UNION

MONTHLY UPDATE AND COMMENTARY
NOVEMBER 2017

Recap: The U.S. economy posted its best six-month stretch of growth in three years despite two hurricanes, a sign that it could be breaking out of its long-running slow-growth trend, with the help of soaring stock prices and rising business and consumer confidence.

Gross domestic product expanded at a 3% annual rate in the third quarter. That followed 3.1% annual growth in the spring. Though not a boom, that's still the first time since mid-2014 that the economy has strung together two quarters of at least 3% growth. Solid spending by consumers and businesses - along with higher sales of American goods overseas - helped prevent the kind of slowdown expected after the two hurricanes in August and September.

Stock-market gains have accelerated this year and both consumer and small-business confidence have moved higher. In the wake of those sentiment advances, household purchases of durable goods have picked up, as have gains in business investment in equipment.

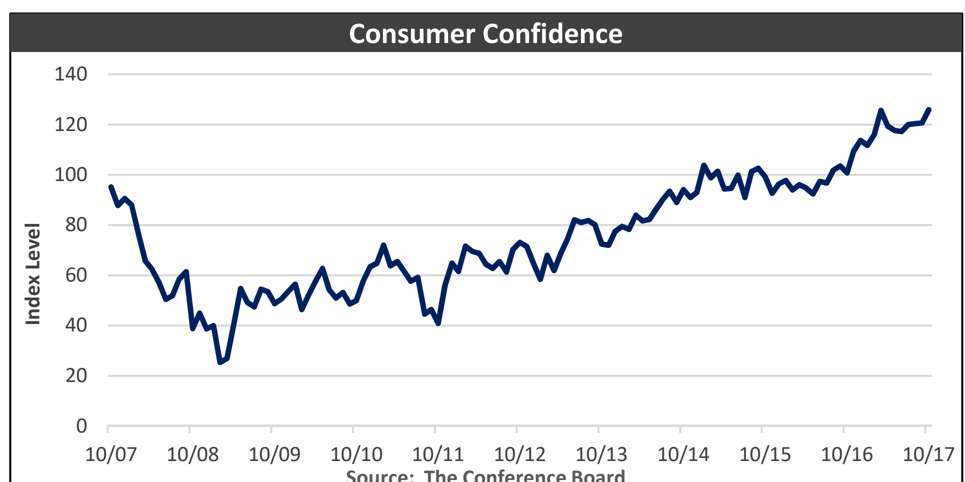
Still, there has been ample reason for caution before concluding the gains could and would be sustained. The economy has produced six-month growth bursts several times during this eight-year expansion, including a period of near-5% growth in mid-2014. But it hasn't been able to keep up that pace. The growth rate as a whole for the expansion has averaged 2.2%. A chunk of the third quarter's growth reflected businesses' replenishing of stockpiles, which had fallen earlier this year, rather than higher sales.

Repair efforts from the hurricanes could boost economic growth in coming quarters, particularly in building sectors. While growth is expected in the fourth quarter to clock near 3% again, nagging trends, including an aging population and weak worker productivity gains, still could stand in the way of the country achieving sustained robust economic growth.

Taken altogether, the Federal Reserve is closer to raising its benchmark short-term interest rate - the federal funds rate - at its policy meeting in December. Inflation picked up this summer after weakening earlier in the year, though it remained below the Fed's 2% target. For the economy to sustain faster growth, much will depend on the outlook for business investment, which would be central to boosting worker productivity and sustaining robust corporate profit gains.

Consumer Confidence Index: The Consumer Confidence Index rose 5.3 points in October to 125.9, its highest level since December 2000. Both the present situation index and the expectations series jumped at least 5 points. The 25% rise over the past year would mean more consumers feel optimistic about the economic environment than a year ago.

The rise in consumer confidence would suggest that the improvement in the economy has broadened and has reached more regions and households. Most of the improvement in the index has come from consumers' views on the labor market suggesting that the run-up in the stock market has played only a supporting role in boosting consumer confidence.

