UNION

MONTHLY UPDATE AND COMMENTARY
AUGUST 2017

Recap: The U.S. entered the ninth year of economic expansion in steady but unspectacular fashion that has shown little sign of abating. Gross domestic product expanded at a 2.6% annual rate in the second quarter, a rebound after a tepid start to the year. The figure repeated a familiar pattern of weak winters followed by a stronger spring and summer, leaving overall growth subdued.

Nonfarm employment has now increased for a record 81 consecutive months and the unemployment rate has fallen from a peak of 10 percent to 4.4%. Longevity was not the only hallmark of this expansion; growth has also been unusually slow – averaging just a 2.1% pace – and extraordinarily uneven – with growth driven largely by the technology and energy sectors.

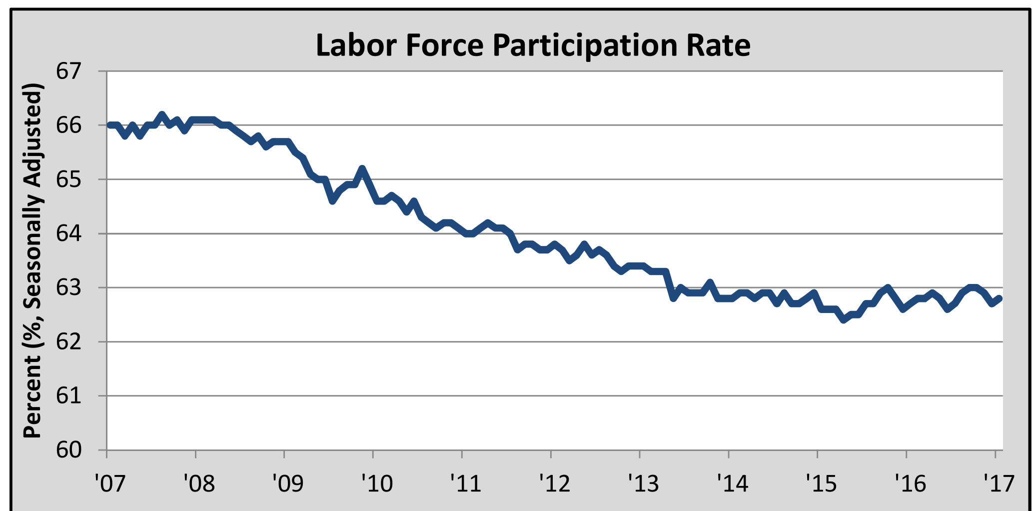
After eight years of economic growth, much of the economy's excess capacity has appeared to have been eliminated. Businesses are increasingly reporting difficulty hiring and retaining the skilled workers they need. Despite the apparent shortage of workers, however, wage increases and inflation have remained unusually modest. The lack of wage pressure was likely at least due in part to the still low proportion of the population that is either working or looking for work, as indicated by the relationship between the employment-population ratio and year-to-year growth in average hourly earnings.

Labor Market: U.S. employers were creating jobs unabated as the economic expansion entered its ninth year, but the inability to generate more robust wage growth represented a missing piece in a largely complete labor recovery. The U.S. has added jobs every month since October 2010, a record 81-month stretch that has absorbed roughly 16 million workers and slowly repaired much of the damage from the 2007-09 recession. The unemployment rate touched a 16-year low and the number of job openings hit a record earlier this year.

Still, average hourly earnings for private-sector workers rose slightly in June, 2.5% compared with a year earlier, a level little changed since March. Since mid-2009, when the expansion started, hourly earnings of blue-collar workers have grown on average 2.2% a year, much less than the previous three decades.

Tepid wage growth has been a puzzle because worker incomes should, in theory, rise faster as employers compete for scarce labor. However, with both productivity growth and inflation continuing to prove sluggish, it is not altogether surprising that wage growth has disappointed.

A more globalized economy has held down what workers can earn everywhere, especially in rich countries losing manufacturing jobs to low-wage economies. The reduced power of unions has impeded the bargaining power of workers. People are more easily replaced by machines or individuals sitting on the sidelines of the labor force waiting to return.



