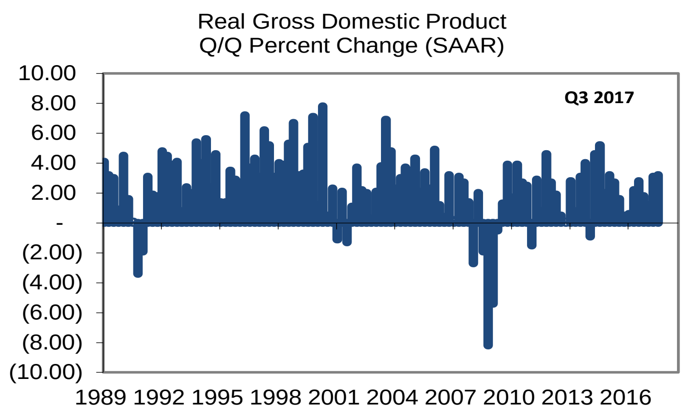
U.S. Bancorp Asset Management, Inc.

Economic and Financial Markets Monthly Review & Outlook Detailed Report

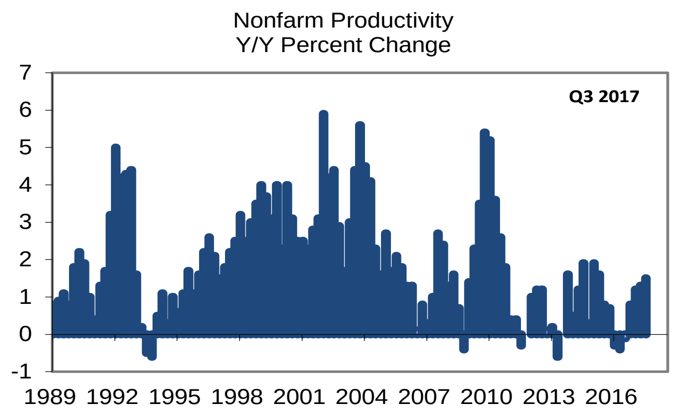
January 2018

Overview of the Economy

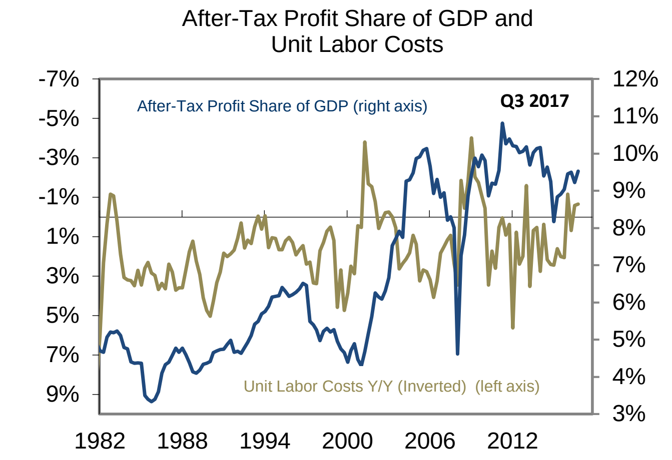
Business and economic confidence continue to stabilize at elevated levels. Financial markets grind higher, reflecting expectations of continued earnings growth and fairly stable inflation rates. The speed of policy changes in Washington remains closely watched. Forecasts for gross domestic product (GDP) growth, including our own estimates, have remained relatively stable. The Federal Reserve (Fed) raised short-term interest rates in December to a range of 1.25% to 1.50%, the fifth increase since the end of the financial crisis. The Fed's pace of quantitative tightening increased by $10 billion in January. Fourth quarter GDP growth came in at 2.6%, leaving full year growth at 2.5%.