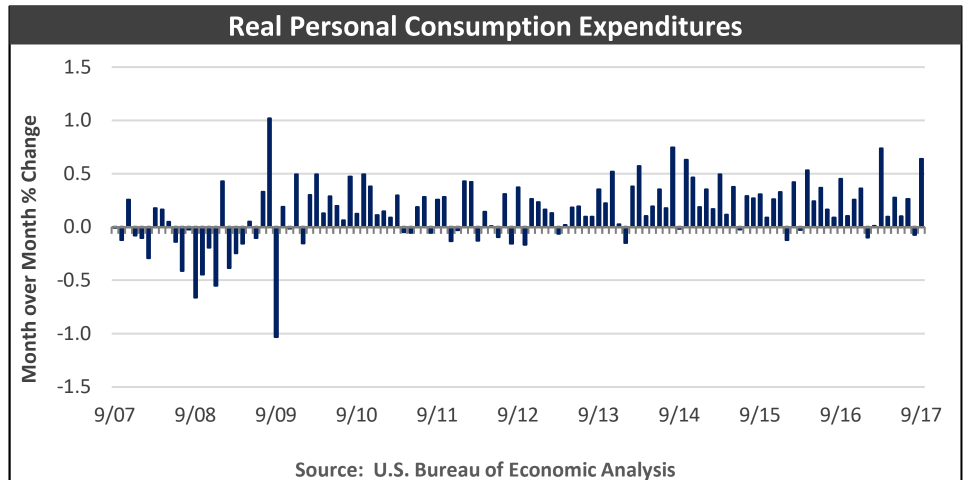


Consumers have also been feeling considerably more upbeat about the short-term outlook, with the prospect

of improving business conditions as the primary driver. They believe the economy will continue to expand at a solid pace for the remainder of 2017.

Personal Income: Nominal personal income rose 0.4% in September while real personal income after inflation was flat in September. Personal consumption rose by 1.0% in nominal terms. In real terms, spending was up only 0.6%, rebounding strongly from the hurricane-related pullback in August.

Prices rose 0.4% in September, due mainly to energy, which rose 6.8% for the month. As a result, inflation accelerated to 1.6% y/y from 1.4% in August. Core PCE inflation, on the other hand, remained steady at 1.3%.



September's strong spending growth made up for August's weakness, and implied a strong handoff for growth for the fourth quarter. Outside of the volatility in energy prices, inflation remained soft. This would mean that even if the Fed continued to raise its key lending rate, it would be very gradual.

Small Business Optimism Index: The NFIB Index of Small Business Optimism fell 2.3 points in September to 103.0. Six of the index subcomponents fell on the month, three improved and one remained unchanged. The biggest declines were recorded among forward-looking indicators. The current level of confidence, while nearly three points short of the recent cycle peak, still sits at the top range of historical highs.

The NFIB report is another example of data being affected by hurricanes, with the pace of job creation weakening in September in line with the payrolls report, and reduced optimism among affected businesses likely weighing on the headline confidence measure.

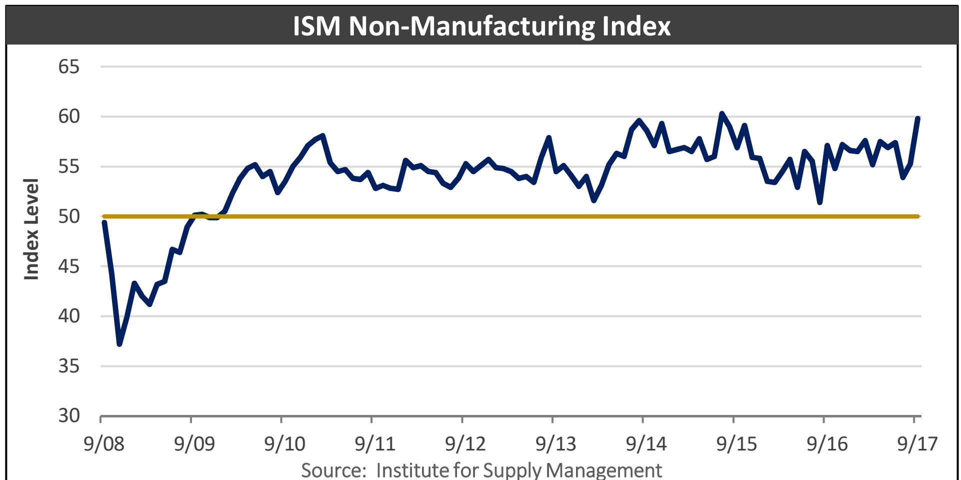
A return to normalcy in hurricane-affected areas should inject some optimism among affected businesses in the months ahead, with overall investment plans also to receive some support from rebuilding efforts.