The burden of slow wage growth, importantly, have softened for workers by the fact that inflation has been low. Inflation-adjusted wage growth for blue-collar workers, at 0.7%

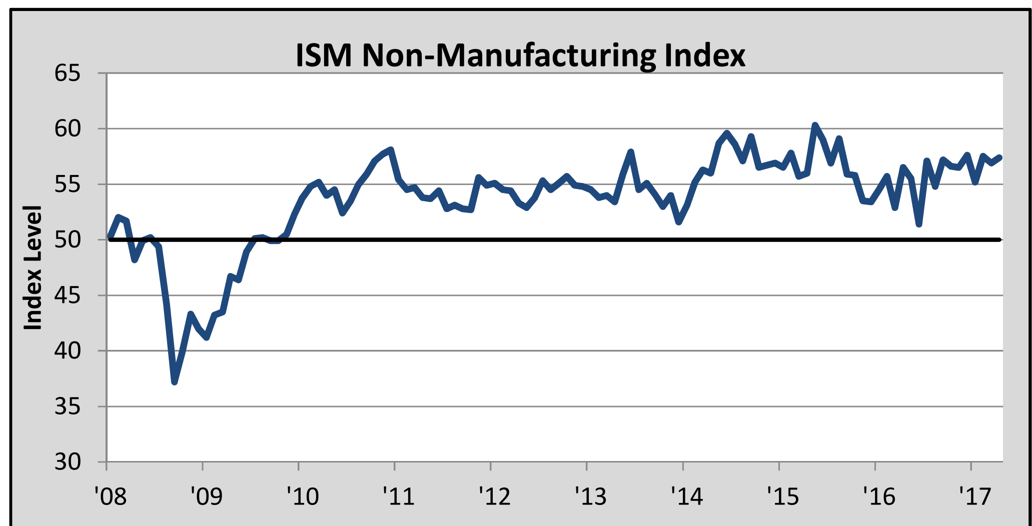
a year in this expansion, has actually been better than in any of the three previous expansions, and wages by this measure have grown for 49 straight months.

Wages are expected to heat up soon. That is in part because more employers are struggling to fill vacancies, which could lead to more bargaining power for workers. Improving opportunities in the job market appear to be slowly pulling Americans off the economy's sidelines. The labor-force participation rate, hovering near a four-decade low, inched up to 62.8% in June from 62.7% the prior month. Low participation is partly because of shifts at both ends of the workforce age spectrum—fewer young Americans are looking for work and baby boomers are retiring. There are other explanations for soft wage gains. Low worker-productivity growth limits the ability of firms to raise pay without eating into profits. Companies may also be hunting out cheaper workers - either younger or less skilled ones - rather than competing solely on wages.

Manufacturing Index: The ISM manufacturing index jumped from 54.9 in May to 57.8 in June, the tenth consecutive month in which the index has been above the demarcation line separating expansion from contraction. It was also the highest reading in the index since August 2014. Fourteen industries reported growth in production in June, while only two industries indicated that production declined last month. In addition, the employment sub component of the overall index rose to a 3-month high in June.

Moreover, the forward-looking indicators were also strong, suggesting that manufacturing production should continue to expand in coming months.

Non-Manufacturing Index: Institute for Supply Management's (ISM) non-manufacturing index rose 0.5 points to 57.4 in June. Gains were broad-based with the majority of the survey components accelerating in June. All of the sub components are now in expansionary territory including prices and imports that had previously been in contractionary territory.



Improvements among most of the main subcomponents included new orders and business activity, both of which have continued to outperform the overall index for most of the post-recession period, adding to the encouraging report.

Housing: U.S. housing starts rebounded in June, promising to help ease a national shortage of single-family homes and restrain price growth in the coming months. Housing starts rose 8.3% in June from the previous month to a seasonally adjusted annual rate of 1.215 million. Residential building permits, which can signal how much construction is in the pipeline, increased 7.4% to an annual pace of 1.254 million last month. That was the largest one-month jump since November 2015.