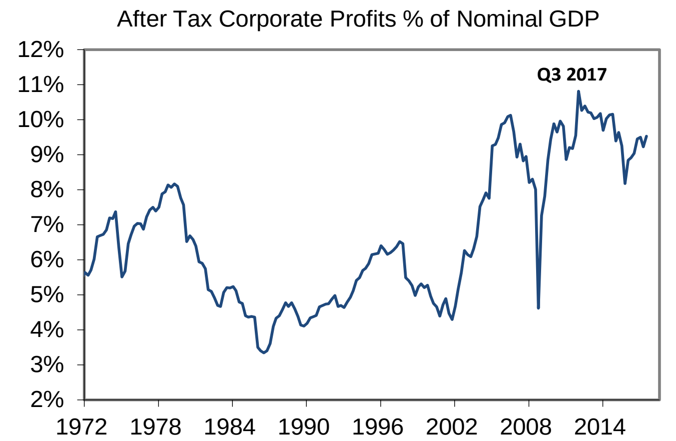
Source: Department of Commerce



Source: Department of Labor



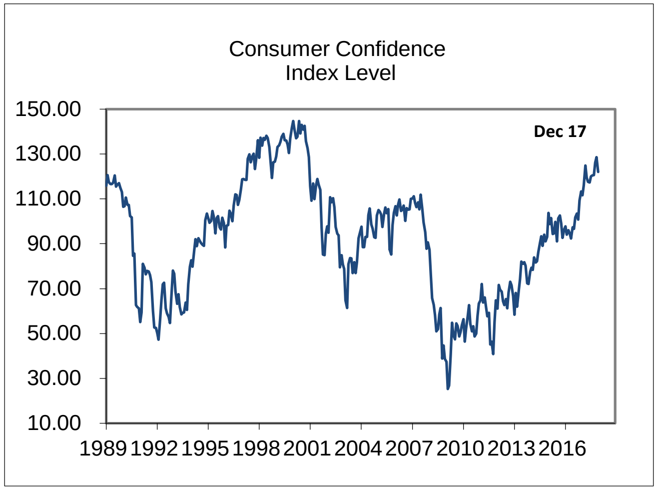
Source: Departments of Commerce, Labor



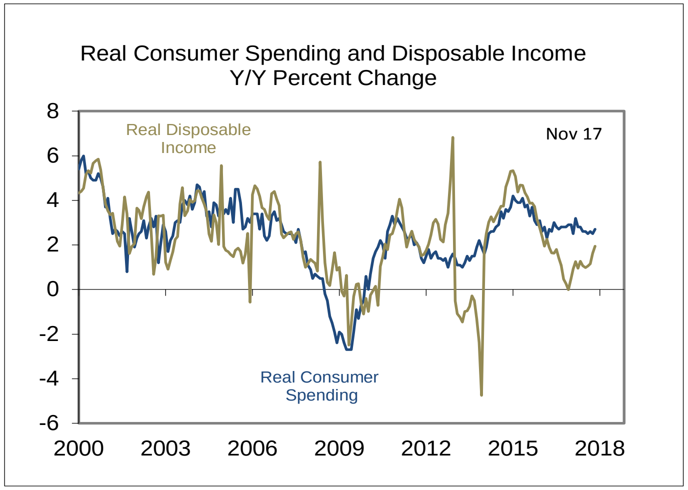
Source: Department of Commerce

Consumer Expenditures

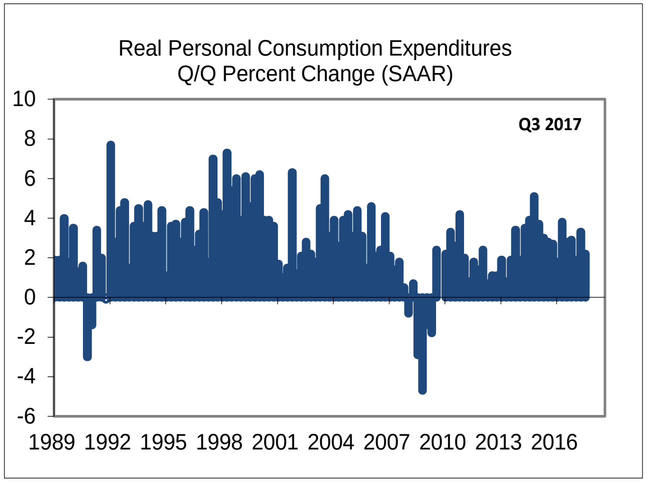
Fourth quarter growth in real personal consumption expenditures (PCE) rose 3.8%, up from 2.2% in the third quarter. Real income growth trends around 2.0% after revisions. Consumer confidence decreased modestly in December, but remains at levels only exceeded during the tech boom of the late 1990s. Household net worth as a percent of disposable income remained at an all-time high during the second and third quarters, supported by rising equity markets and strong housing price growth. Savings rates, after revisions, have moved to 2.4%, reflecting 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. Policy changes from the Trump administration may have begun to boost confidence, such as the recently enacted tax legislation.



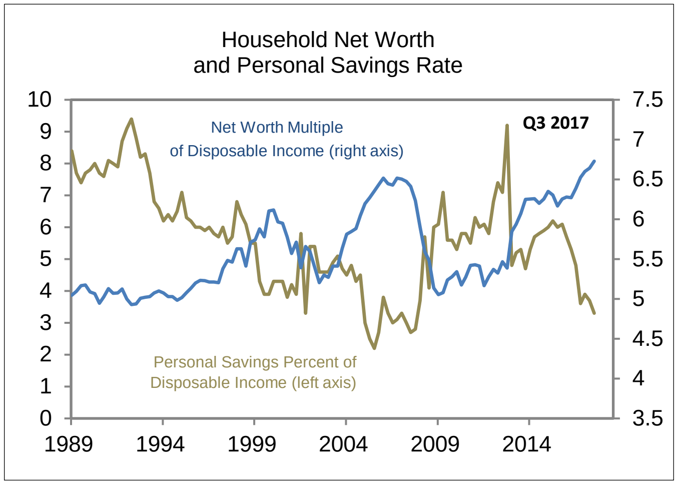
Source: Conference Board



Source: Department of Commerce



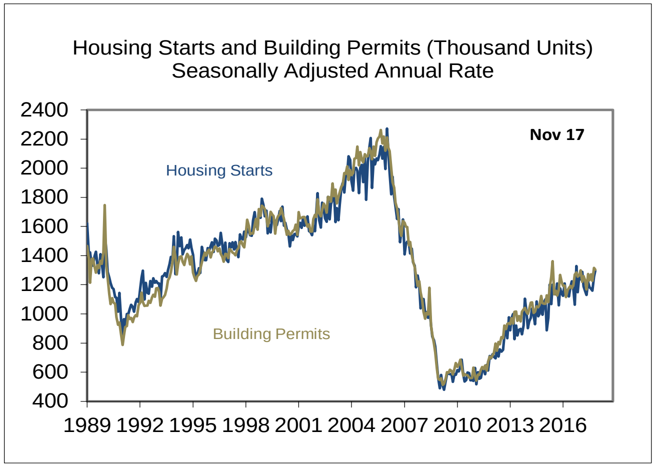
Source: Department of Commerce



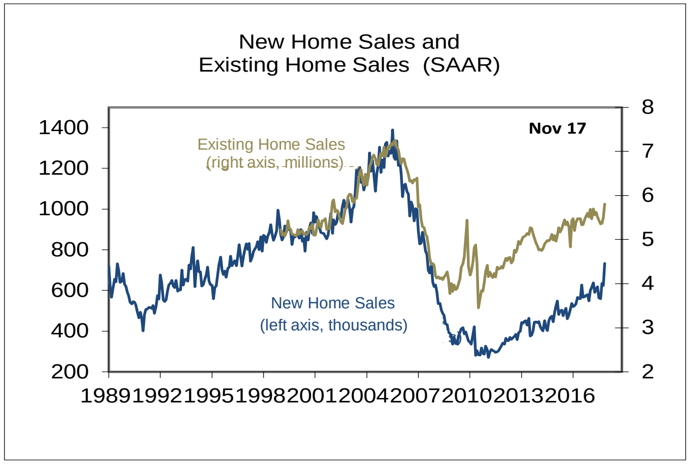
Sources: Department of Commerce, Federal Reserve

Housing

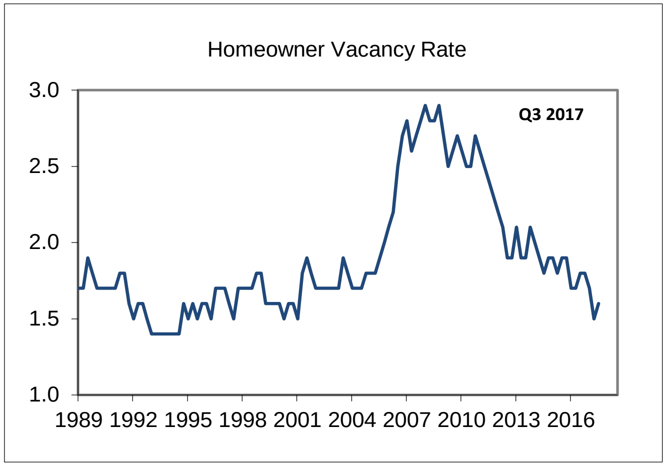
Housing data improved modestly in November. Vacancy rates remain low, housing activity (new and existing home sales) has picked up and housing prices are rising at a 6% to 7% annual rate. Mortgage rates were relatively stable during 2017, trending at around 4% after jumping higher after the election. While rates are higher than 2016 averages, they remain historically low and should continue as a tailwind for homebuyers. However, strong home price growth in excess of income growth over the last few years has contributed to a decline in the trend of homebuyer affordability. This level is the lowest since 2008 and this trend could eventually slow home sales.



