UNION

MONTHLY UPDATE AND COMMENTARY
SEPTEMBER 2017

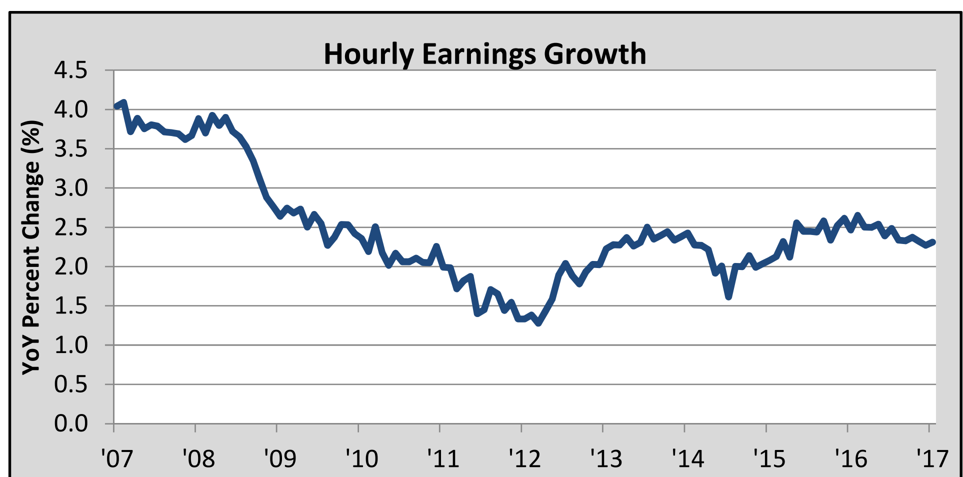
Recap: The U.S. economy has hit a sweet spot seldom seen in past expansions, posting in August a record 83rd straight month of job creation and an unemployment rate at a 16-year low, despite slow growth in economic output. Growth has been stuck stubbornly near a 2% annual rate, the weakest expansion since World War II. But by a range of measures the economy has pushed into new territory, including record stock-price highs, improving consumer confidence and rising corporate profits. Even wages, though rising slowly, have advanced at a healthy pace when adjusted for exceptionally low inflation. Other parts of the global economy, including Europe and China, have now contributed after stumbles in recent years, adding to global growth that has spilled back into the U.S.

The current status of the global economy has been a result of years of easy monetary policy, improved corporate earnings and stronger global growth. The latest employment reports will likely keep the Federal Reserve on track to begin slowly shrinking its portfolio of treasury and mortgage securities this fall and to raise short term interest rates after that for the third time this year.

One mixed factor for the economic outlook has been wage growth. From a year earlier, average hourly earnings increased 2.5%. While slower than normal in the past quarter-century, the wage picture has not been all bad. When adjusting for low inflation, real wages grew 0.9% in June from a year earlier, a stronger rate than the 30-year average. One factor holding back wages in recent months has been the mix of jobs added. One in four new jobs came from restaurants, among the lowest-paying fields. Labor-force participation has been rising among Americans with a high-school diploma or less. The figures have been stable for those with college degrees, suggesting low-skill, low-wage workers have been getting a slightly larger piece of the expanding economic pie.

Hurricane Harvey: Hurricane Harvey which hit Texas was easily one of the worst U.S. natural disasters in recent memory. There will be a measurable economic impact which can be divided into two phases. The first, taking place right now, is a slump in economic activity related to the shuttering of refineries, ports, oil rigs, and other places of business. This is going to reduce economic activity during the current quarter the size of which will depend on the duration of the stoppage and the breadth of businesses affected. The second phase will be the rebuilding phase, which will add to economic activity as homes and businesses are rebuilt and automobiles and other equipment are replaced. Taken together, it will slow third quarter GDP by about 0.1 of a percentage point.