Manufacturing Index: The Institute for Supply Management (ISM) manufacturing fell 2.1 points to 58.7 in October. All components except customers' inventories and imports lost some ground in the month. The decline in new orders and inventories pushed up the spread between the two – useful as a leading indicator of activity – to 15.4 (+3.3 points). This remained consistent with a view of manufacturing activity holding or strengthening in coming months. Sixteen of the eighteen manufacturing industries reported expansion in October.

The key subcomponents affected by hurricanes in August and September were largely responsible for the pullback in October. Abstracting from the storm-related impacts, small declines in new orders, production, and employment were likely more a reflection of monthly noise rather than the start of a new trend. Overall, this report remained consistent with a resilient and robust U.S. manufacturing sector supported by strong foreign demand that has helped to offset domestic policy uncertainty and U.S. dollar volatility.

Non-Manufacturing Index: The Institute for Supply Management's (ISM) non-manufacturing index surged by 4.5 points to

59.8 in September – the highest reading since August 2005. September marked the second consecutive month of broad-based gains among the sub-indices, with pullbacks recorded only in inventories and inventory sentiment. Just as in the case of the manufacturing index, some of the September gains appeared to be driven by supply chain disruptions and rebuilding efforts in the aftermath of Hurricane Harvey and Irma.



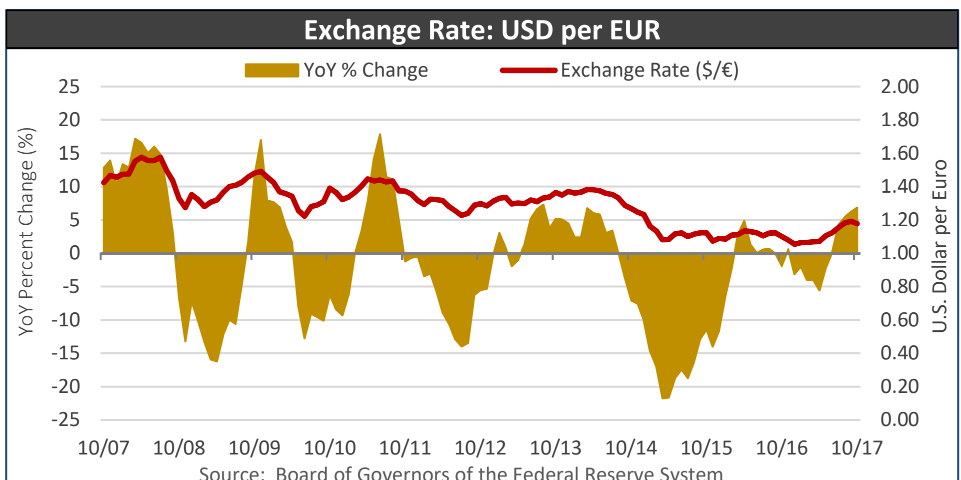
Housing: The post crisis home-price recovery has begun to look vulnerable. Housing starts and sales have slowed. Slumping household formation has been undermining demand at a time when affordability is under pressure, reflecting soft wage growth. Interest rates have been, yet again, beginning to rise, adding to concerns about pricing.

A sharp downturn however would appear unlikely: Inventories have remained generally low, and the financial market still is optimistic about the prospects for U.S. growth. The mortgage deduction appeared to have survived this round of tax overhaul discussions. But the best days of this housing cycle may be over.

Inflation: Higher energy prices pushed up the headline consumer price index (CPI) in September. The index jumped up 0.5% on the month and inflation on a year-on-year basis also moved up to 2.2% in September from 1.9% in August. Core inflation rose a disappointing 0.1% m/m in September, which left the year-over-year pace unchanged for the fifth month in a row, at 1.7%.

Another 0.1% monthly increase in core inflation has added to worries about when the soft spot in U.S. inflation will end. The impact of the past appreciation of the U.S. dollar has taken longer to abate than previously expected. Exchange rate impacts could ebb, and goods prices should help lift inflation higher over the next few years. And, as slack in the domestic economy diminishes further, services prices are also likely to perk up. However, this process has taken longer than previously expected, creating a dilemma for the Federal Reserve.

Currencies: The dollar has bounced roughly 3% from its September lows and has risen every week since then, powered by gains against the euro, yen and emerging-market currencies. The Federal Reserve signaled four rate increases by the end of next year and the Republican tax overhaul plan spurred hopes for faster U.S. growth. Meanwhile, strong showings by anti-establishment parties in Germany and Spain and the Catalonia crisis led to renewed concerns about the EU, halting gains in the euro which had sapped the dollar's strength.