Source: Department of Commerce



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



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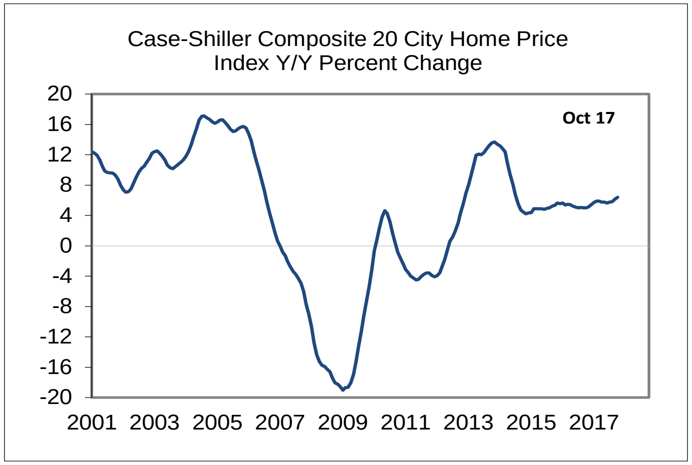
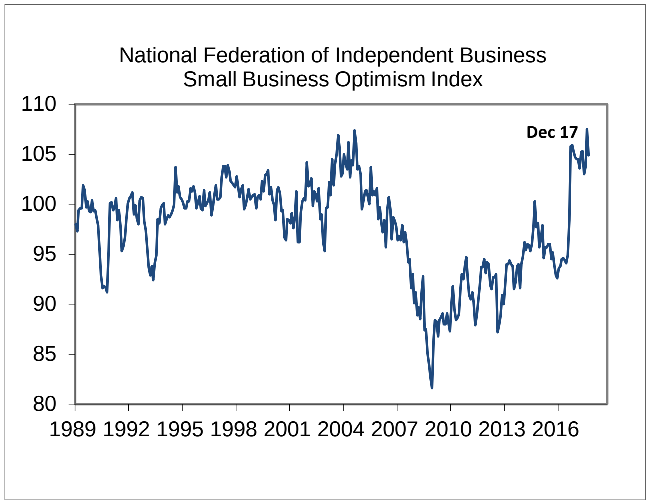


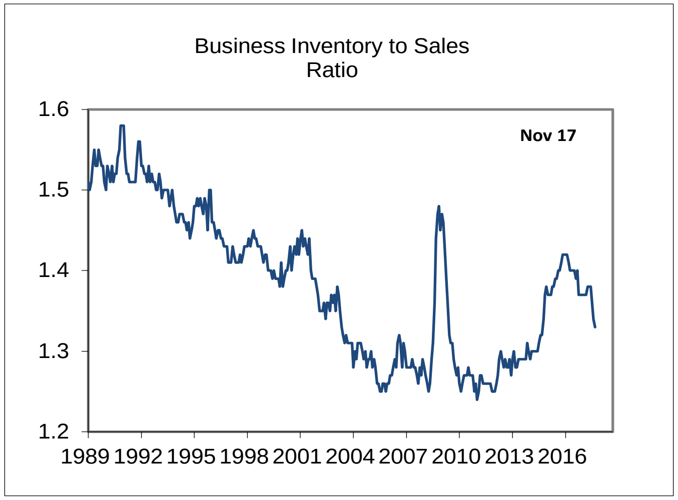
Source: Standard and Poors

Production and Investment

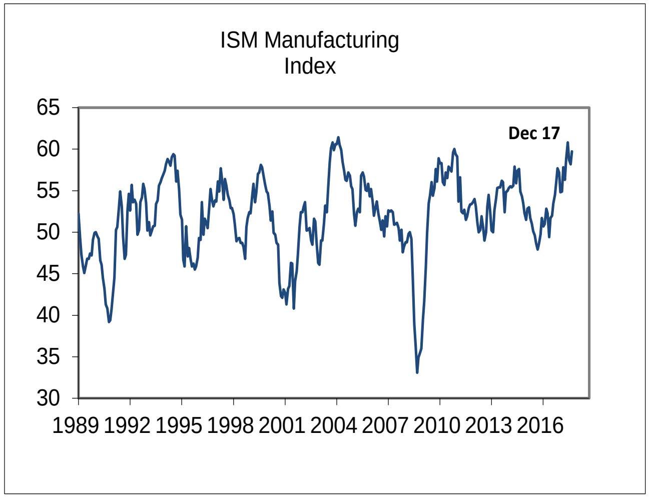
Production and investment data are consistent with moderate economic growth. Small business optimism decreased slightly in December, industrial production and manufacturing PMI rose modestly and capacity utilization was little changed. The business inventory-to-sales ratio has decreased in recent months, but remains higher than average for non-recessionary periods over the last 20 years. This may continue to be a headwind to investment in the near term. Private investment growth advanced at a moderate pace in 2017, a trend that should continue in 2018.



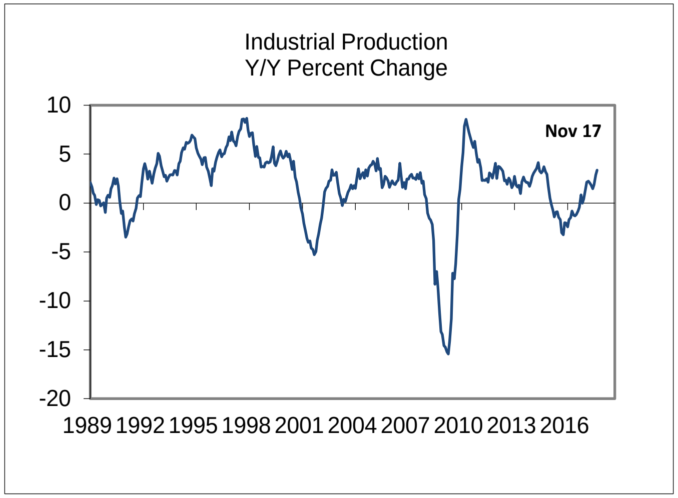
Source: National Federation of Independent Business



