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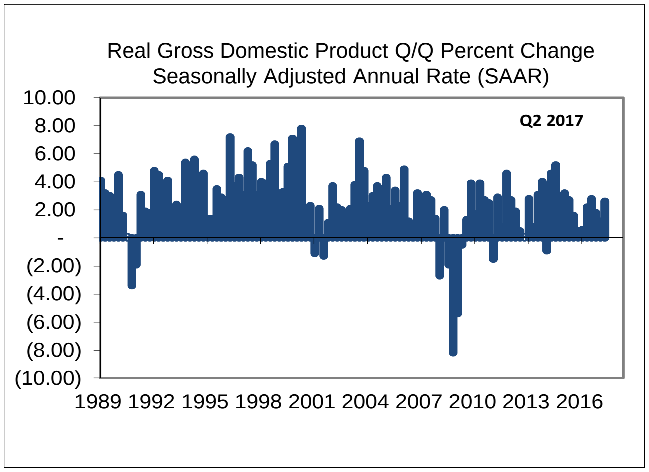
Asset Management, Inc.

Economic and Financial Markets
Monthly Review & Outlook
Detailed Report

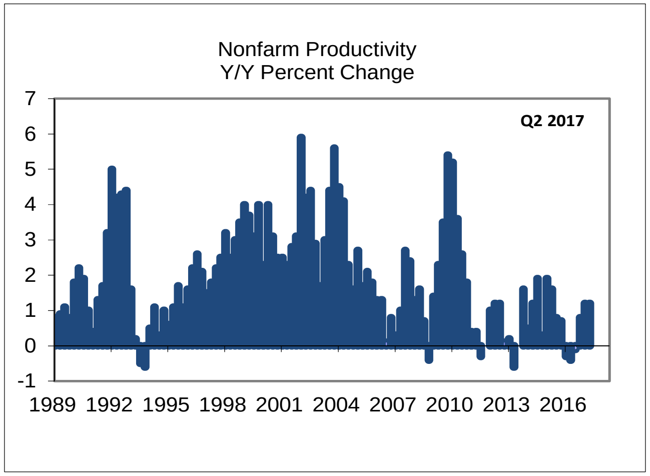
August 2017

Overview of the Economy

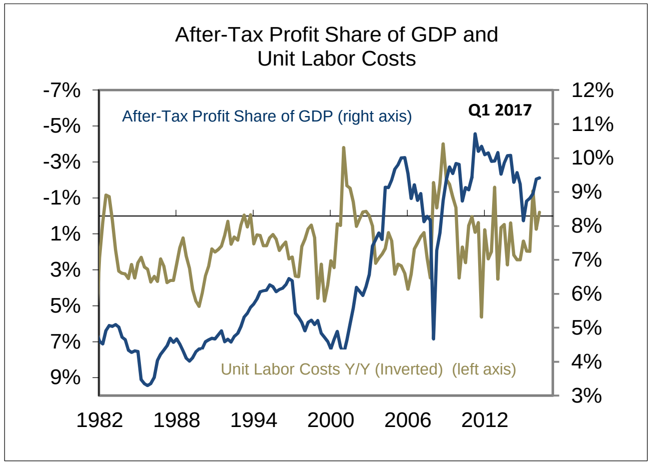
Business and economic confidence indicators remain elevated, albeit with some moderation from post-election highs. Financial markets continue to grind higher, reflecting expectations of continued earnings growth and fairly stable inflation rates. The speed of policy changes in Washington remains closely watched. Forecasts for gross domestic product (GDP) growth, including our own estimates, have remained relatively stable. The Federal Reserve (Fed) raised short-term interest rates in June to a range of 1.00% to 1.25%, the fourth increase since the end of the financial crisis. Futures markets are pricing in a less than 50% chance of the next rate hike occurring in December, perhaps reflecting expected changes in Fed balance sheet management. The first estimate of second quarter GDP growth came in at 2.6%, while first quarter real GDP growth was revised down slightly to 1.2%. We continue to anticipate full-year 2017 growth of 1.0% to 2.0%.



