Quarterly Economic Update

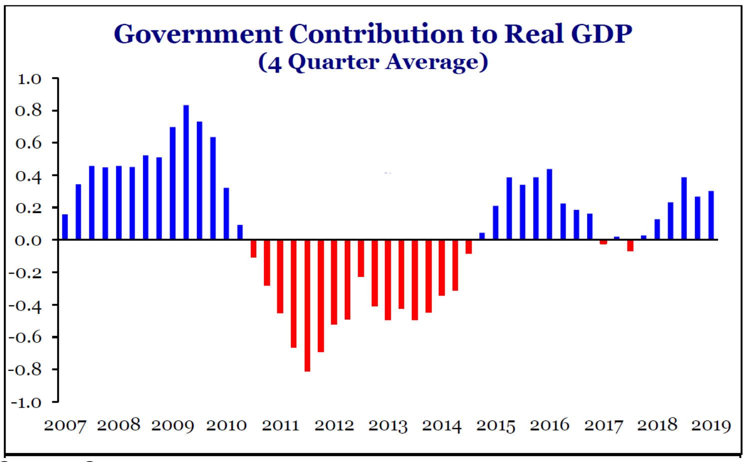
May 14, 2019

MACROECONOMIC COMMENTARY

Fiscal Policy

By Michael McNair

US real GDP grew by 3.2% in the first quarter of 2019. This marks the first time since 2006 that the US economy has sustained 3 consecutive quarters with real GDP at, or above, 3%. Stimulative fiscal policy by the federal government added 0.3% to the growth rate and kept US economic growth above 3%.

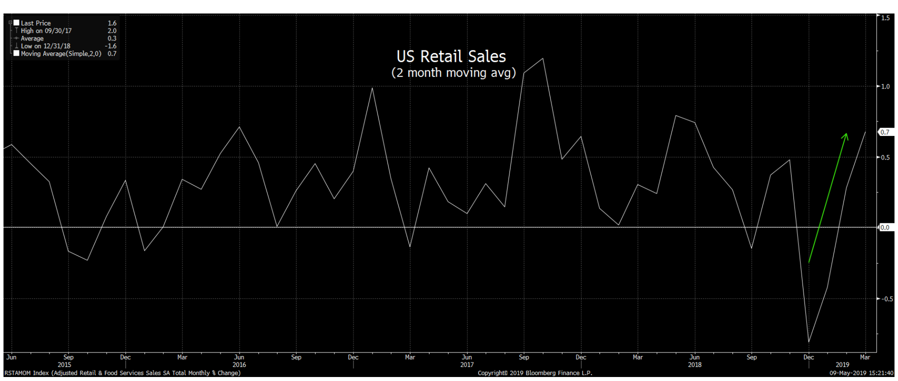


Source: Strategas

Timing of Tax Refunds Distorting Economic Data

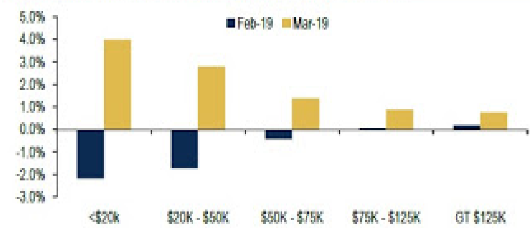
Despite strong GDP growth, US retail sales data was surprisingly weak to start the year. However, soft retail sales were likely a result of a change in the timing of tax refunds, which distorted the data, rather than a weakening consumer.

Earned Income Tax Credits were significantly delayed this year, resulting in lower spending from December to February. However, tax refunds were finally received at the end of February, which caused a spike in March retail sales of 1.8%, month over month (seasonally adjusted).



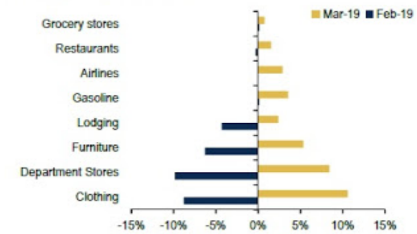
The delay in tax refunds had a particularly strong impact on spending by lower-income households and spending on clothing, furniture, and lodging were the most affected categories.