Source: Department of Commerce



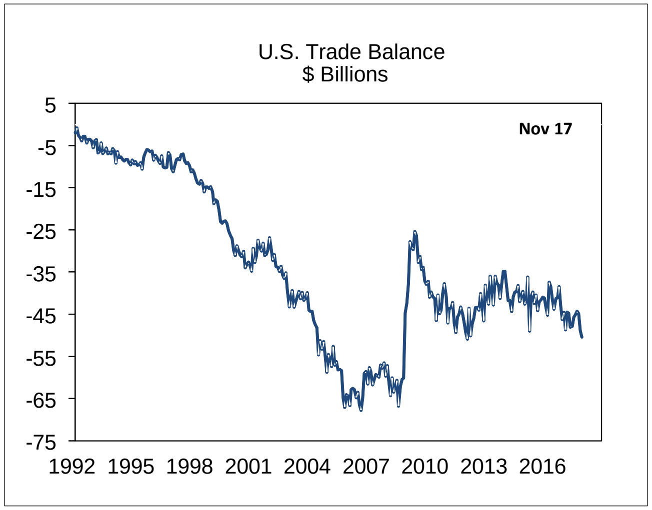
Source: Institute for Supply Management



Source: Federal Reserve Board

International Trade

The trade deficit worsened again in November and December, as imports rose moderately more than exports. Real net exports subtracted -1.1% from fourth quarter GDP. The dollar has weakened throughout 2017 (including December). This trend, along with stronger growth readings in several foreign economies, should provide a more favorable trade backdrop in early 2018. Overall, we anticipate the trade deficit to continue its gradually widening trend. Trade policy and the potential for greater protectionism remains a wildcard.



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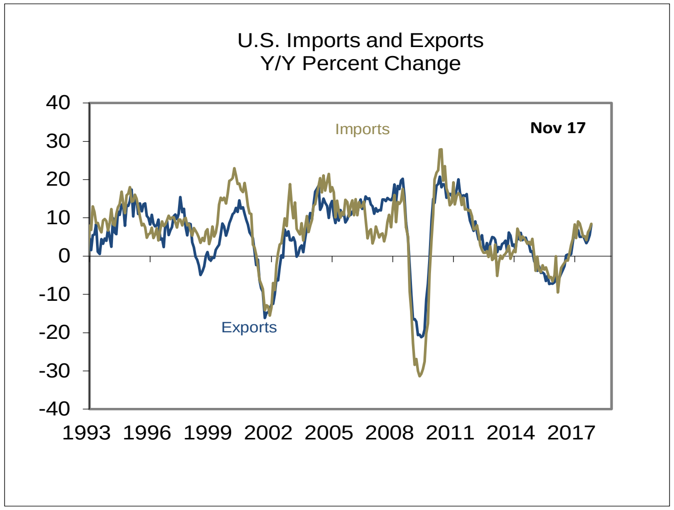
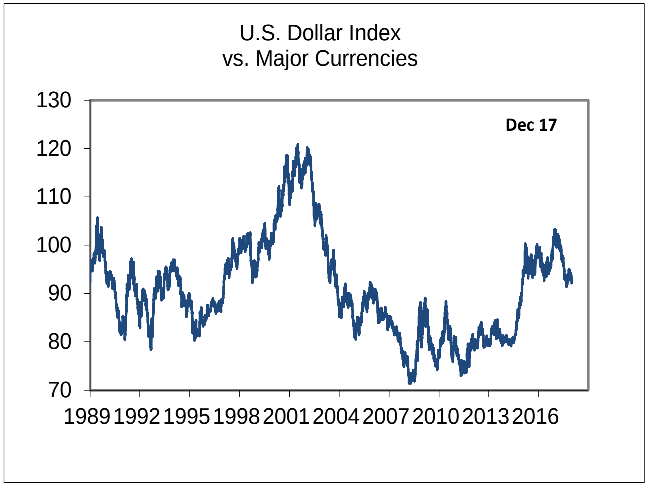
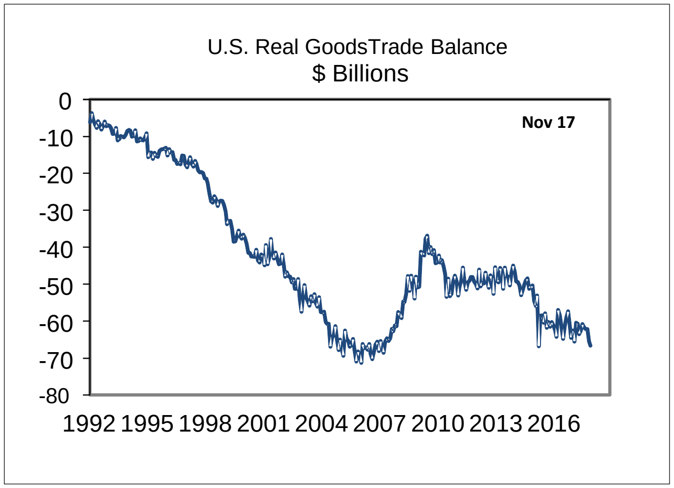


Source: Department of Commerce



Source: Bloomberg



Sources: U.S. Department of Commerce

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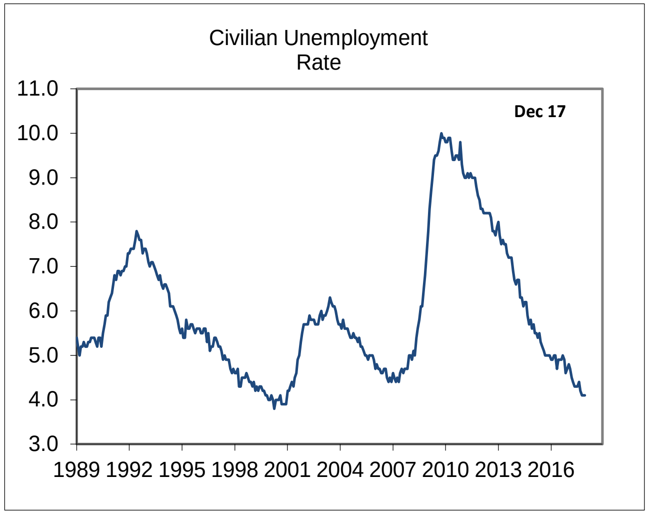
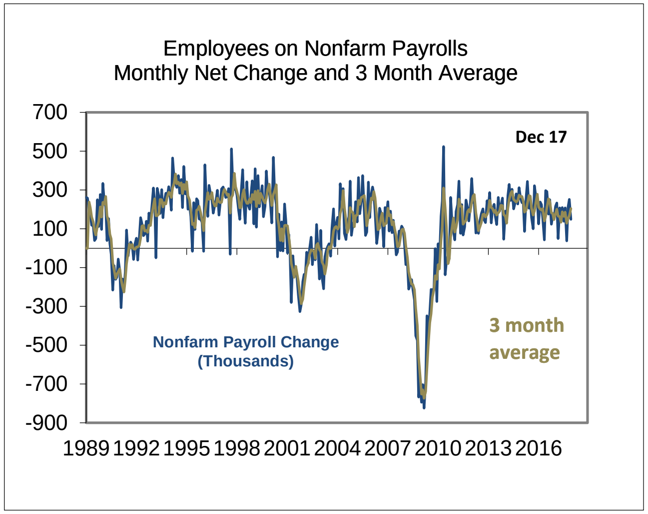
Labor Market Conditions