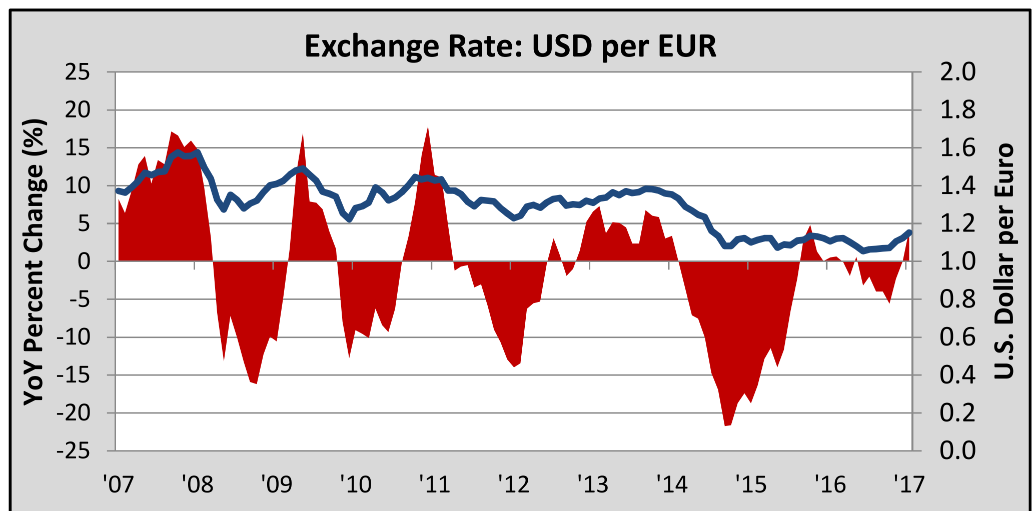
The pace of construction has been sluggish in recent months, with starts declining in the previous three months, and permits down in April and May. But that was likely because a warm winter pushed up some activity by a month or two. The overall trend showed continued improvement in the construction sector.

The increase in single-family starts should bode well for home buyers struggling to find properties to buy. The number of homes on the market has fallen year-over-year for 24 consecutive months, helping drive prices up much more quickly than incomes.

Budget Deficit: The U.S. ran a budget deficit in June, amid higher government spending and steady revenues. Government spending exceeded revenues by $90 billion, about $96 billion higher than it was in June 2016, when the government recorded a $6 billion surplus. Through the first nine months of the fiscal year, which began in October, the overall budget gap was about 31% bigger compared with the same period a year earlier.

Lackluster receipts have been compressing the period of time the government has before it runs out of cash. The Treasury Department has been employing cash-conservation measures since mid-March when government debt hit the borrowing limit. Those measures will last until October, unless the Congress raises the debt ceiling. Declining government revenues and long-term costs associated with an aging population, including higher Social Security and Medicare spending, will continue to push up the deficit.

US Dollar: The dynamism of the dollar at the end of 2016 has given way to enthusiasm for the euro. That shift could yet support an appetite for riskier assets such as emerging-market stocks and bonds. The US Dollar Index has now unwound the boost it got from the election of Donald Trump in November, and is down about 6.5% this year. The dollar's key counterpart, the euro, has risen close to 10% in 2017, under the influence of monetary-policy divergence between Europe and the U.S.



The focus at the start of the year was on the U.S. Federal Reserve and its efforts to raise interest rates; now the European Central Bank has stolen the spotlight as it tacks gently away from ultraloose policy settings.

A further sharp rise in the euro might cause European policy makers to feel the currency is doing the tightening work on its own. Conversely, the risk might yet be that the Fed has raised rates more than the market thinks is likely. But the ramifications of this shift are broad. A weaker dollar should add to the attraction of local-currency emerging-market assets. The Mexican peso, Brazilian real and South African rand have all risen against the dollar in July.

China: China touted its buoyant economic expansion this year as evidence it could reduce debt without harming growth. But the outlook appeared hazier when considering the property market's outsized role in the economy, jittery consumers and signs that significant deleveraging hasn't fully set in.

Domestic demand fueled 6.9% growth in the second quarter, a result that matched the first-quarter growth. However, the result would have to be measured against a continued reliance on problematic sectors such as real estate and a lack of meaningful progress toward cutting the country's debt. Meanwhile, Chinese consumers have not been spending as fast as their wages rose, suggesting many have become more financially strapped because of high property prices.