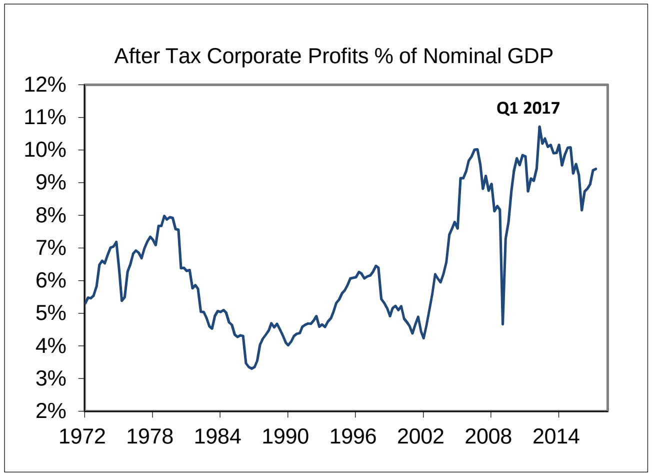
Source: Department of Commerce



Source: Department of Labor



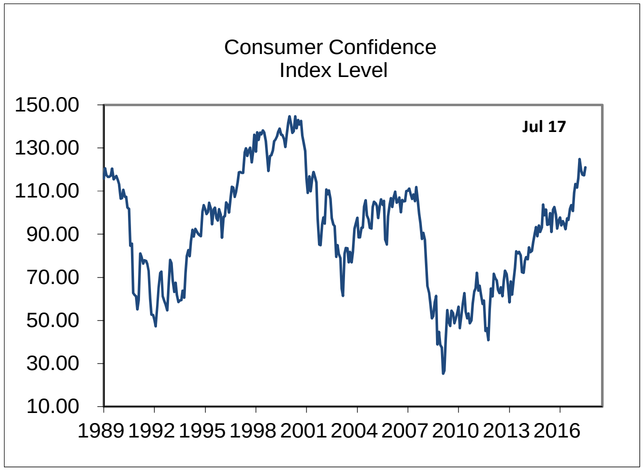
Source: Departments of Commerce, Labor



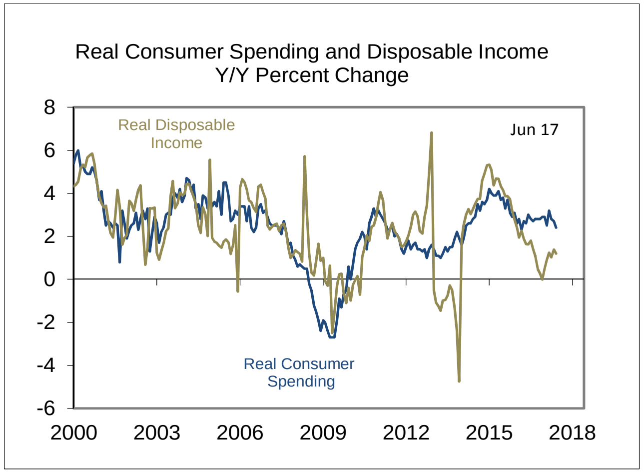
Source: Department of Commerce

Consumer Expenditures

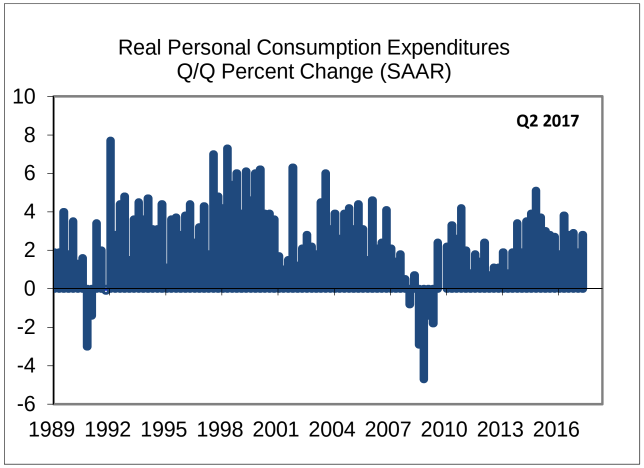
Second quarter growth in real personal consumption expenditures grew by 2.8%, with first quarter growth revised up to 1.9%. Real income growth continues to trend around 1.0% to 1.5% after new revisions. Consumer confidence rebounded decently in July, remaining at levels only exceeded during the tech boom of the late 1990s. Household net worth as a percent of disposable income remained at an all-time high during the first quarter, supported by rising equity markets and strong housing price growth. Savings rates, after new revisions, have moved below 4% since last fall. This reflects generally elevated levels of confidence and asset values. Previous cyclical peaks in consumer confidence during the past two decades have been followed by disappointing returns in equity markets. We are watching for policy changes from the Trump administration that may boost confidence.



Source: Conference Board



Source: Department of Commerce



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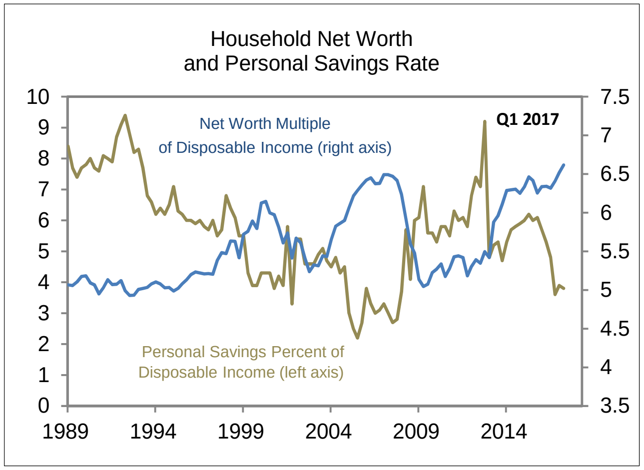
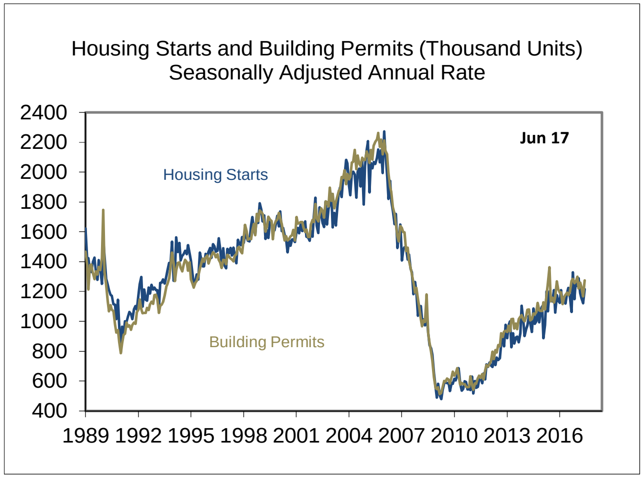


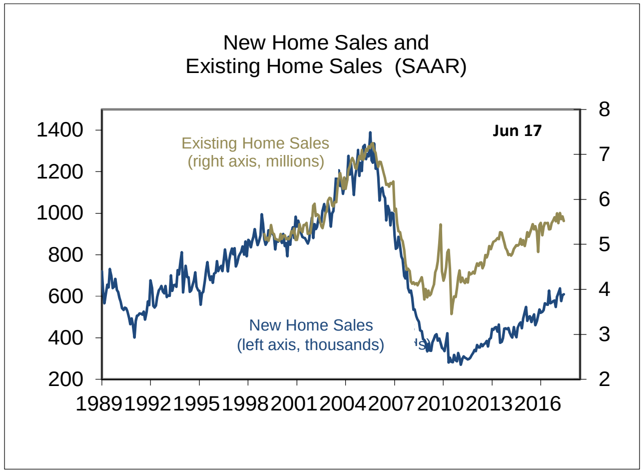
Sources: Department of Commerce, Federal Reserve

Housing

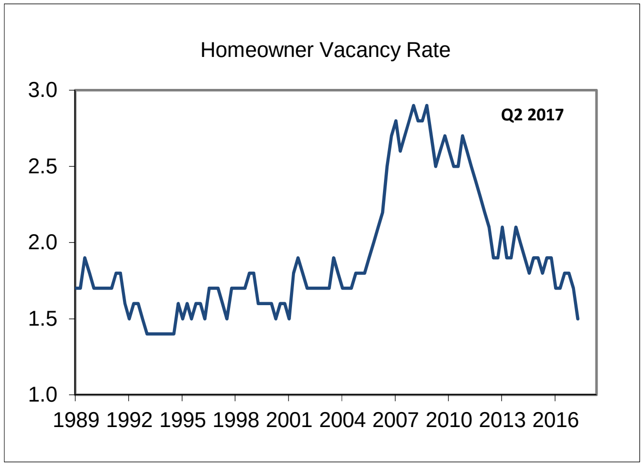
Recent housing data remained generally in line with prior months' trends. Vacancy rates remain low, housing activity (new and existing) remains stable and housing prices continue to increase at a 5% to 6% annual rate. Mortgage rates were relatively stable during the first half of the year, trending at around 4% after jumping higher after the election. While rates are higher than 2016 averages, they remain historically low and should continue as a tailwind for homebuyers. Low interest rates have helped keep mortgage payments affordable, even as home price growth continues to outpace average hourly earnings gains. Strong home price growth in excess of income growth over the last few years, however, has contributed to a decline in the trend of homebuyer affordability, which could eventually slow home sales.



