%.

Greece made headlines as a rift between European officials and the IMF looked to delay the next disbursement of much needed funds, while anxiety about upcoming elections in France have investors rethinking holding French bonds.

United Kingdom: The U.K. economy exhibited some signs of weakness, with retail sales declining in January. Brexit anxiety and rising prices related to the falling pound began to affect U.K. consumers who previously appeared unfazed by the vote results.

Outlook: Political uncertainty has remained on the back-burner in the U.S. as investors focused on healthy earnings growth with U.S. corporate profits looking to grow by over 6% after three quarters of declines. Moreover, the animal spirits that have been driving stock markets since the election appear to also be showing up in the economic data.

Much of the positive sentiment can be found in survey data. The NFIB's Small Business Optimism index surprised to the upside, rising to the highest level since December 2004, while both the Empire and Philly indices – the earliest indicators of February activity – rallied strongly with the latter at a more than three-decade high. Retail sales also surprised to the upside in January. This performance would suggest that the consumer is becoming increasingly confident to spend and should remain a key support for the U.S. economy this year as job gains eat up slack and push wages higher. The reduction in slack would also appear to be manifesting in higher prices. Both the core CPI and PPI measures surpassed expectations with the headline consumer inflation measure accelerating to 2.5%.

The hotter-than-expected data has added pressure on the Fed to not fall behind the curve and raise interest rates in the near-future. The continued increase in underlying inflation, driven in part by firming wage growth, should be interpreted by the Federal Reserve as a sign of a decreasing economic slack, and therefore confirm the need for a tightening of monetary policy. A March or May hike is not off the table, should the data continue to come in above expectations. It may be unwise to wait too long to raise rates, because it could force the Fed to tighten policy more quickly down the road and potentially cause a new recession in the process.

Going forward, a decent follow-through of around 2% GDP growth in the first quarter of 2017 is likely. As a result economic slack will continue to diminish. The big uncertainty for the outlook in 2017 remains future fiscal policy. The new Congress and President have expressed tax reform and infrastructure spending as their priorities. However, it will take a while longer to know the precise details of fiscal policy and what effects it might have on the economy. For now, the markets appear to be saying no matter what the precise policies are or when they might get implemented, growth will accelerate.