Chart of the month: Retail ex auto spending by income group (SA, %mom)



Source: BAC internal data

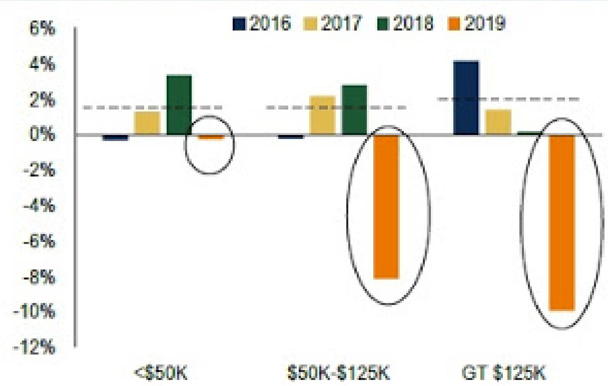
Chart 2: Spending growth by sector for the low income group (households earning <$50k / year, SA, %mom)



Source: BAC internal data

Tax legislation, which capped state and local tax (SALT) deductions, also altered refunds this year for the high-income group. Examining the top 10 states, in terms of SALT deductions, shows that tax refunds were down 10% this year vs a 1.7% average increase from 2016 - 2017.

Chart 4: Tax refunds were down relative to last year for the high income households (earning more than $125K/year) in the high SALT tax states (%yoy)

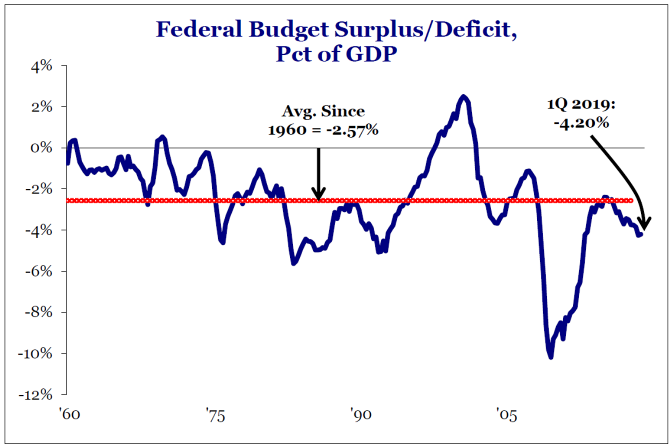


Source: BAC internal data, note: high SALT states include NY, CT, CA, NJ, DC, MA, MN, MD, OR, IL
Dotted line means average for 2016-2018.

It is still unclear how spending will be impacted by lower tax refunds for upper-income groups in high SALT states because higher income households are less dependent on tax refunds to finance their expenditures.

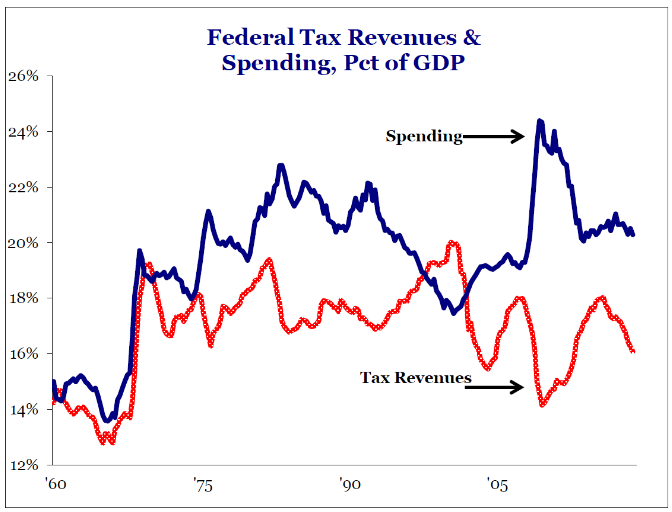
Federal Budget Deficit

The US Federal budget deficit currently stands at 4.2% of GDP. The deficit has shrunk considerably since it peaked during the financial crises, but it remains wide relative to historical standards.



Source: Strategas

The widening budget in 2018 is a result of Tax Reform, which lowered federal tax revenue but has not been matched with a commensurate drop in spending.



Source: Strategas

However, the budget deficit actually declined in the first quarter of 2019 due to an increase in tax revenues. We are lapping the one-year anniversary of the income tax cuts and tax revenue increased by 10% in February and 8% in March. April is the largest month for tax collection and early estimates point to greater than 5% increase over April 2018.

We believe the budget deficit has now peaked and fiscal policy will begin to become less stimulative over the course of the year and into 2020. However, a possible infrastructure bill would be a source for a prolonged fiscal stimulus.