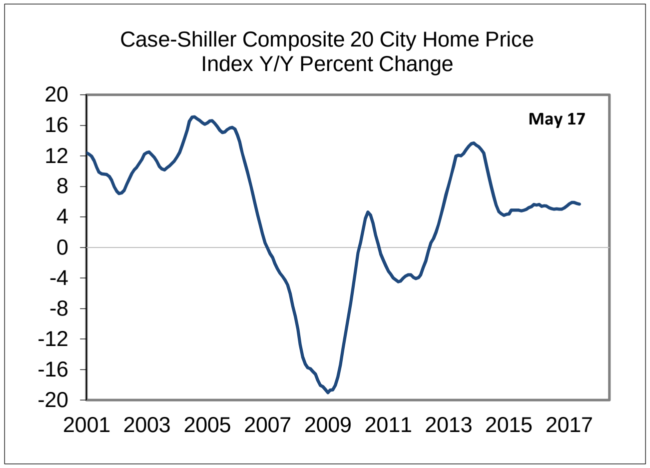
Source: Department of Commerce



Sources: Department of Commerce, Nat'l Assoc. of Realtors



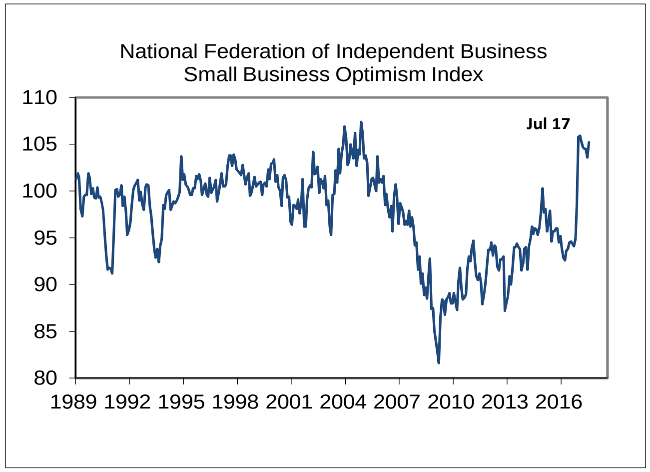
Source: Department of Commerce



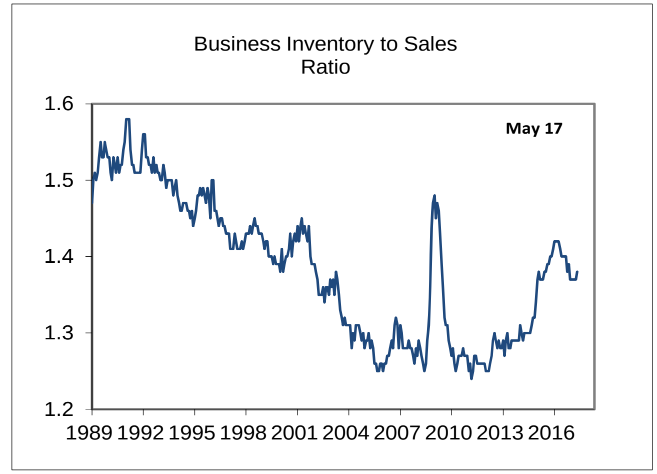
Source: Standard and Poors

Production and Investment

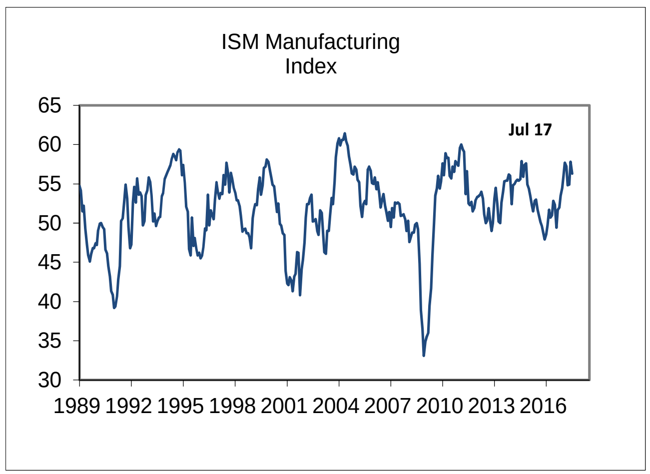
Production and investment data are consistent with moderate economic growth. Survey-based data remain strong (manufacturing PMI and small business optimism), while hard data such as industrial production and capacity utilization are continuing to strengthen, reflecting the survey-based data. The business inventory-to-sales ratio has stabilized in recent months, remaining higher than average for non-recessionary periods over the last 20 years. This should be a near-term headwind to investment. Private investment growth was weak in 2016 and only contributed slightly to total year economic growth. We anticipate investment growth will be moderate in 2017, as excess capacity and sluggish demand growth will likely limit new investment spending.



