

ECONOMIC & MARKET REVIEW

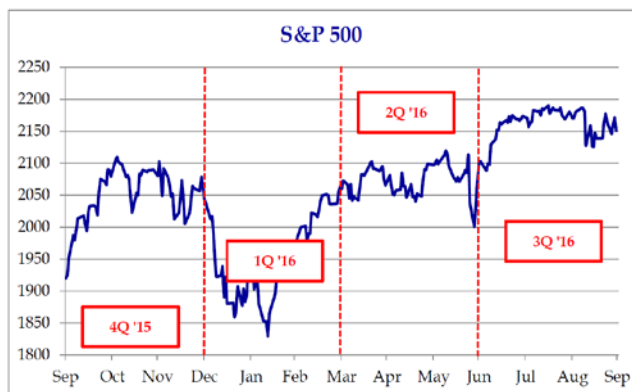
Third Quarter 2016



2016 has proven to be a decent year for markets despite all of the distractions. Of course, that could change in an instant, but in spite of so many headwinds, markets have produced reasonable returns.

Third Quarter 2016 and Year-to-Date Performance

	3 rd Quarter	YTD
S&P 500	3.85%	7.84%
Russell 2000	9.05%	11.46%
Barclays Agg.	0.46%	5.80%
MSCI EAFE	6.43%	1.73%
MSCI EM	9.03%	16.02%



Source: Strategas Research Partners

Gains in employment are the best economic news of the year, actually good since 2009. From a peak of 10% in 2009, the unemployment rate has been consistently at or below 5%. Lower weekly unemployment claims support the expectation that job gains will continue, at least for the immediate future. Consumer confidence has been on an upswing this year. This is particularly good news because consumers drive GDP growth in the U.S. There are many reasons for the GDP improvement, including more jobs, less unemployment, low mortgage rates, gasoline prices are still low and wages have

started to improve...slowly. Consumers haven't been overspending though. The new "smarter" consumer has been saving more and been cautious with mortgage debt. American consumers seem to be more focused on balance sheet repair since the recession of 2008-2009. Good news for the long-term, but something of a headwind in the near-term for an economy built on consumer consumption.

New single family home starts have improved this year and new home prices are up. However, existing home sales are weaker, impacted by the lack of inventory...which has led to higher prices, significantly higher in some markets. Those higher prices make it more difficult for buyers to qualify, thus causing slower sales.

Leading economic indicators are up, but the pace of improvement has started to slow. This implies that growth over the next six to nine months may show some softness.

All in, U.S. economic news is mixed.

The U.S. presidential election is just around the corner. A few things look highly likely to me. First, both candidates are emphasizing the need for infrastructure spending. The only way to finance a significant increase in spending is to borrow more. So, it seems likely that government debt, which is already high relative to GDP, will move higher. Because of incredibly low interest rates, the government has been able to keep our debt problems out of the headlines. That may not be the case for long, even if interest rates move up only a small amount. Secondly, defense spending is going to move higher. We live in a precarious world. Regardless of who is elected President, we are going to need to spend more on defense. Again, additional spending will enlarge the U.S. deficit. Finally, it seems likely that the U.S. will experience a recession some time during the first term of the new President. Recessions cause tax receipts to decline and government spending to increase. I am a broken record on this topic thus

far, but U.S. government spending is set to jump and the deficit will return as a major political debate in the next few years.

Central Banks have by choice, or because there was no real choice, become the primary driver of economic conditions and markets around the world. The grand experiment in central bank policy started as a result of the economic meltdown in 2008. Previously unused and experimental policies have taken rates down, even negative, placed central banks into the securities markets as major buyers, printed new currency and now are attempting to shape the yield curve. Central banks around the globe face a number of challenges in maintaining stimulus and trying to keep expectations up for longer than anticipated due to stubbornly weak inflation. You can't prove a negative, so knowing precisely what would have happened without these actions is an unknown. I am sure they have helped stabilize economies and markets. However, I am concerned about the continuous and now growing quantitative easing programs and the unintended consequences that these programs could have. It isn't a concern now, but the longer these programs last, coupled with the lack of growth around the world, causes me concern. If growth is as slow as it is globally with these programs in place, what happens when we reach the next recession? Not an immediate concern, but something I do think about for the future.



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Disclosures

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