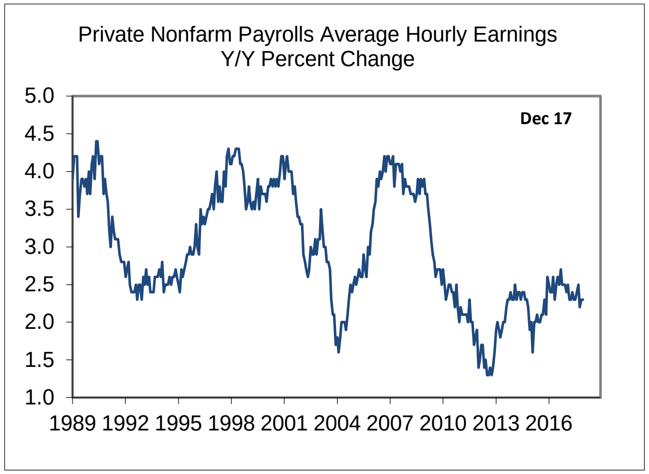
Nonfarm payrolls increased by 148,000 in December. Following the December employment report, the average payroll gain was 204,000 over the trailing three months and 166,000 over the past six months. Payroll growth should continue at a moderate pace in the coming months relative to last year's pace, with the economy at full employment. The report did not have a significant effect on expectations for the path of Fed rate hikes. Average hourly earnings remained steady again in December at a 2.3% annual rate. Unemployment remained at a new cyclical low of 4.1% in December. The unemployment rate is unlikely to fall much further. Additional demand for labor going forward is more likely to raise wages and / or increase the participation rate than reduce the unemployment rate meaningfully from current levels.