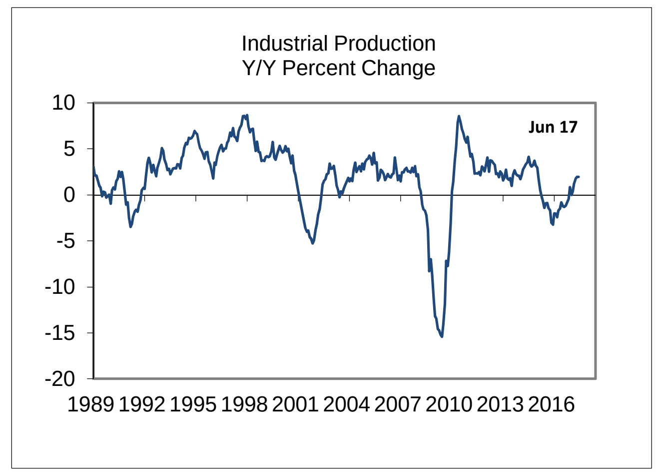
Source: National Federation of Independent Business



Source: Department of Commerce



Source: Institute for Supply Management



Source: Federal Reserve Board

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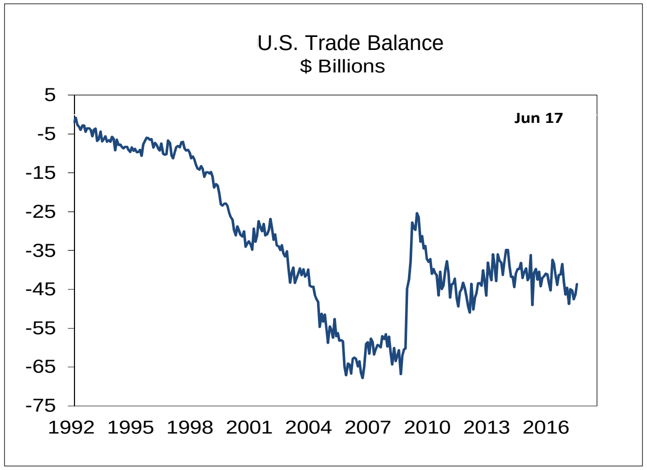
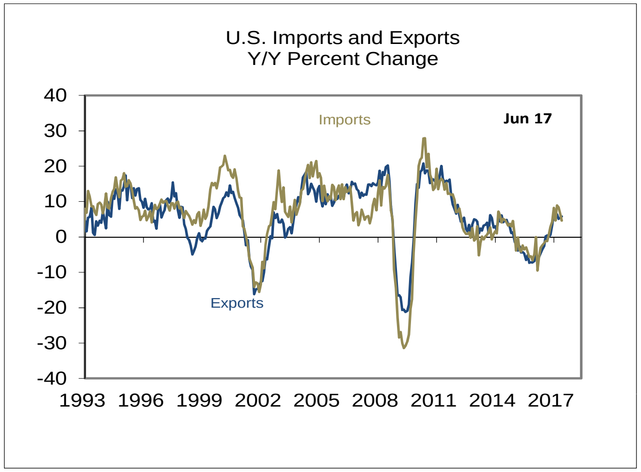
International Trade

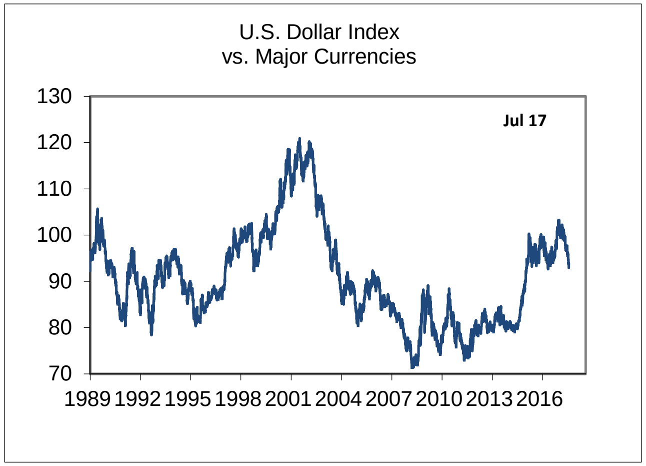
The trade deficit narrowed significantly in June, reversing all of the widening since last October. Exports increased moderately in June, while imports slightly decreased. Real net exports contributed not quite 0.2% to second quarter GDP. The dollar has weakened through the first seven months of 2017, which should provide a more favorable trade backdrop in early 2018. However, this will depend on continued momentum in major foreign economies. Overall, we anticipate modest further tightening in the trade deficit in the coming quarters.