Going forward, clean-up, and reconstruction and replacement efforts will provide an economic boost during Q4 and in early-2018. A relatively rapid return to full capacity for the refining, chemical, and oil & gas industries in Q4 will produce a sizeable economic boost of 0.1 to 0.4 percentage points, while activity in the first half of 2018 may see a more muted lift. In addition to GDP, other economic indicators including net exports and industrial production should show some weakness in the coming months given the importance of Texas and Louisiana as an energy and export hub.



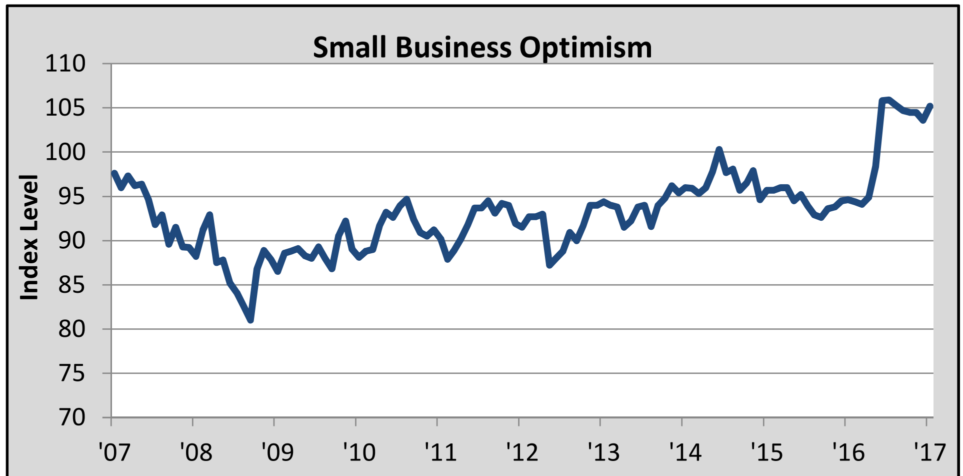
Personal Spending: A string of data releases in August helped provide additional context as far as economic momentum for the third quarter. Personal spending rose by a meager 0.1% in June, with the softness providing somewhat of a weak handoff to consumer spending in the third quarter. Personal income was essentially flat for the month.

However, much of the slowdown in personal income was related to decreases in personal dividend and interest income, factors that should prove temporary.

On the other hand, growth in wages and salaries was a solid 0.4% month over month and looked to be strong in July also given the average hourly wage data. The strengthening in income growth, together with the relatively healthy auto sales figures for July, would suggest that consumers will continue driving economic growth in the third quarter, with consumption expected to rise by at least 2.5%.

Retail Sales: Retail sales were up a robust 0.6% month over month in July while June figures were revised upward from a decline of 0.2% to an increase of 0.3%. The control group (i.e. sales excluding gas, autos, building materials, and food services) was also up 0.6% the month, with June revised up to +0.1% (from -0.1% previously).
This data would suggest that the consumer will be in much better shape heading into the third quarter of the year. The strong showing should be enough to push GDP growth to at least 2.5% in the third quarter and would imply somewhat stronger growth in the second quarter as well. With continued job growth and gradually accelerating wages, consumers should continue to lead the economic outlook in the coming months.

NFIB's Small Business Optimism Index: The NFIB's small business optimism index rose by 1.6 points in July to 105.2, reversing the declining trend seen over the start of the year. Seven of the ten index components gained ground on the month, two retrenched, and one remained unchanged. The positive sentiment was reflected in forward-looking indicators, with expectations for economic improvement, higher sales volumes, and plans to increase employment leading the way.



The reversal of the downward trend was likely due to a pickup in growth last quarter, with strength in consumer spending having shored up confidence and leaving firms less reliant on plans for tax reform to support growth. With this momentum in growth expected to continue into the third quarter, firms will likely remain positive as robust demand supports expansion.