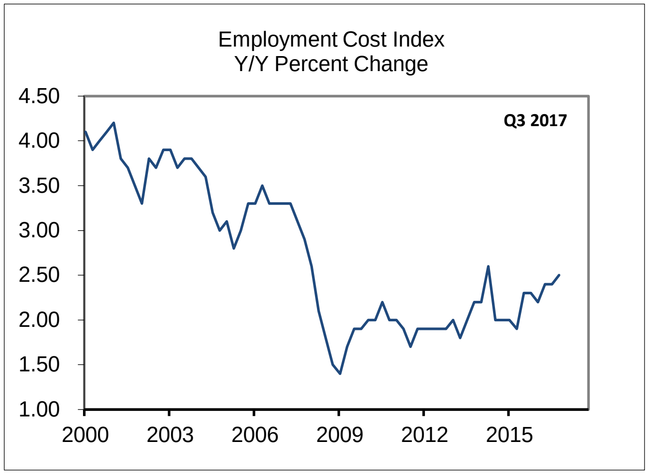
Source: Bureau of Labor Statistics



Source: Bureau of Labor Statistics



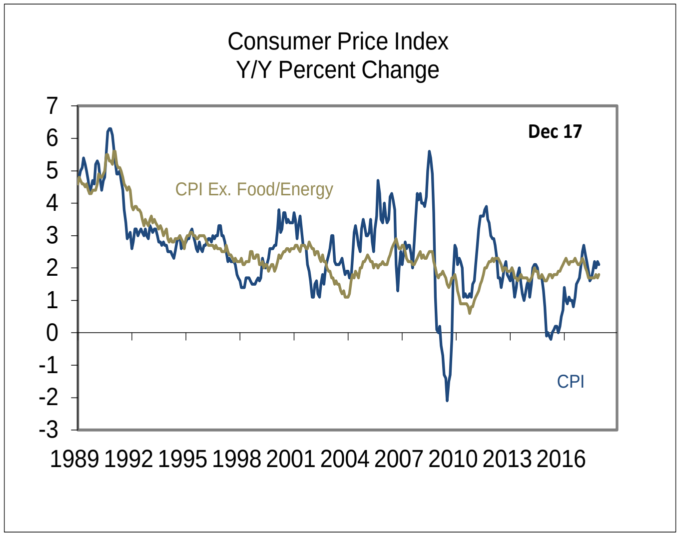
Source: Bureau of Labor Statistics



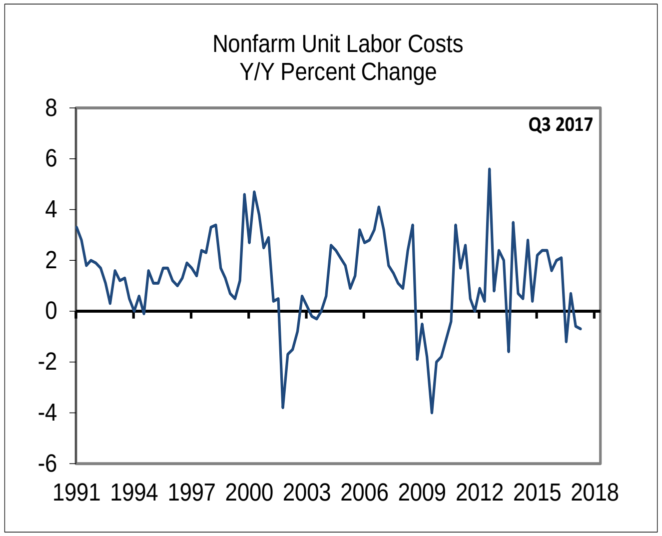
Source: Bureau of Labor Statistics

Inflation and Monetary Policy

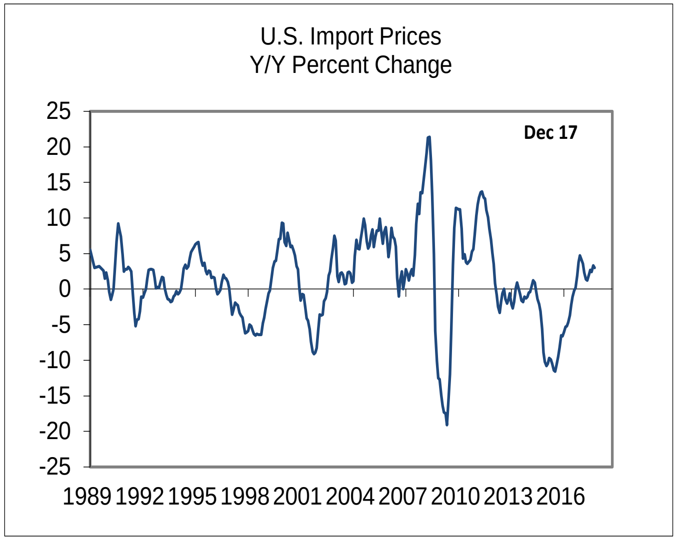
Consumer Price Index (CPI) inflation decreased slightly in December to a 2.1% annual rate. Core CPI inflation (excluding food and energy costs) increased slightly to a 1.8% annual rate. The PCE deflator, which typically runs below the CPI, remains below the Fed's 2% policy objective at 1.8%. The Fed continued to tighten in December. The latest economic projections indicate it will raise the fed funds rate steadily higher in 2018. We expect the Fed will continue tightening until broader financial conditions tighten, with a move in March highly likely.



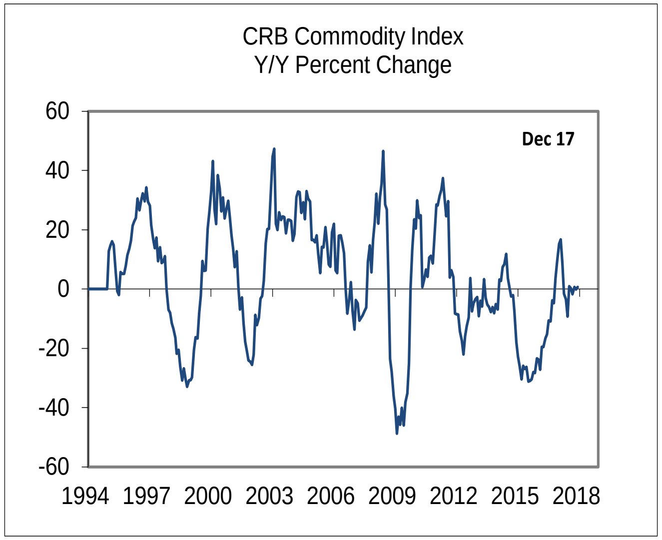
Source: Bureau of Labor Statistics



Source: Federal Reserve Board



Source: Bureau of Labor Statistics



Source: Reuters

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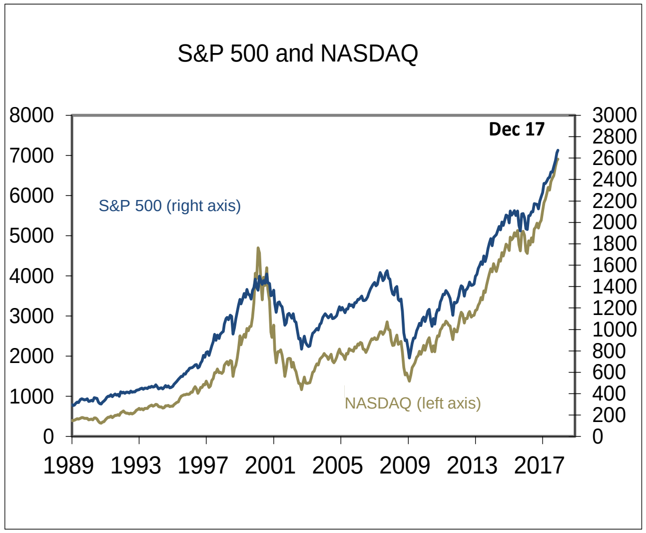
Equity Market

U.S. equity markets experienced slightly positive performance in December. While the Russell 2000® Index of small cap stocks returned -0.4%, the S&P 500® Index of large cap stocks returned 1.1% and the Nasdaq Composite Index returned 0.5%. Implied and realized volatility remained depressed during the month, hitting a record low in early January. During December, telecom stocks led the market with returns of 5.8%, while health care stocks came in last at -0.7%. Technology was the standout performer in 2017, returning 38.8%, while telecom lost 1.3%. Domestic markets in aggregate lagged international equities in 2017, a reversal of past years.



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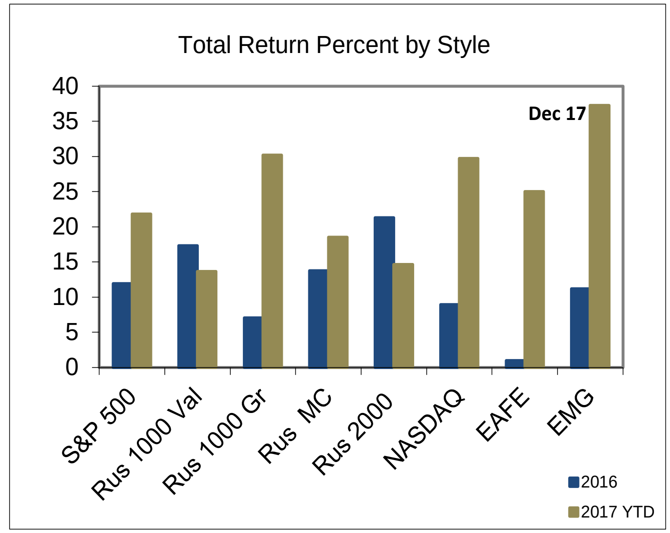