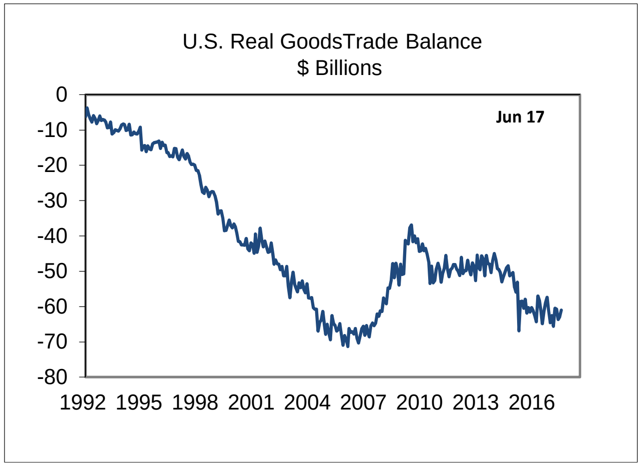
Source: Department of Commerce



Source: Department of Commerce



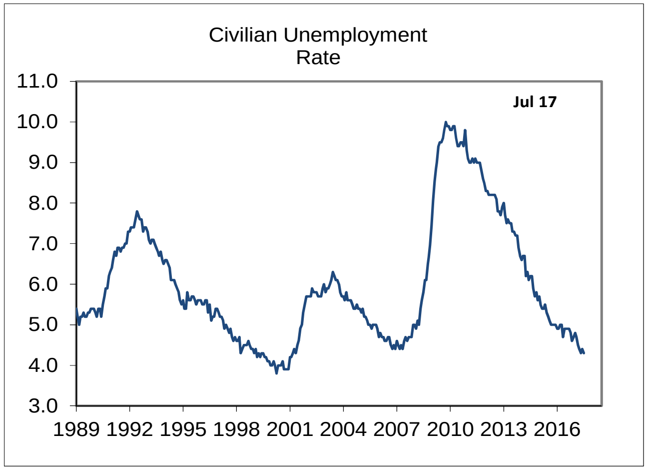
Source: Bloomberg



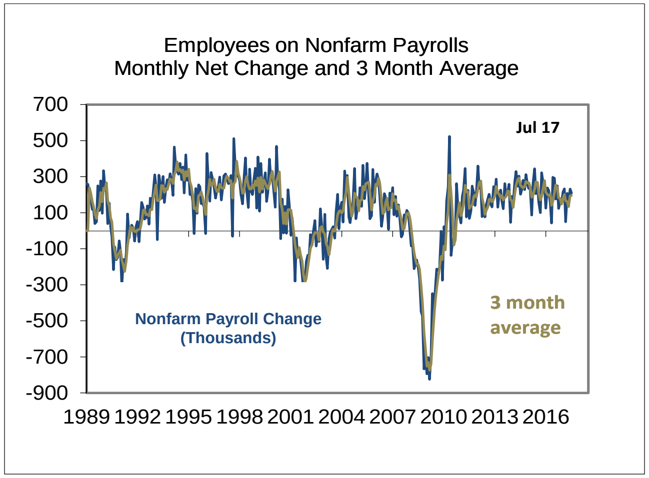
Sources: U.S. Department of Commerce

Labor Market Conditions

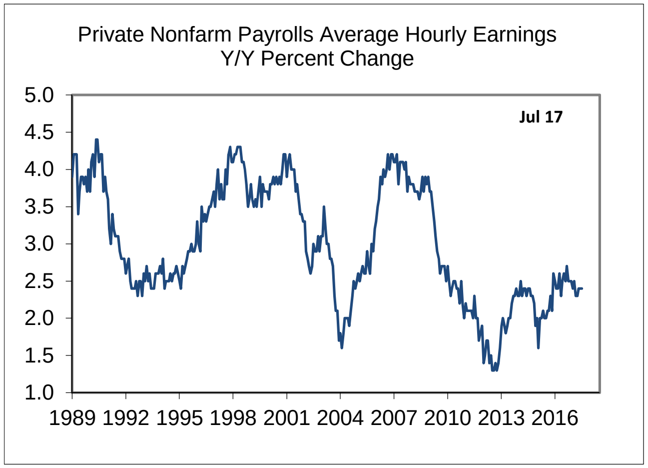
Nonfarm payrolls increased by 209,000 in July. Following the July employment report, the average payroll gain was 195,000 over the trailing three months and 180,000 over the past six months. Payroll growth should continue at a moderate pace in the coming months relative to last year's pace, with the economy at full employment. The report did not significantly affect expectations for the path of Fed rate hikes, with the market implying less than a 50% chance of an additional increase in December and only modest adjustments thereafter. Average hourly earnings were in line with expectations and consistent with moderate wage growth. Unemployment ticked down to 4.3% in June. The tight labor market should keep the unemployment rate from falling much further, with additional demand for labor going forward more likely to raise wages and / or increase the participation rate than reduce the unemployment rate.



Source: Bureau of Labor Statistics



Source: Bureau of Labor Statistics



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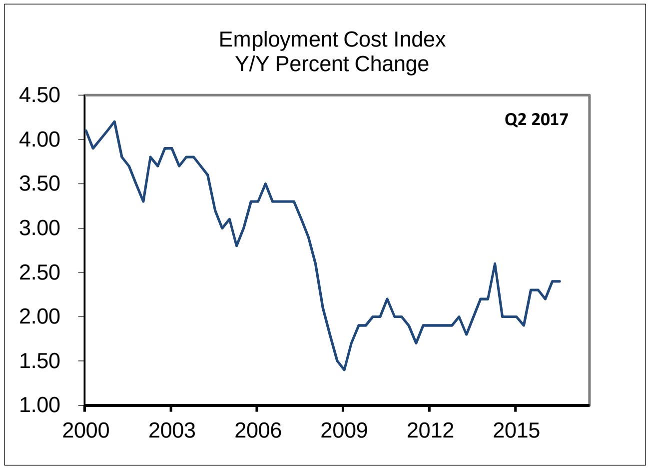

Source: Bureau of Labor Statistics

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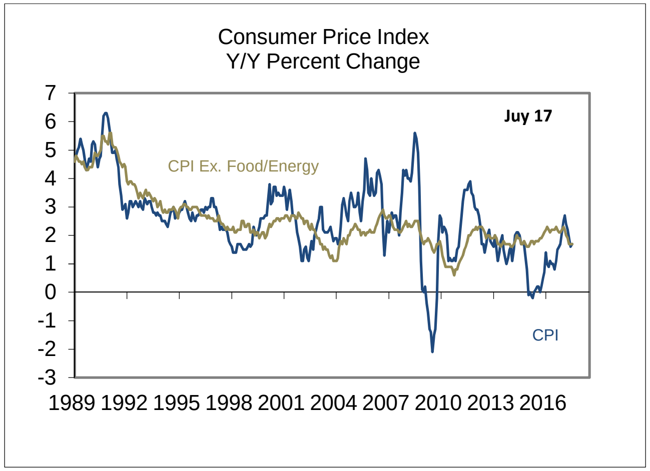
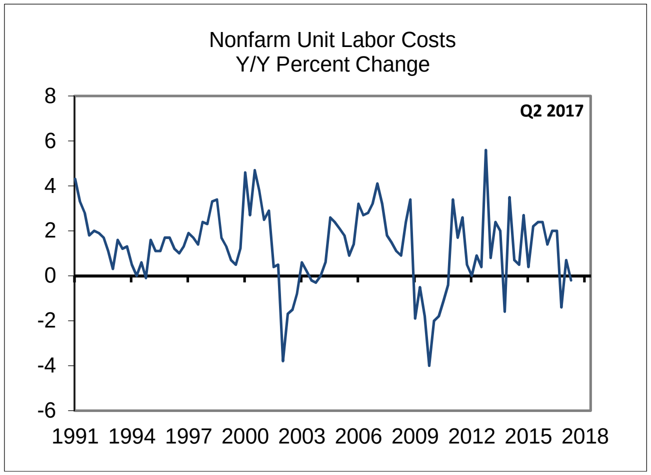
Inflation and Monetary Policy