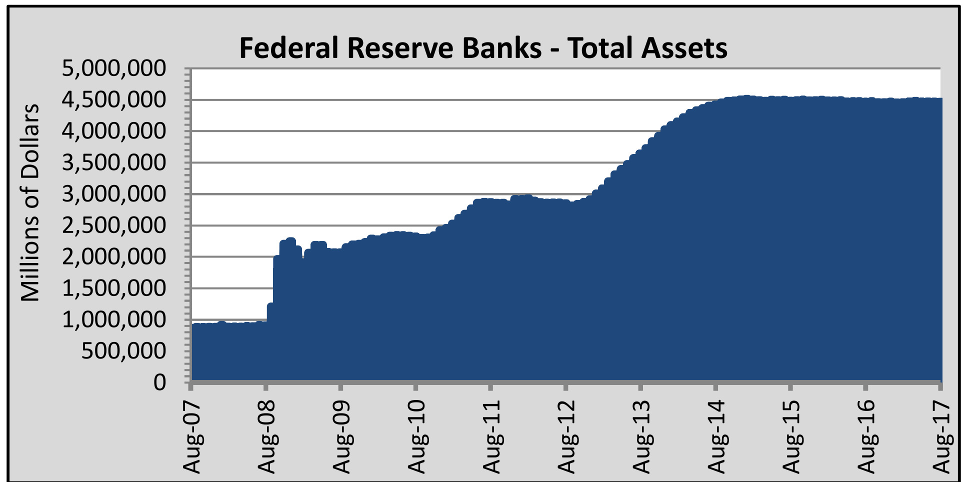
ISM Manufacturing Index: Manufacturing activity in the U.S. reached a six-year high in August, with factories continuing to register a big rise in sales and boost hiring in response. The Institute for Supply Management's index of factory activity rose to 58.8 in August from 56.3 in July, hitting the highest level since April 2011. The reading would suggest stronger global growth, a softer dollar, a booming stock market and a rising consumer and business confidence which have boosted American manufacturers.

The non-manufacturing index telegraphed a deceleration in activity, but remained in expansionary territory while most industries have continued to report growth. Importantly, both ISM surveys indicated significant increases in their price sub-indices.

Together with a slightly firmer core Personal Consumption Expenditure (PCE) price index, which was revised up to 1.5% year over year in July, these would suggest that a turnaround in price pressures could be underway. Should this in fact be the case, further tightening would likely take place later this year, with the Fed likely to slip in a December rate hike. Lack of such evidence, on the other hand, could stay the Fed's hand as far as the hike is concerned, but

would be unlikely to prevent the Fed from starting the balance sheet unwinding process in the fall.

Federal Reserve: Strong gains in hiring and a slight decline in the jobless rate last month should keep the Federal Reserve on track to begin slowly shrinking its balance sheet this fall and to raise short-term interest rates after that for the third time this year. Recent speeches and interviews with officials would indicate a relatively high bar has been set to knock the central bank off its plans to begin shrinking the balance sheet in fall. An announcement on the balance sheet policy change is expected at the September meeting.



The Fed is unlikely to raise rates again until December, and it would have more jobs, inflation, consumer spending and GDP reports to study before making any decisions.

U.S. Dollar: After rising to a 14-year high at the end of last year, the trade-weighted value of the U.S. dollar has declined about 7% so far in 2017. Its decline has been especially pronounced against the euro and the peso. Part of the weakness has been owed to improved stability in the rest of the world, particularly Europe. After years of repeated fiscal and political crises, Europe's growth so far in 2017 has slightly outpaced the U.S. European Central Bank officials have publicly contemplated pulling back their stimulus measures as growth has improved, which has given the euro a boost. Meanwhile, the Trump administration has not pursued action against Mexican exports as aggressively as some feared when he was elected, which has given a bump to the peso.

The change in the purchasing power of the dollar could be especially helpful to exporting manufacturers. U.S. manufacturing output was up 1.4% in June from a year earlier, after registering declines in 2015 and 2016. Some of that was due to a recovery in the energy sector, but it was not all energy.