The surprise recovery in the dollar highlights the unpredictable turns financial markets have taken this year. Expectations that stock prices would remain flat as rising inflation pushed bond yields and the dollar higher have been upended in recent months as stocks soared while yields and the dollar fell. The currency's bounce began at a point where many investors were looking for the euro to extend its gains.

But even a temporary reversal in the currency could have widespread implications for asset markets. A stronger dollar could dent profits for U.S. exporters and multinationals, after rising corporate earnings have helped propel major stock indexes to records. It could also complicate the plans of many investors who have notched big gains this year by betting on the euro, yen and emerging markets.

Fed officials have indicated that they're aiming for a third rate increase by the end of this year, and would support three more in 2018. That would be important, as rising interest rates typically attract yield-seeking investors to a currency in search of higher returns. The lack of sustained inflation has not restrained the Fed in its efforts to bring its policies into alignment with pre-crisis standards.

Events in Europe have also supported the dollar, which rallied after German elections offered Chancellor Angela Merkel a more tenuous governing majority, increasing anxiety about the stability of Europe's largest economy. Those concerns were amplified after the Catalonian government declared independence followed by crackdown from the Spanish government. This marked a reversal after investors bought the euro following a May election in France where business-friendly centrist Emmanuel Macron defeated right-wing populist Marine Le Pen.

While this dollar bounce could be temporary, and could end with the next piece of bad data or dovish Fed comment, these rebounds could also last many months, making their impact felt on corporate balance sheets and affecting global fund flows.

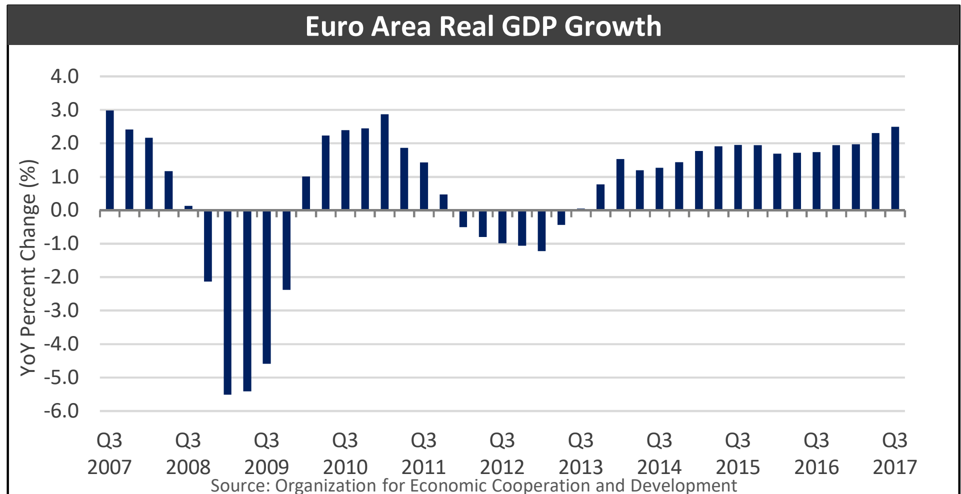
Global: Although economic growth in the global economy has remained well off, the pace registered during the first decade and a half of this century has been solid enough to push central banks of large developed countries outside of the U.S. to start considering their own response to years of extremely expansionary monetary policies. The recovery would seem especially significant in the all-important manufacturing sector, with manufacturing Purchasing Manager Indexes (PMI) hitting heights not seen in many years. In the United States, the ISM manufacturing index hit 60.8 in September, the highest reading since May 2004 when it was 61.4 and was the highest reading of that cycle. Meanwhile, the Eurozone PMI reading for September was the highest since late 2011, at 58.1.

What makes this strengthening in manufacturing sentiment in the U.S., as well as in the Eurozone interesting, would be that the recovery has not been accompanied by a strong manufacturing PMI in China. Thus, although economic growth in this environment could be weaker than what the global economy experienced since the emergence of China as a global growth engine, the economic environment would seem to be more balanced and potentially more sustainable than the environment that existed when China was pulling the strings of economic growth across the global economy.

Euro Zone: The Eurozone's economic recovery has gathered pace this year, aided in part by an increase in consumer spending. Real GDP in the Eurozone expanded 2.5% year-over-year in the third quarter of 2017, the fastest year-over-year growth rate since Q1-2011. Recent results have been in line with the continued improvement in the Eurozone economy over the past few quarters. A strengthening labor market in the Eurozone likely helped boost Q3 output. Eurozone unemployment data released recently showed the unemployment rate at 8.9% for September, down from 9.6% in early 2017.