Armed with a more stable yuan and reduced capital outflows, Beijing has been able to tighten credit without causing

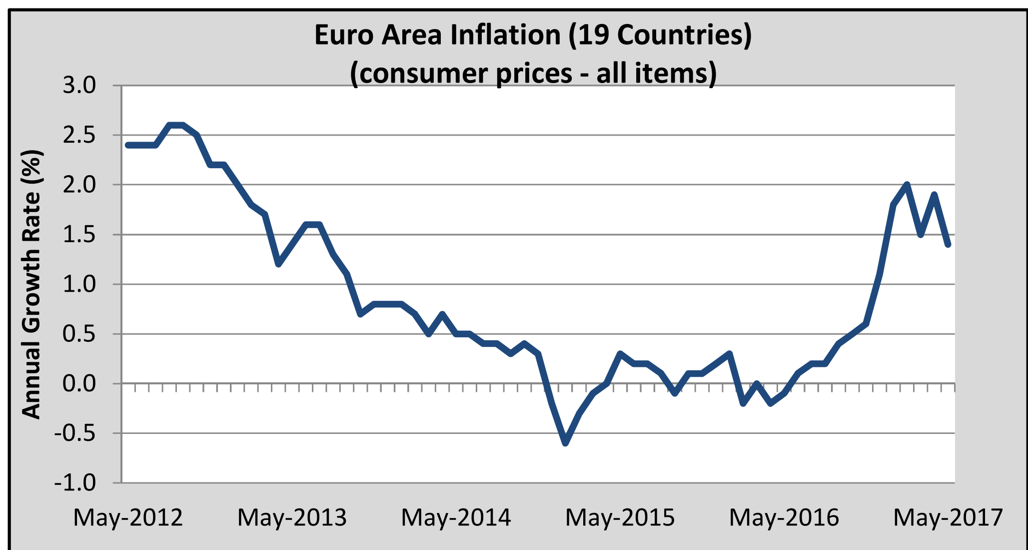
market panic or affecting headline growth. That effort has forced banks and other financial institutions to cut back on borrowing from each other. But it has not led to significant debt reduction in the economy. In June, more than a third of new loans issued by Chinese banks went to home lending.

Beijing will need to continue to clamp down on credit to shift to a more sustainable growth model. Should growth weaken, the Peoples' Bank of China (PBOC) likely will gradually guide down the short-term interest rates used to price bonds and bank-to-bank loans and ease the liquidity constraints on the country's financial system to help the economy. That would mark a shift in strategy since late last year, when the PBOC embarked on an untraditional tightening path by pushing up the short-term rates, while leaving unchanged the benchmark rates.

Beijing faces a policy dilemma in its battle to tame the property market, which, together with construction and home furnishings, have now contributed to a third of the overall economy. China doesn't want home prices to soar for fear of destabilizing bubbles; on the other hand, it needs to prevent a property crash that could torpedo the economy.

Eurozone: Output at the eurozone's factories in May rose 1.3% compared to April and 4% from May 2016; this has been the fastest annual pace in more than five years, a fresh indication that the area's economic recovery picked up in the second quarter. The Eurozone economy grew at the fastest rate in two years during the first three months of 2017, outpacing the U.S., the U.K. and Japan. Industry, which accounted for about one fifth of total economic activity in the eurozone, made only a modest contribution to first-quarter growth, with output up just 0.2% across the three months. But that was largely because of weakened demand for heating in response to a milder winter than is usual. There were signs in April and May that the second quarter had seen more normal levels of output from the utilities, with energy production up in both months.

But the pickup in industrial output was more broadly based, and was supported by a large increase in the production of capital goods, which may be a sign of increased investment by eurozone businesses.



In response to the unexpected strength of the recovery in the first half of this year, the European Central Bank has indicated it may soon consider withdrawing some of the stimulus it has provided since mid-2014. However, there have been few firm indications that inflation is set to rise to and stay at the central bank's target, so any move is likely to be gradual and cautious.

Global: The global economy has continued to show signs of improvement with industrial and manufacturing production numbers moving higher across the world. Global export growth has followed closely behind. Last month, industrial production strengthened in several European countries, particularly in Germany and France, the largest members of the Eurozone, which would point to, perhaps, further strengthening of overall economic growth in the region.