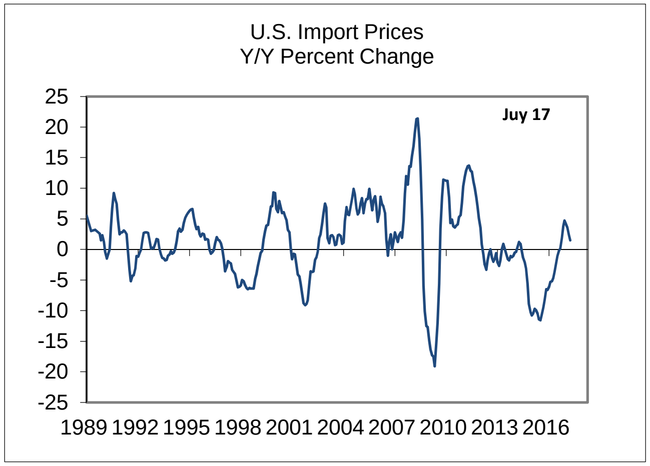
Consumer Price Index (CPI) inflation moderated once again in July to a 1.7% annual rate. Core CPI inflation (excluding food and energy costs) remained at a 1.7% annual rate for the third month in a row. The difference between headline and core inflation has decreased from 0.3% to zero over the last three months. The PCE deflator, which typically runs below the CPI, has fallen back below the Fed's 2% policy objective, to around 1.3% to 1.4%. The much-anticipated Fed rate hike took place in June. The latest economic projections indicate it will raise the fed funds rate steadily higher in 2018 and 2019, ending 2019 at 2.9%. This stands in stark contrast to futures market pricing, which shows limited increases for the next 2.5 years. The Fed will likely begin reducing its balance sheet size in September 2017.



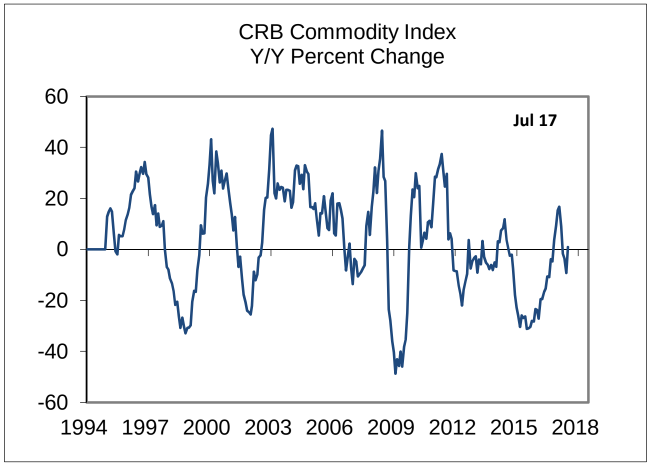
Source: Bureau of Labor Statistics



Source: Federal Reserve Board



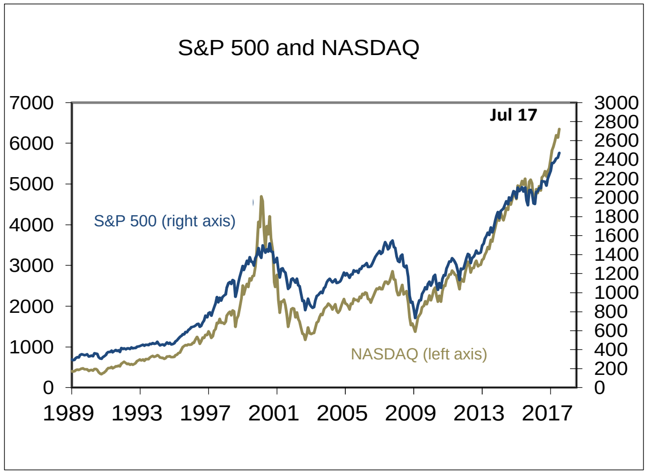
Source: Bureau of Labor Statistics



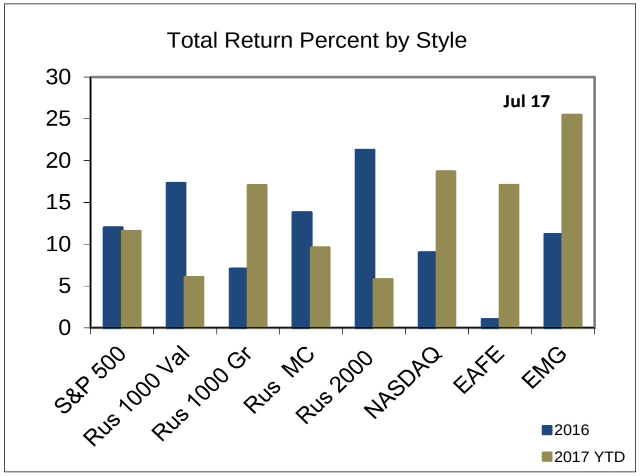
Source: Reuters

Equity Market

U.S. equity markets experienced solid performance in July. The Russell 2000® Index of small cap stocks returned 0.7%, the S&P 500® Index of large cap stocks 0.7% and the Nasdaq Composite Index returned 3.4%. Realized and implied volatility remained at historic lows through July. Telecom and technology stocks led the market with returns of 6.4% and 4.3%, respectively. All sectors experienced positive returns during July. Technology and health care have been the standout performers year-to-date through July, returning 22.3% and 17.0%, respectively, while energy lost more than 10%. Domestic markets in aggregate have lagged international equities so far in 2017, a reversal of the past several years.



Source: Bloomberg



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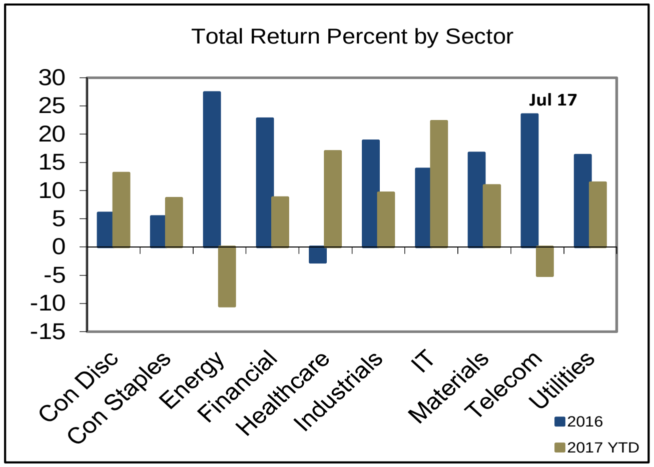
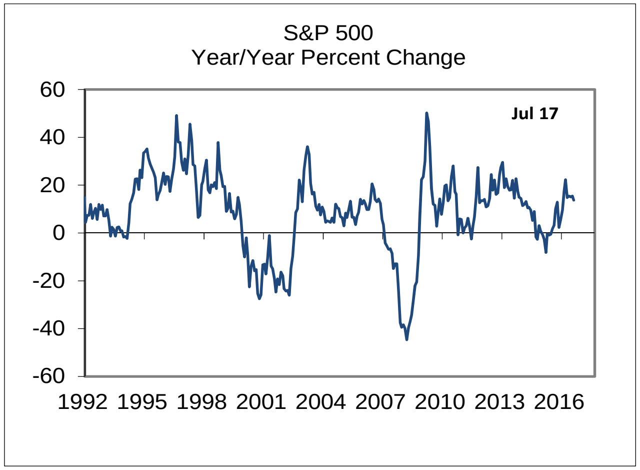


Source: Bloomberg. Based on the S&P 500 Index.