A weaker currency has also increased the value of profits that multinationals earned overseas in other currencies—such as euros, pesos or yen—boosting the bottom line for investors when those foreign currencies are converted back into dollars. Moreover, at a time when Federal Reserve officials have found domestic inflation too low, it has put upward pressure on consumer prices. Going forward, the dollar is likely to continue to trend lower versus most currencies for the foreseeable future.

Euro Zone: Real GDP in the Eurozone rose 0.6 percent in Q2-2017, the 17th consecutive quarter in which economic output in the euro area has grown. The demand-side drivers of real GDP growth have appeared to be broad based, and the economic expansion has become increasingly self-sustaining. Although the unemployment rate has receded to an 8-year low, there are few signs yet of a sustained upturn in CPI inflation in the euro area.

As a result, the ECB is expected to proceed with caution when shifting from an easing to a tightening policy framework, just like its Federal Reserve counterpart did a few years ago. The ECB is expected to leave its policy rates unchanged for the time being and announce a reduction in its monthly bond purchases at the September meeting, although policymakers could conceivably wait until the end-October meeting to make the announcement.

Some crisis-era effects linger in the region, however, including high unemployment in Southern Europe, lack of growth in laggards such as Italy and Greece, and widespread popular discontent with political elites. But improving

growth has dispelled fears of the euro's demise, reviving the confidence of the EU's political class that it can fend off challenges from nationalist or anti-establishment parties, and boosting optimism that the continent has mostly returned to normal after a lost decade.

Global: For the first time in a decade, the world's major economies have been growing in sync, a result of lingering low-interest-rate stimulus from central banks and the gradual fading of crises that over years has ricocheted from the U.S. to Greece, Brazil and beyond. All 45 countries tracked by the Organization for Economic Cooperation and Development (OECD) have been on track to grow this year, and 33 of them are poised to accelerate from a year ago. It is the first time since 2007 that all have grown together and the most countries in acceleration since 2010, when many nations enjoyed a fleeting snapback from the global financial crisis.

The development has come, ironically, just as nationalist movements in the U.S., Europe and beyond have gotten a new life, driven by suspicion over global trade and finance. There are, however, downside risks. As years of crisis have demonstrated, soaring global stock prices or regional property markets could reverse quickly to financial mayhem that takes down economies. For now, though, the global upturn appears on track, in part because inflation has been low and central bankers have moved gradually.

The Federal Reserve and the ECB can both point to the global backdrop to justify plans to pull back stimulus programs. The Fed in September should begin reducing $4.5 trillion in holdings built up over the decade, designed to help drive down interest rates and boost risk-taking by investors, households and business. The ECB is nearing the end of its own bond-purchase program. For the first time in many years, there have been signs of synchronized economic expansions at home and abroad.

A wide range of factors have been at play in the global upturn. Among them, long-troubled eurozone economies have shown signs of finally turning a corner. In many advanced economies, including the U.S., the aftereffects of the financial crisis have finally started fading. American households have stopped paring back their debt exposures and have started returning to normal spending patterns.

The fiscal stance in many advanced economies has also shifted from austerity to ease. And although the Fed has begun to raise its target interest rate, most interest rates around the world have remained low and below inflation rates. The world has also benefitted from a reversal in the global commodity bust that began in 2014. At that time new energy supplies, such as from U.S. fracking, have combined with soft global growth to send prices plunging. Now, prices have firmed and investment is picking up.

Outlook: Real economic growth should continue though the financial background of monetary and economic policy has remained unresolved. For the past three months, employment gains in the U.S. have averaged 180,000 while industrial production growth in the first half of 2017 was 2.5%. These provide positive signals for the economy. The outlook for U.S. GDP and real final sales growth in the second half of 2017 is around 2.5%, with solid contributions likely from the consumer, business and government sectors. As for inflation, the PCE deflator, the Fed's preferred benchmark, should remain near 1.5%, comfortably below the Fed's 2% target.