Meanwhile, there seemed to be an understanding that central banks across the global economy would probably have to start reigning in ultra-loose monetary policy. However, this move would be very slow and gradual, just as had been

the case in the U.S. economy with the Federal Reserve.

Perhaps the biggest issue for the global economy today would be how strong and how sustainable this recovery has remained even if some of the monetary stimulus continued to be taken away. Another threat to this global economic recovery would be a trade war. So far, only the United States has continued to talk about unfair trade and thus the discussion has remained contained. However, the United States has engaged in pre-negotiations with Mexico regarding the future of NAFTA. If something happened to trade it could unsettle the recent improvement in export growth across the world, affecting one of the few drivers of economic activity today that is helping despite a lack of fiscal stimulus.

Outlook: With the first half of the year concluded, the current expansion entered its ninth year, the third longest on record. After rising at just a 1.1% pace in the first quarter, real personal consumption expenditures rose at a substantial pace in the second quarter. This gain reflects some benefit from this year's relatively late Easter and later than usual tax refunds, which both bolstered spending in the second quarter at the expense of the first.

Business fixed investment has been another area where growth has been uneven. Investment came roaring back in the first quarter, largely due to a rebound in oil and gas exploration. Investment grew more modestly during the spring as oil prices backed off their recent highs.

Attitudes toward business investment are improving particularly at small businesses, as a growing proportion reported greater ease at accessing the credit that they need. Residential investment has appeared to have pulled back a bit in the second quarter after unseasonably mild weather boosted growth earlier this year.

Although continued improvement is expected in global growth prospects, there are risks that could stall this economic recovery. In particular, higher interest rates normally make growth across the developing world more difficult.

Moreover, while the monetary policy levers continue to help economic growth across the globe, fiscal levers remain extremely limited. Thus, earnings from export growth could help offset the lack of fiscal stimulus across the world at a time when monetary policy is starting to make an about face. Additionally, export earnings could help support growth, especially in the developing world. This is the reason why any threat to international trade could exert some damage to the current global environment at a time when monetary policy is starting to look less accommodative.