Index Performance as of 2/28/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Russell								
3000 Value	-0.30	3.42	4.04	6.77	4.04	30.04	9.77	13.97
3000	-0.22	3.72	5.67	7.73	5.67	26.31	9.92	13.86
3000 Growth	-0.14	4.02	7.39	8.73	7.39	22.78	10.06	13.68
1000 Value	-0.17	3.59	4.33	6.94	4.33	29.15	9.90	14.03
1000	-0.10	3.87	5.96	7.95	5.96	25.55	10.19	13.95
1000 Growth	-0.03	4.15	7.66	9.00	7.66	22.17	10.47	13.80
Mid Cap Value	-0.59	2.79	4.52	6.38	4.52	31.86	9.76	14.75
Mid Cap	-0.64	2.83	5.31	6.51	5.31	26.83	8.44	13.63
Mid Cap Growth	-0.69	2.88	6.31	6.67	6.31	21.55	7.01	12.32
2000 Value	-1.82	1.45	0.72	4.88	0.72	41.32	8.37	13.43
2000	-1.64	1.93	2.33	5.20	2.33	36.14	6.92	12.90
2000 Growth	-1.46	2.45	4.12	5.54	4.12	30.93	5.42	12.29
Standard & Poors								
S&P 500	-0.01	3.97	5.94	8.04	5.94	24.99	10.63	14.01
Consumer Disc	-0.80	1.95	6.27	6.33	6.27	18.31	10.83	16.83
Consumer Staples	0.23	4.95	6.68	10.07	6.68	11.56	12.25	13.74
Energy	-1.34	-2.19	-5.71	-3.90	-5.71	26.21	-3.91	1.24
Financials	-0.29	5.20	5.45	9.56	5.45	46.40	13.90	17.72
Health Care	1.27	6.43	8.82	9.62	8.82	15.18	9.80	17.77
Industrials	-0.56	3.82	5.29	5.82	5.29	27.69	10.50	14.61
Information Technology	-0.20	5.13	9.77	11.48	9.77	32.98	15.94	15.20
Materials	-0.35	0.69	5.35	5.48	5.35	27.77	5.68	9.44
Real Estate	1.04	4.68	4.61	9.17	4.61	14.58	11.22	11.37
Telecom Services	0.07	-0.39	-2.85	5.03	-2.85	9.42	10.05	10.81
Utilities	3.34	5.28	6.60	11.87	6.60	15.89	12.62	12.44
Other U.S. Equity								
Dow Jones Industrial Avg.	0.42	5.17	5.82	9.46	5.82	29.35	11.17	12.77
MSCI USA	-0.05	3.93	6.08	8.06	6.08	25.33	10.37	13.89
Wilshire 5000 (Full Cap)	-0.31	3.55	5.58	7.62	5.58	26.72	9.53	13.65
International Equity - Broad Market								
MSCI EAFE	0.06	1.43	4.37	7.94	4.37	15.77	-0.62	5.16
MSCI EM	-0.97	3.06	8.70	8.94	8.70	29.48	1.35	-0.37
MSCI Frontier Markets	-1.02	-0.37	6.27	9.16	6.27	13.17	-1.50	5.80
MSCI ACWI	-0.26	2.81	5.62	7.90	5.62	22.09	4.81	8.25
MSCI ACWI Ex USA	-0.48	1.59	5.19	7.88	5.19	19.32	-0.19	3.55
MSCI AC Asia Ex Japan	-0.05	3.39	9.79	7.54	9.79	26.54	3.89	3.43
International Equity - Country Region								
MSCI Brazil	-3.73	4.36	15.56	16.54	15.56	95.24	1.49	-7.71
MSCI BRIC	-1.64	3.20	9.73	8.41	9.73	39.55	3.10	-1.21
MSCI China	-0.95	3.54	10.57	6.04	10.57	31.15	5.05	3.65
MSCI Europe	0.08	1.19	3.30	8.71	3.30	12.16	-3.13	4.68
MSCI India	0.30	5.90	10.51	10.43	10.51	26.35	8.38	3.89
MSCI Japan	0.16	1.12	4.88	5.90	4.88	20.31	5.69	7.19
MSCI EM Latin America	-2.40	3.57	11.45	12.41	11.45	47.57	-1.42	-6.83
MSCI Russia	-5.82	-6.35	-6.60	5.04	-6.60	43.31	-2.63	-5.93

Index Performance as of 2/28/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Fixed Income								
Barclays U.S. Aggregate	0.44	0.67	0.87	1.01	0.87	1.42	2.64	2.24
BofAML 3-Month T-Bill	0.01	0.04	0.09	0.13	0.09	0.39	0.16	0.14
Barclays U.S. Gov't	0.34	0.48	0.72	0.61	0.72	-1.15	1.96	1.41
Barclays U.S. Credit	0.69	1.11	1.45	2.07	1.45	5.72	3.61	3.57
Barclays High Yield Corp.	0.49	1.46	2.93	4.83	2.93	21.85	4.72	6.84
Barclays Municipal	0.57	0.69	1.36	2.55	1.36	0.25	3.53	3.07
Barclays TIPS	0.46	0.47	1.32	1.22	1.32	3.36	1.89	0.77
Barclays Gbl Agg Ex USD	1.66	0.29	2.17	1.19	2.17	-0.30	-2.78	-1.36
Barclays Global Aggregate	1.10	0.47	1.61	1.14	1.61	0.59	-0.47	0.21
BofAML Emerg. Mkt. Cred	0.42	1.67	4.30	6.06	4.30	24.97	9.37	8.16
Alternative Investments								
Alerian MLP	-2.50	0.40	5.31	9.94	5.31	40.86	-4.29	2.07
Bloomberg Commodity	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
FTSE NAREIT Equity REIT	0.49	3.41	3.53	8.39	3.53	16.75	11.32	11.62
S&P Global Natural Res.	-2.34	-1.39	3.03	6.08	3.03	36.94	-1.95	-1.90
S&P N. Amer Natural Res.	-2.57	-3.03	-3.70	-2.98	-3.70	32.07	-5.14	-1.43

Sources: Department of Commerce, Department of Labor, National Federation of Independent Business, National Association of Realtors.

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