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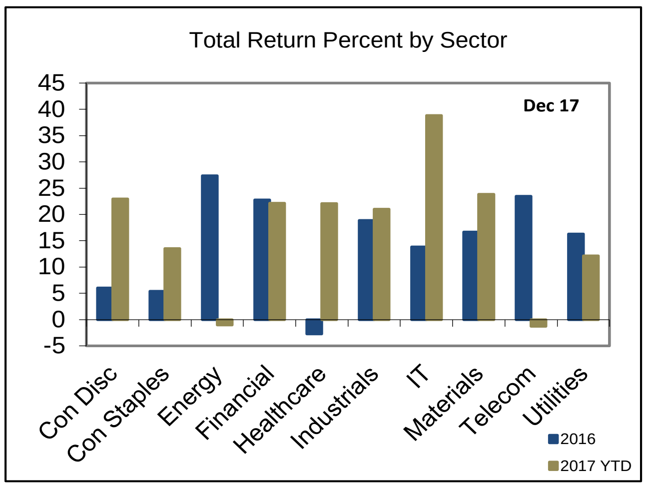
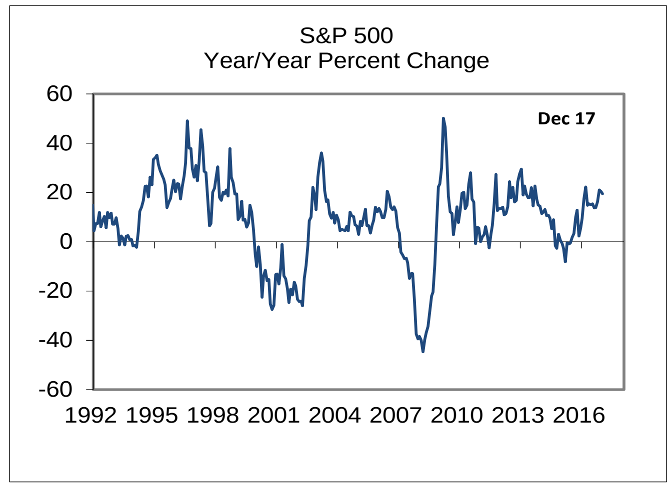


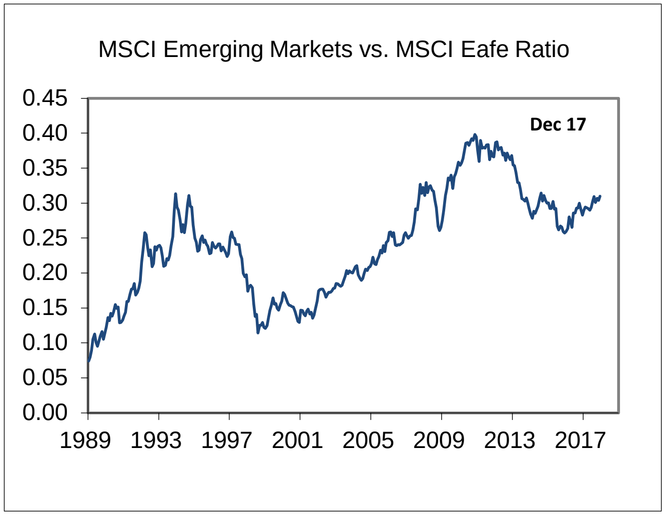
Source: Bloomberg. Based on the S&P 500 Index.



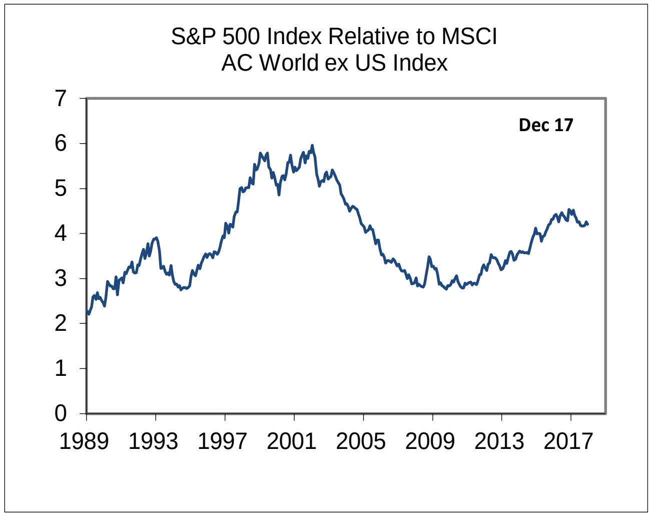
Source: Bloomberg

International Markets

International equities outperformed U.S. stocks in December. EAFE (Europe, Australasia, Far East) returned 1.61% and emerging market equities returned 3.59%. Emerging markets have been the clear winners year-to-date, returning 37.28% vs. 21.82% for the S&P 500. This is the first time since 2012 that international stocks outperformed the U.S. for a calendar year. Dollar weakness is unlikely to remain a continued source of foreign stock outperformance. But better growth measures and ongoing policy support, as well as valuation differentials, suggests continued foreign stock outperformance.



Source: MSCI Barra



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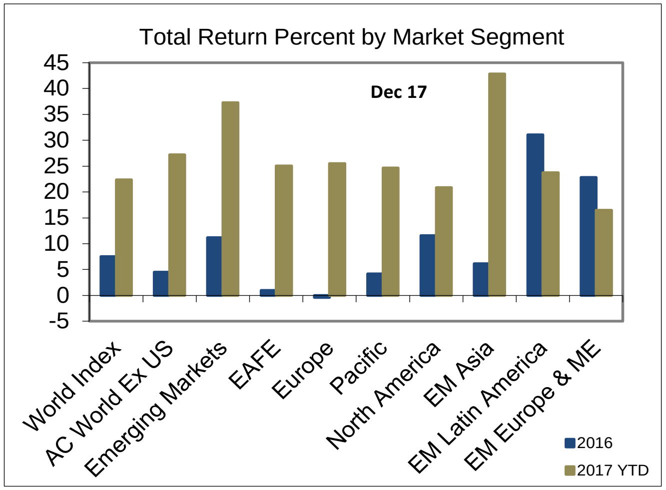

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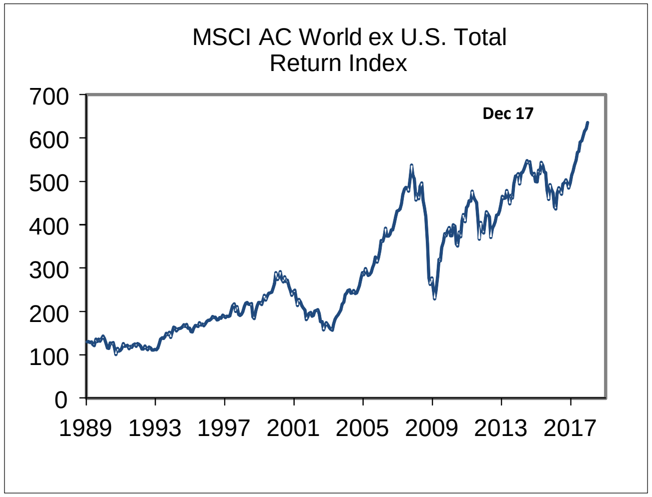
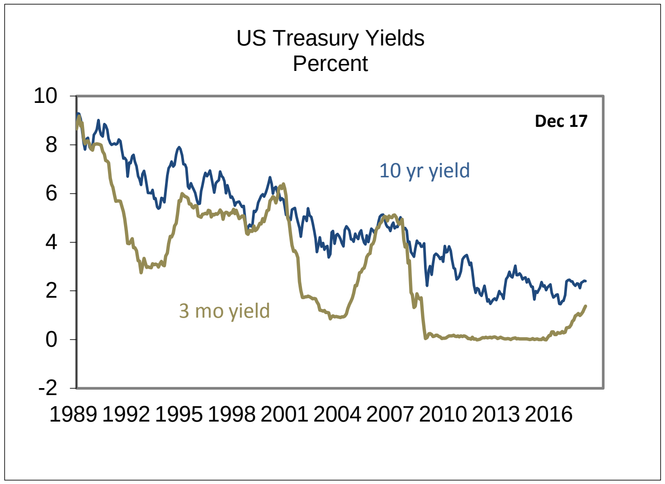