But inflation in the Eurozone has maintained its sluggish pace of growth in October, registering 1.4% year over year. Core CPI also showed weakness, with inflation of just 0.9% year-over-year. A cooling labor market and a greater reluctance

among households to spend would suggest consumer inflation is unlikely to accelerate over the coming months.
The ECB's move in late October to lower its bond purchases from €60 to €30 billion a month starting in January would reflect the strengthening economic recovery taking hold in Europe. However, with inflation in the euro area remaining benign, ECB policy makers would seem likely to opt for a cautious approach to reducing stimulus.



China: The course China's leaders have set for their country over the next five years will have a major bearing on global markets and the economy. The opening of China's economy, the development of its financial markets and the rising wealth of its citizens have integrated it into the rest of the world like never before.

The biggest fear coming out of China would be debt. China's growth over the past decade has been driven by borrowing that has pushed the country's debt-to-GDP ratio up to worrisome levels.

Breakneck growth has raised Chinese incomes, not just giving people a place at the global economy's table but a stake in that economy performing well. A healthy China would matter a lot to the world. Without strong China growth, global gross domestic product would have increased by a third less over the past five years.

China has achieved its economic miracle by unleashing the entrepreneurial private sector. With President Xi Jinping consolidating power at the Communist Party's twice-a-decade leadership conference in October, the narrative of the next five years should begin becoming clear.

With private business already commanding around 70% of the economy, Mr. Xi and his allies have decided to strengthen key state-controlled companies by boosting their market power and easing their debt burdens.

For investors, the implications have been significant: higher global goods prices because state-owned companies are notoriously inefficient, and smaller chances for the long-feared Chinese debt crisis. Corporate debt, which has largely been in the state-owned sector, ticked down as a percentage of GDP in the second quarter - the first decline since 2011. The trade-off was slower Chinese growth. Chinese banks would need to keep subsidizing bloated state enterprises. And those enterprises' need for a deep pool of capital inside China would mean a free-floating yuan would remain a distant dream.

Outlook: After expanding at a 3.0% pace in the third quarter, real GDP growth should rise at a 2.5 percent pace in Q4 and expand 2.4 percent in 2018. Some sort of tax cut is expected to be enacted but the magnitude will be less than has been proposed and the timing will likely be a bit later. Those impacts might not appear until the second quarter of 2018, assuming passage of a $1.6 trillion cut over ten years in early spring of next year. At this stage of the business cycle, tax cuts would largely play a supporting role in economic growth. Consumer spending and business fixed investment would be stronger. Without those cuts, 2018 growth is likely to be closer to 2 percent.