Source: Bloomberg

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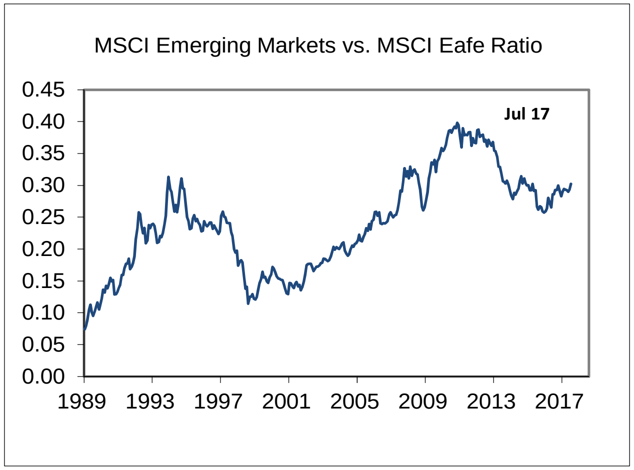
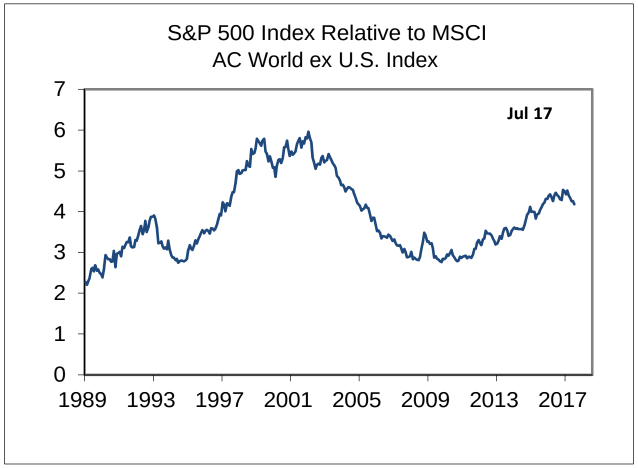
International Markets

International equities largely outperformed U.S. stocks in July. EAFE (Europe, Australasia, Far East) returned 2.9% and emerging market equities returned 6.0%. Emerging markets have been the clear winners year-to-date, returning 25.5% vs. 11.6% for the S&P 500. If international stocks maintain their performance advantage over U.S. equities through the remainder of the year, it would be the first time since 2012 that international stocks outperformed the U.S. for a calendar year.



Source: MSCI Barra



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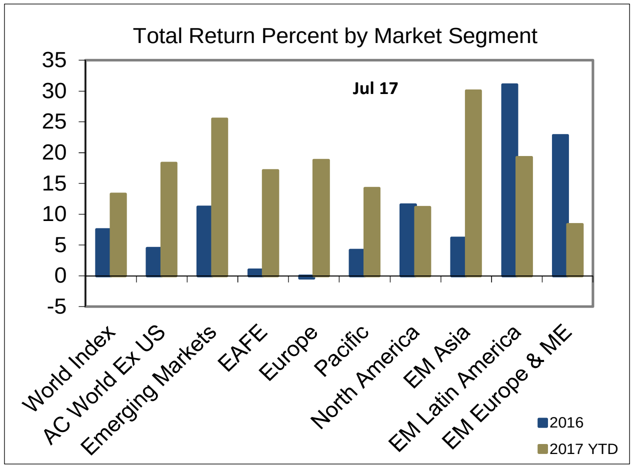

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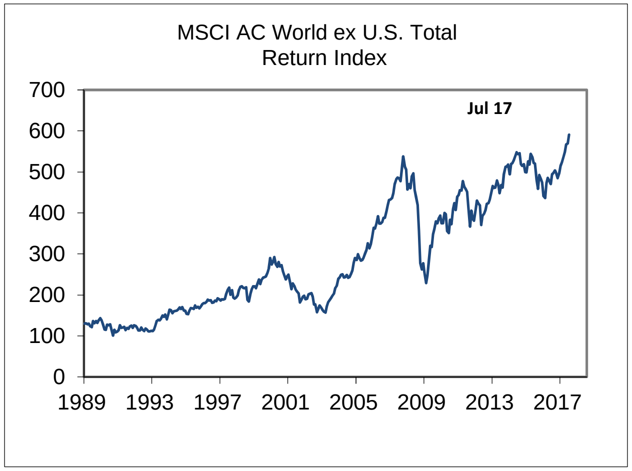
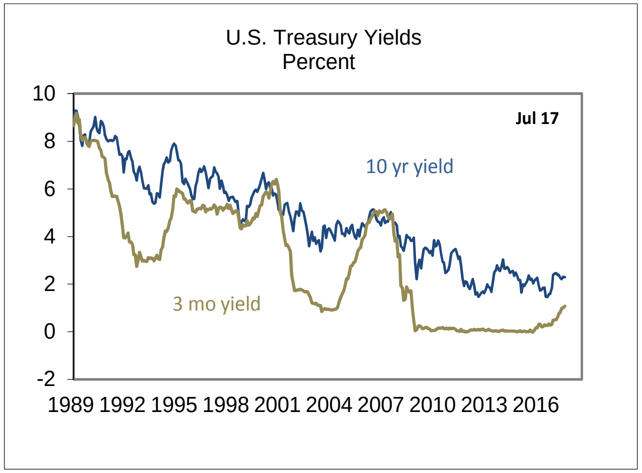