The creation of new jobs should slow somewhat. However, the lower trend should be accompanied by stronger wage gains for existing job holders. While the relationship between labor market slack and inflation has become more muted in recent years, and has taken longer to materialize, the link still holds. As such, a pick-up in inflation should materialize before the end of 2017, with the stronger data motivating the Fed to take interest rates higher.

Recent data has indicated that growth in the global economy picked up in the first half of 2017, and global trade volumes also accelerated. The recent strengthening in global economic growth has reflected, at least in part, supportive policy stances in many countries. For example, not only did Chinese authorities adopt an expansionary policy stance when growth appeared to be slowing last year, but monetary policy has been accommodative in many other major economies as well. With growth picking up again in many economies, central banks have started to transition to less accommodative policy stances.

The trade-weighted value of the U.S. dollar rose to a 14-year high late last year due to market euphoria that U.S. fiscal policy would become more expansionary. However, the dollar has been following a downtrend in 2017 as markets have re-assessed expectations for U.S. fiscal policy. Looking forward, the U.S. dollar will likely continue to follow a downtrend as market expectations transition from monetary policy divergence (i.e., rates in the United States rising relative to rates abroad) to convergence (i.e., other central banks adopting less accommodative policy stances). A wild card that remains for the relative strength of the dollar are fiscal policy initiatives in the U.S. still off in the future with uncertain detail.

Index Performance as of 8/31/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Russell								
3000 Value	0.89	-1.26	0.00	1.78	4.32	11.73	6.76	13.19
3000	1.52	0.19	2.08	3.00	11.20	16.07	9.08	14.27
3000 Growth	2.14	1.68	4.24	4.24	18.51	20.48	11.39	15.28
1000 Value	0.83	-1.16	0.15	1.79	4.81	11.59	6.74	13.25
1000	1.45	0.31	2.30	3.01	11.79	16.17	9.21	14.37
1000 Growth	2.08	1.83	4.54	4.26	19.17	20.83	11.66	15.41
Mid Cap Value	0.90	-1.87	-0.57	0.91	4.58	10.82	6.83	14.22
Mid Cap	1.41	-0.78	0.68	1.69	8.73	12.45	7.32	14.12
Mid Cap Growth	2.08	0.71	2.39	2.69	14.06	14.53	7.88	14.00
2000 Value	1.67	-2.46	-1.84	1.59	-1.31	13.47	7.06	12.51
2000	2.32	-1.27	-0.54	2.90	4.42	14.93	7.67	13.15
2000 Growth	2.96	-0.12	0.73	4.20	10.78	16.40	8.20	13.75
Standard & Poors								
S&P 500	1.40	0.31	2.37	3.01	11.93	16.25	9.54	14.34
Consumer Disc	1.45	-1.84	0.00	-1.19	11.00	13.23	11.07	16.47
Consumer Staples	0.42	-1.06	-0.49	-2.74	7.49	3.79	9.53	12.00
Energy	0.49	-5.18	-2.81	-2.99	-15.07	-6.09	-11.01	-0.22
Financials	-0.20	-1.61	0.09	6.52	6.98	26.04	11.38	17.24
Health Care	3.03	1.85	2.64	7.38	19.13	13.79	10.17	17.98
Industrials	1.87	0.15	0.21	1.60	9.74	17.53	10.32	15.69
Information Technology	2.17	3.47	7.96	5.04	26.56	31.22	16.84	17.58
Materials	1.51	0.89	2.44	4.34	11.88	15.69	4.97	11.36
Real Estate	0.91	1.14	2.35	4.32	8.90	2.71	8.40	9.85
Telecom Services	-0.55	-3.02	3.15	0.14	-7.93	-4.43	4.20	5.70
Utilities	0.04	3.25	5.77	2.91	15.03	15.65	12.23	12.81
Other U.S. Equity								
Dow Jones Industrial Avg.	0.87	0.65	3.35	5.15	13.01	22.31	11.46	13.70
Wilshire 5000 (Full Cap)	1.54	0.15	2.06	2.97	11.09	16.12	8.76	14.13
International Equity - Broad Market								
MSCI EAFE	0.61	-0.04	2.85	2.66	17.05	17.65	2.83	8.48
MSCI EM	0.57	2.23	8.32	9.42	28.29	24.55	2.38	5.30
MSCI Frontier Markets	0.23	3.68	5.87	6.52	22.35	26.12	-1.79	9.18
MSCI ACWI	1.01	0.38	3.19	3.66	15.03	17.13	5.58	10.46
MSCI ACWI Ex USA	0.60	0.52	4.23	4.55	18.92	18.89	2.36	7.37
MSCI AC Asia Ex Japan	0.69	1.33	6.75	8.45	31.10	24.84	5.77	8.94
International Equity - Country Region								
MSCI Brazil	-0.75	6.31	17.95	15.95	21.49	24.42	-6.61	-1.89
MSCI BRIC	0.94	3.84	12.80	13.59	31.77	28.88	3.67	6.36
MSCI China	0.94	4.22	13.48	16.09	41.69	35.02	9.75	12.14
MSCI Europe	0.54	0.06	3.05	1.92	18.87	19.44	1.93	8.29
MSCI India	1.13	-0.75	6.90	6.06	28.84	17.48	5.29	10.34
MSCI Japan	0.87	-0.05	1.97	3.05	12.09	13.70	6.80	10.68
MSCI EM Latin America	-0.57	4.62	13.29	14.03	24.75	22.65	-5.43	-1.49
MSCI Russia	4.36	8.13	12.55	8.28	-3.41	18.95	-0.51	-1.84