Index Performance as of 10/31/17

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Russell								
3000 Value	-0.81	0.68	0.68	2.66	8.46	18.31	8.11	13.48
3000	0.25	2.18	2.18	4.88	16.40	24.00	10.53	15.12
3000 Growth	1.31	3.69	3.69	7.14	24.87	29.83	12.93	16.71
1000 Value	-0.85	0.73	0.73	2.50	8.70	17.79	7.99	13.48
1000	0.26	2.29	2.29	4.80	16.78	23.69	10.57	15.18
1000 Growth	1.37	3.87	3.87	7.15	25.40	29.73	13.14	16.83
Mid Cap Value	-0.40	0.80	0.80	1.62	8.30	17.13	8.26	14.49
Mid Cap	-0.22	1.67	1.67	3.67	13.60	21.11	9.03	14.87
Mid Cap Growth	0.02	2.80	2.80	6.45	20.57	26.27	9.97	15.34
2000 Value	-0.31	0.13	0.13	4.59	5.81	24.83	9.67	13.58
2000	0.17	0.85	0.85	5.78	11.89	27.87	10.12	14.49
2000 Growth	0.62	1.55	1.55	6.95	18.62	31.02	10.50	15.36
Standard & Poors								
S&P 500	0.25	2.33	2.33	4.76	16.91	23.65	10.77	15.18
Consumer Disc	1.10	2.11	2.11	1.08	14.30	19.76	12.41	16.78
Consumer Staples	-1.10	-1.40	-1.40	-3.29	5.08	3.76	7.20	11.41
Energy	0.50	-0.66	-0.66	3.55	-7.25	2.48	-5.01	1.28
Financials	-0.77	2.93	2.93	6.49	15.78	37.09	13.40	17.85
Health Care	-2.39	-0.76	-0.76	2.07	19.39	22.62	8.20	17.19
Industrials	-2.10	0.20	0.20	4.37	14.36	25.13	10.90	16.38
Information Technology	3.75	7.76	7.76	12.21	37.24	38.99	19.63	20.89
Materials	0.08	3.87	3.87	8.48	20.30	28.73	9.02	12.62
Real Estate	0.29	0.75	0.75	0.49	8.20	9.45	N/A	N/A
Telecom Services	-2.67	-7.62	-7.62	-7.26	-11.95	-1.37	2.21	4.86
Utilities	0.28	3.90	3.90	4.34	16.24	15.41	10.45	12.46
Other U.S. Equity								
Dow Jones Industrial Avg.	-0.28	4.44	4.44	7.40	20.58	32.09	13.17	15.12
Wilshire 5000 (Full Cap)	0.29	2.10	2.10	4.70	16.14	23.77	10.24	14.94
International Equity - Broad Market								
MSCI EAFE	0.41	1.52	1.52	4.01	21.78	23.46	6.08	8.53
MSCI EM	0.53	3.51	3.51	5.39	32.26	26.47	5.70	4.83
MSCI Frontier Markets	-1.14	1.23	1.23	7.10	26.39	27.53	0.55	9.15
MSCI ACWI	0.31	2.08	2.08	4.45	19.69	23.22	7.92	10.80
MSCI ACWI Ex USA	0.35	1.88	1.88	4.32	23.41	23.66	5.71	7.29
MSCI AC Asia Ex Japan	1.07	4.72	4.72	5.99	37.13	30.47	8.85	8.50
International Equity - Country Region								
MSCI Brazil	-2.89	-3.29	-3.29	7.18	22.47	9.68	0.38	-2.09
MSCI BRIC	0.24	3.02	3.02	7.94	36.97	30.44	7.51	5.65
MSCI China	0.62	3.97	3.97	9.48	48.85	41.09	12.46	10.59
MSCI Europe	0.52	0.47	0.47	3.85	23.37	27.03	5.45	8.15
MSCI India	2.16	7.37	7.37	2.64	33.23	23.22	5.61	8.93
MSCI Japan	0.64	4.61	4.61	6.61	19.55	17.81	9.86	12.03
MSCI EM Latin America	-2.51	-3.60	-3.60	2.45	22.15	10.15	-1.46	-2.56
MSCI Russia	-1.26	-1.95	-1.95	10.76	-1.06	16.58	3.02	-1.73

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	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year
Fixed Income								
Barclays U.S. Aggregate	0.22	0.06	0.06	0.47	3.20	0.90	2.40	2.04
BofAML 3-Month T-Bill	0.02	0.09	0.09	0.27	0.66	0.72	0.35	0.24
Barclays U.S. Gov't	0.21	-0.11	-0.11	0.10	2.13	-0.62	1.65	1.26
Barclays U.S. Credit	0.24	0.34	0.34	0.95	5.43	3.19	3.62	3.07
Barclays High Yield Corp.	-0.18	0.42	0.42	1.28	7.45	8.92	5.56	6.27
Barclays Municipal	-0.23	0.24	0.24	0.49	4.92	2.19	3.04	3.00
Barclays TIPS	0.42	0.21	0.21	0.63	1.94	-0.11	1.40	-0.11
Barclays Gbl Agg Ex USD	0.05	-0.75	-0.75	-0.95	7.93	1.26	0.18	-0.79
Barclays Global Aggregate	0.13	-0.38	-0.38	-0.30	5.85	1.18	1.17	0.43
BofAML Emerg. Mkt. Cred	0.01	0.79	0.79	3.05	10.08	10.47	10.29	7.95
Alternative Investments								
Alerian MLP	1.32	-4.14	-4.14	-8.25	-9.53	-3.39	-12.78	-1.50
Bloomberg Commodity	0.19	2.14	2.14	2.40	-0.79	2.35	-9.53	-9.38
FTSE NAREIT Equity REIT	-0.66	-0.96	-0.96	-1.24	2.67	5.68	6.10	9.67
S&P Global Natural Res.	-0.29	2.18	2.18	6.89	15.43	23.07	3.18	1.69
S&P N. Amer Natural Res.	0.79	-1.32	-1.32	2.38	-5.71	2.43	-5.22	-0.60

Sources: Department of Labor, Department of Commerce, The Conference Board, Institute for Supply Management, National Federation of Independent Business, European Central Bank.

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