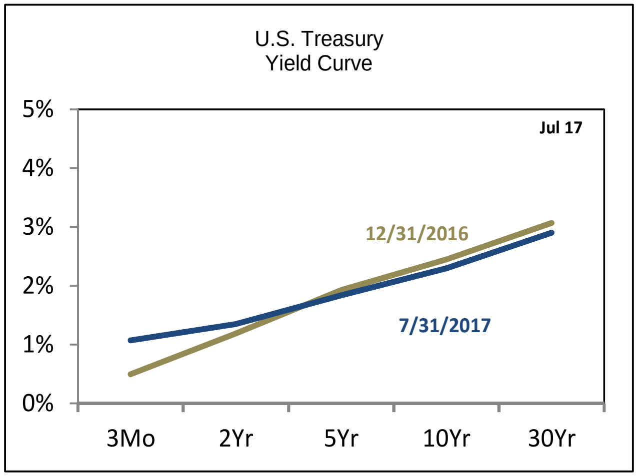
Source: MSCI Barra

Fixed-Income Market

The U.S. Treasury yield curve steepened slightly in July, with the two- and 10-year yields decreasing around 0.02% and 30-year yields increasing approximately 0.07%. Short-term rates have risen in 2017, reflecting continued Fed tightening. 10-year Treasury yields have risen from 2.44% on December 31st to a high of 2.63% on March 13th, declined to 2.17% on April 18th and ended July at 2.29%. Investment grade credit spreads continued to decrease slightly in July. The high-yield sector was the best-performing fixed income sector in July, returning 1.11%. The key drivers of long-term interest rates over the past five years have been equivalent foreign bond yields and longer-term expectations for the fed funds rate. These will likely need to move higher before long-term Treasury yields move meaningfully higher.



Source: Bloomberg



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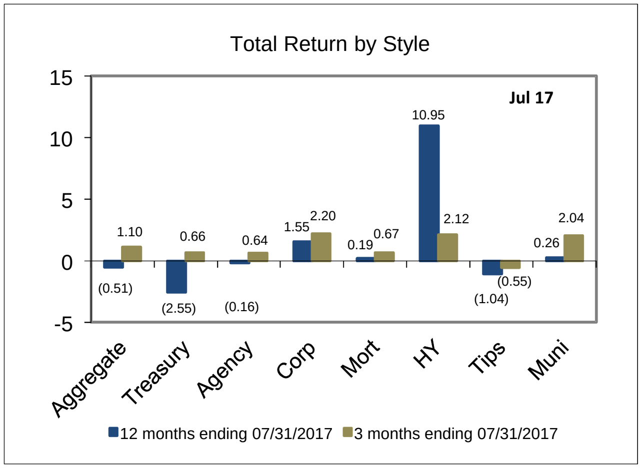
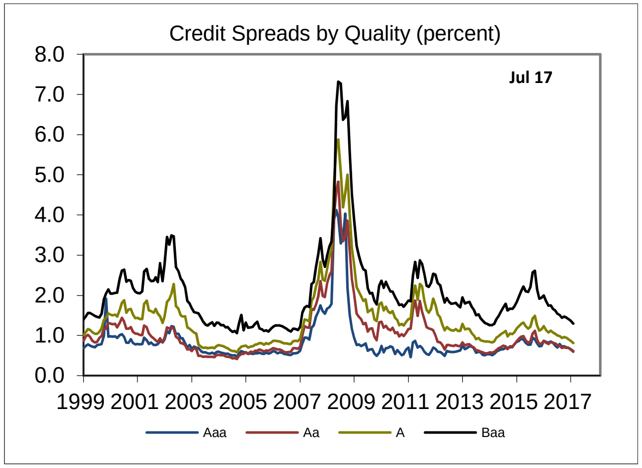


Source: Barclays Capital. Based on the Barclays U.S. Aggregate Bond Index.



Source: Barclays Capital. Based on the Barclays U.S. Aggregate Bond Index.

Economic, Rates and Earnings Forecast

	2016 (A)	2017 (F)	2018 (F)	2017 Bloomberg Consensus*	2018 Bloomberg Consensus*
Real GDP (Q4/Q4)	2.1%	1.0% - 2.0%	1.0% - 2.0%	2.10%	2.30%
Personal Consumption Expenditures	3.1%	1.0% - 2.0%	1.0% - 2.0%		
Investment	0.1%	1.0% - 2.0%	1.5% - 2.5%		
Net Exports ($)	-$563B	-$620B	-$620B		
Government Spending	0.2%	1.0%- 2.0%	1.0%- 2.0%		
Unemployment Rate* **	4.7%	4.3%	4.3%	4.40%	4.20%
CPI* **	2.1%	1.5% - 2.5%	1.5% - 2.5%	2.00%	2.10%
CPI Excluding Food and Energy* **	2.2%	1.5% - 2.5%	1.5% - 2.5%		
Fed Funds* **	0.50% - 0.75%	1.00% - 1.50%	1.00% - 2.00%	1.50%	2.15%
10 Year Treasury* **	2.44%	1.50% - 2.50%	2.00% - 3.00%	2.56%	3.06%
Corporate Earnings (S&P Operating)	$106.26	$120.00	$123.00	$127.63**	$144.73**
Trade Weighted Dollar* **	102.21	98 - 108	95 - 105		
*Bloomberg - August 11,2017					
**Standard and Poors - August 11, 2017					
***End of Period Level					

(A) Actual

(F) Forecast

Index Definitions

The Barclays U.S. Aggregate Bond Index represents securities that are SEC-registered, taxable and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities.

The MSCI EAFE Index is an equity index which captures large and mid cap representation across Developed Markets countries around the world, excluding the U.S. and Canada.

The MSCI Emerging Markets Index captures large and mid cap representation across 21 Emerging Markets (EM) countries

The MSCI ACWI (All Country World Index) Index is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

The MSCI ACWI (All Country World Index) Index ex U.S. is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the United States.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.

The MSCI EM (Emerging Markets) Asia Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of emerging markets in Asia.

The MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe.

The MSCI Europe & Middle East Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe and the Middle East.

The MSCI EM (Emerging Markets) Latin America Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of emerging markets in Latin America.

The MSCI North America Index is designed to measure the performance of the large and mid cap segments of the U.S. and Canada markets.

The MSCI Pacific Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region.

The Russell 1000® Growth Index is a market-capitalization-weighted index that measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000® Value Index is a large-cap value index measuring the performance of the largest 1,000 U.S. incorporated companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000® Index is composed of the 2,000 smallest stocks in the Russell 3000® Index and is widely regarded in the industry as the premier measure of small-cap stock performance.

The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap is a subset of the Russell 1000® Index.

The S&P 500® Index is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy.

Disclosure

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Past performance does not guarantee future results.

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