Index Performance as of 8/31/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Fixed Income								
Barclays U.S. Aggregate	0.36	0.90	1.33	1.23	3.64	0.49	2.64	2.19
BofAML 3-Month T-Bill	0.02	0.09	0.18	0.26	0.48	0.62	0.29	0.20
Barclays U.S. Gov't	0.34	1.06	1.23	1.08	3.12	-0.84	2.12	1.37
Barclays U.S. Credit	0.44	0.84	1.57	1.84	5.31	1.90	3.46	3.40
Barclays High Yield Corp.	0.43	-0.04	1.07	1.20	6.05	8.64	4.77	6.47
Barclays Municipal	0.16	0.76	1.58	1.21	5.20	0.88	3.40	3.23
Barclays TIPS	0.55	1.06	1.51	0.55	2.38	0.46	0.98	0.25
Barclays Gbl Agg Ex USD	0.35	1.07	3.78	3.68	10.13	-0.17	-0.82	-0.09
Barclays Global Aggregate	0.35	0.99	2.69	2.60	7.22	0.19	0.65	0.91
BofAML Emerg. Mkt. Cred	0.28	1.31	2.13	1.69	8.22	10.28	8.04	8.39
Alternative Investments								
Alerian MLP	2.54	-4.94	-3.72	-4.34	-6.27	-2.59	-13.58	-0.31
Bloomberg Commodity	1.39	0.40	2.67	2.48	-2.72	2.99	-12.27	-10.14
FTSE NAREIT Equity REIT	0.76	-0.25	0.96	3.17	3.69	-1.08	7.64	9.30
S&P Global Natural Res.	1.52	1.40	7.40	7.43	9.50	19.40	-2.12	1.48
S&P N. Amer Natural Res.	1.18	-3.84	-0.45	-1.02	-11.44	-3.50	-11.66	-1.41

Sources: Department of Commerce, Department of Labor, National Association of Independent Business, Federal Reserve, European Central Bank, Organization for Economic Cooperation and Development, Institute for Supply Management.

Securities are not insured by FDIC or any other government agency, are not bank guaranteed, are not deposits or a condition to any banking service or activity, are subject to risk and may lose value, including the possible loss of principal.