Source: MSCI Barra

Fixed-Income Market

The U.S. Treasury yield curve flattened slightly in December, with the two-year yields increasing around 0.10% and 10-year yields unchanged. Short-term rates rose in 2017, reflecting continued Fed tightening. 10-year Treasury yields rose from 2.44% on December 31, 2016, to a high of 2.63% on March 13, 2017. They then declined to 2.17% on April 18, 2017 and ended December at 2.41%. Investment grade credit spreads decreased slightly in December. The best-performing fixed income sector in December was the municipals, returning 1.05%. The key drivers of long-term interest rates over the past five years have been equivalent foreign bond yields and longer-term fed funds rate expectations. Both factors will likely be a near-term source of upward pressure on yields.



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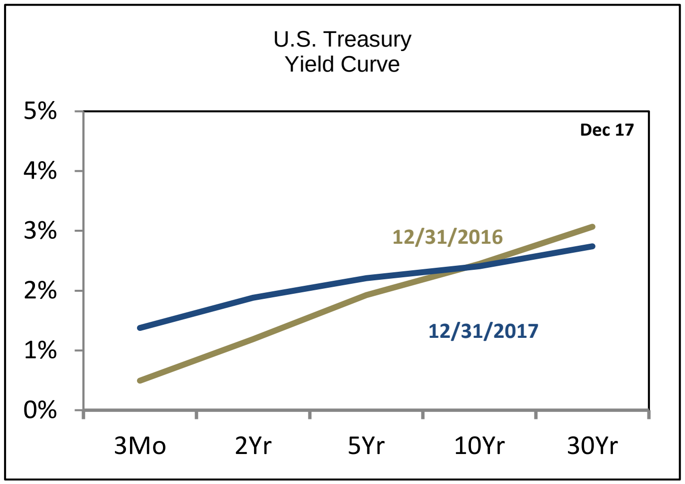

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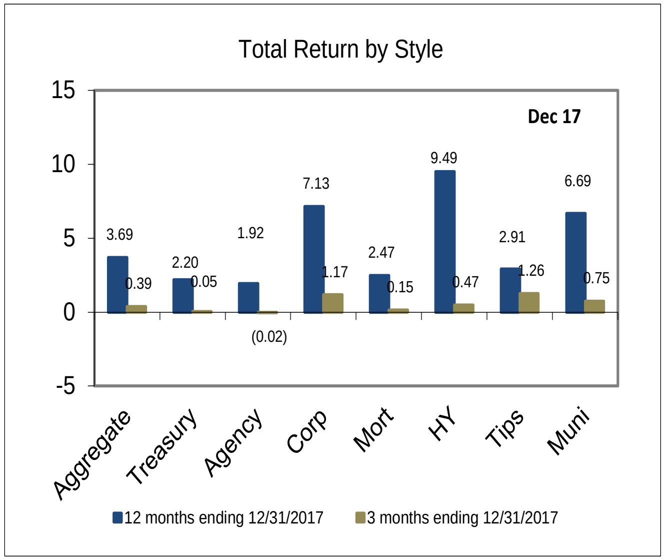
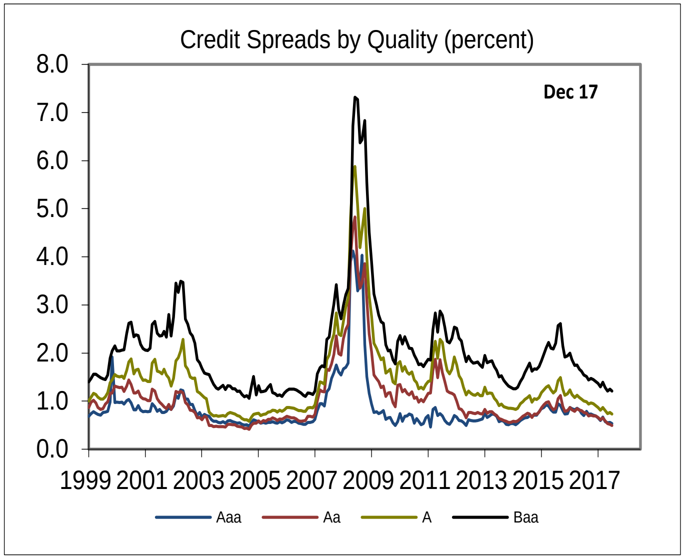


Source: Barclays Capital. Based on the Barclays U.S. Aggregate Bond Index.



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Economic, Rates and Earnings Forecast

	2016 (A)	2017 (Est)	2018 (F)	2017 Bloomberg Consensus*	2018 Bloomberg Consensus*
Real GDP (Q4/Q4)	1.8%	2.5%	1.0% - 2.0%	2.60%	2.60%
Personal Consumption Expenditures	2.8%	2.8%	1.0% - 2.0%		
Investment	0.9%	3.3%	1.5% - 2.5%		
Net Exports ($)	-$586B	-$621B	-$620B		
Government Spending	0.4%	0.7%	1.0%- 2.0%		
Unemployment Rate* **	4.7%	4.1%	4.0%	4.10%	3.90%
CPI* **	2.1%	2.1%	1.5% - 2.5%	2.10%	2.20%
CPI Excluding Food and Energy* **	2.2%	1.8%	1.5% - 2.5%		
Fed Funds* **	0.50% - 0.75%	1.375%	1.25% - 2.00%	1.50%	2.25%
10 Year Treasury* **	2.44%	2.40%	2.00% - 3.00%	2.41%	2.91%
Corporate Earnings (S&P Operating)	$106.26	$124.00	$135.00	$124.99**	$145.79**
Trade Weighted Dollar* **	102.21	92.12	95 - 105		
*Bloomberg - January 12, 2017					
**Standard and Poors - January 3, 2018					
***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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