Index Performance as of 7/31/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Russell								
3000 Value	0.55	1.28	1.28	2.73	5.65	14.18	8.52	13.98
3000	-0.10	1.89	1.89	3.86	10.99	16.15	10.51	14.79
3000 Growth	-0.76	2.52	2.52	4.92	16.55	18.04	12.46	15.52
1000 Value	0.61	1.33	1.33	2.88	6.05	13.77	8.45	14.00
1000	-0.03	1.98	1.98	4.00	11.44	15.96	10.58	14.85
1000 Growth	-0.69	2.66	2.66	5.05	17.02	18.07	12.66	15.60
Mid Cap Value	-0.03	1.33	1.33	2.52	6.57	12.70	9.00	15.32
Mid Cap	-0.22	1.47	1.47	3.42	9.58	13.05	9.30	15.01
Mid Cap Growth	-0.48	1.67	1.67	4.41	13.26	13.40	9.53	14.60
2000 Value	-0.17	0.63	0.63	0.91	1.18	19.23	9.50	13.76
2000	-0.89	0.74	0.74	2.11	5.77	18.47	9.89	14.19
2000 Growth	-1.57	0.85	0.85	3.37	10.91	17.77	10.22	14.58
Standard & Poors								
S&P 500	0.03	2.06	2.06	4.14	11.59	16.05	10.87	14.78
Consumer Disc	0.61	1.87	1.87	1.79	13.08	13.91	13.40	17.92
Consumer Staples	0.65	0.57	0.57	1.11	8.65	4.40	11.62	12.12
Energy	2.43	2.50	2.50	-1.16	-10.43	0.19	-8.75	1.31
Financials	0.80	1.72	1.72	6.95	8.73	33.02	13.54	18.36
Health Care	-1.29	0.77	0.77	6.29	16.97	8.01	11.25	17.79
Industrials	-0.38	0.06	0.06	2.98	9.57	18.32	11.79	15.98
Information Technology	-1.40	4.33	4.33	5.97	22.31	29.50	17.03	17.95
Materials	-0.95	1.54	1.54	3.32	10.90	14.59	5.95	11.70
Real Estate	0.57	1.20	1.20	3.88	7.68	-2.08	9.27	9.49
Telecom Services	8.53	6.36	6.36	2.25	-5.06	-7.04	4.92	5.81
Utilities	0.85	2.44	2.44	3.90	11.41	5.71	12.85	11.15
Other U.S. Equity								
Dow Jones Industrial Avg.	1.77	2.68	2.68	5.21	12.28	21.83	12.53	13.79
Wilshire 5000 (Full Cap)	-0.07	1.91	1.91	3.79	10.93	16.31	10.22	14.64
International Equity - Broad Market								
MSCI EAFE	0.89	2.88	2.88	6.47	17.09	17.78	2.79	9.06
MSCI EM	0.21	5.96	5.96	10.19	25.49	24.86	2.39	4.76
MSCI Frontier Markets	0.37	2.11	2.11	7.12	18.01	20.26	-3.26	8.83
MSCI ACWI	0.32	2.79	2.79	5.54	14.59	17.07	6.22	10.85
MSCI ACWI Ex USA	0.67	3.69	3.69	7.38	18.30	19.02	2.37	7.70
MSCI AC Asia Ex Japan	0.38	5.35	5.35	11.68	29.38	27.36	5.54	8.54
International Equity - Country Region								
MSCI Brazil	1.88	10.95	10.95	3.59	14.27	18.05	-5.25	-3.00
MSCI BRIC	1.58	8.63	8.63	11.66	26.90	29.97	3.47	5.37
MSCI China	1.71	8.89	8.89	17.27	35.96	39.11	8.34	10.51
MSCI Europe	0.96	2.99	2.99	6.80	18.80	19.72	2.05	9.22
MSCI India	1.31	7.70	7.70	8.74	29.81	19.74	6.45	10.76
MSCI Japan	0.61	2.02	2.02	6.21	12.14	14.20	6.04	10.53
MSCI EM Latin America	0.58	8.28	8.28	6.40	19.24	18.03	-4.44	-2.48
MSCI Russia	0.49	4.09	4.09	-6.15	-10.67	12.75	-3.56	-3.19

Index Performance as of 7/31/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Fixed Income								
Barclays U.S. Aggregate	-0.11	0.43	0.43	1.10	2.71	-0.52	2.71	2.02
BofAML 3-Month T-Bill	0.03	0.09	0.09	0.22	0.39	0.54	0.26	0.19
Barclays U.S. Gov't	-0.17	0.17	0.17	0.66	2.03	-2.40	2.10	1.14
Barclays U.S. Credit	-0.12	0.73	0.73	2.08	4.44	1.26	3.67	3.27
Barclays High Yield Corp.	0.17	1.11	1.11	2.12	6.09	10.95	5.34	6.73
Barclays Municipal	-0.09	0.81	0.81	2.04	4.40	0.26	3.55	3.10
Barclays TIPS	0.04	0.45	0.45	-0.55	1.30	-1.04	0.77	-0.02
Barclays Gbl Agg Ex USD	0.65	2.68	2.68	4.83	8.96	-2.02	-1.11	-0.03
Barclays Global Aggregate	0.32	1.68	1.68	3.16	6.16	-1.28	0.51	0.88
BofAML Emerg. Mkt. Cred	0.11	0.81	0.81	0.62	6.82	11.01	6.49	8.89
Alternative Investments								
Alerian MLP	0.71	1.29	1.29	-3.91	-1.40	1.13	-9.77	1.03
Bloomberg Commodity	2.14	2.26	2.26	0.71	-3.11	0.77	-12.69	-9.98
FTSE NAREIT Equity REIT	0.71	1.22	1.22	2.64	3.96	-4.47	8.78	9.36
S&P Global Natural Res.	2.47	5.91	5.91	5.48	7.99	16.95	-2.45	1.55
S&P N. Amer Natural Res.	2.19	3.52	3.52	-0.80	-7.90	0.60	-9.73	0.19

Sources: Department of Labor, Department of Commerce, Institute for Supply Management, European Commission, National Association of Realtors.

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