Possible Infrastructure Bill

Infrastructure is the one area where both sides of the isle would like to get something done. In the wake of the release of the Mueller Report, Nancy Pelosi called the President to discuss an infrastructure bill:

*One day last week, amid spiraling fallout over special counsel Robert Mueller's Russia probe, House Speaker Nancy Pelosi dialed up the president and requested a meeting. She talked to President Donald Trump about working together on an infrastructure package… As the two cross the 100-day mark of the era of divided government, theirs is a relationship like almost none other in Washington…**She says 80 percent of their conversations, including the talk last Thursday, are about infrastructure**. They're trying, she said, to find areas of "common ground."*

AP, 4/11/2019

There is little doubt that there is a common interest in increasing infrastructure spending but there are many hurdles which make a large scale infrastructure package unlikely. The biggest impediment is how to pay for the infrastructure package. President Trump has made it clear that he wants a large infrastructure package but he is wary of further increasing the deficit ahead of the 2020 election. The President recently pushed back on a two year spending deal for defense and non-defense spending.

Trump Scoffs at Deal

Trump on Thursday night said a two-year deal to raise spending caps is "not happening," writes POLITICO's Jennifer Scholtes. "While the proposal would increase discretionary spending to about $1.3 trillion for the upcoming fiscal year, the Trump administration contends that it would lead to nearly $2 trillion in spending increases over 10 years.

Politico, 4/12/2019

It is difficult to envision President Trump green lighting a $1 trillion unfunded infrastructure package when the administration is increasingly pushing back on increasing the deficit for defense and non-defense spending. It is also highly unlikely that the Democrats would accept an infrastructure deal that increases the deficit. It is also highly unlikely that there is a substantial untapped source of revenue that the two parties can agree upon to fund the infrastructure spending. Especially, in light of the fact that all of the easiest sources revenue increases were used to get tax reform passed.

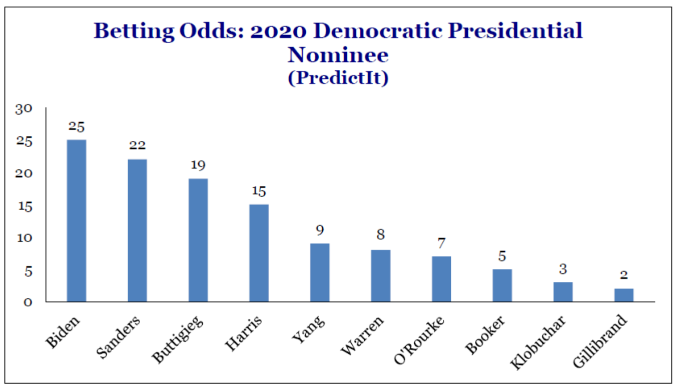
It was recently reported that the Department of Education is looking at selling its $1.5 trillion student loan portfolio to private investors. However, this is unlikely to generate more than $500 million in revenue. The government's effort to sell their student loan portfolio will face strong political and legal opposition, yet only generate 0.05% of the revenue needed for Trump's infrastructure package. It just goes to show that the administration is scratching the bottom of the revenue barrel.

Pelosi and the Democrats, on the other hand, will demand a tax increase – likely an increase in the gas tax or corporate tax rate – in order to pay for an infrastructure package. We believe a tax increase will be a non-starter for Republicans heading into an election year.

While there might be a will, there is unlikely to be a way. Thus, our base case calls for Congress to agree to a slight two year increase in infrastructure spending as part of a debt ceiling deal. We place low odds on a major infrastructure deal before the 2020 election.

2020 Election and Possible Tax Legislation

The 2020 Democratic primary looks to be wide open. The current betting odds place Joe Bidden and Bernie Sanders as favorites but the early odds always favor the well-known commodities.



The Democrats are likely to push for changes to the current tax code, regardless of who ends up as the nominee. However, Democrats face a high hurdle in order to get their tax policies passed into law. The Democrats must win the Presidency and the Senate while preserving their majority in the House. Further, a slim majority in the Senate will make any tax legislation difficult with a number of moderate Democrats who have resisted tax increases in the past.

Below we summarize the list of the most likely tax proposals for the Democrats to target.

1. Increase the Corporate Tax Rate to At Least 25% - most Democrats believe that a 21% corporate tax rate is too low. Each 1% increase in the corporate tax rate generates $100 billion of tax revenue over 10 years. Thus, moving the corporate tax rate to 25% would generate $400 billion of incremental tax revenue that could be used to fund a number of government spending plans.
2. Increase the Top Marginal Tax Rate From 37% to At Least 40%: The Democrats were appalled that the Tax Cuts and Jobs Act lowered the top marginal individual tax rate to 37% in an era of income inequality.

3. Raise the Capital Gains Tax: Policymakers have been up in arms over the increase in corporate buybacks in the wake of the Tax Cuts and Jobs act. Democrats believe that corporations have used the corporate tax cut to buy back shares and boost their stock prices rather than adding jobs so raising the capital gains tax will be a popular remedy.

The Treasury moves from Fiscal Policy to Control of Monetary Policy

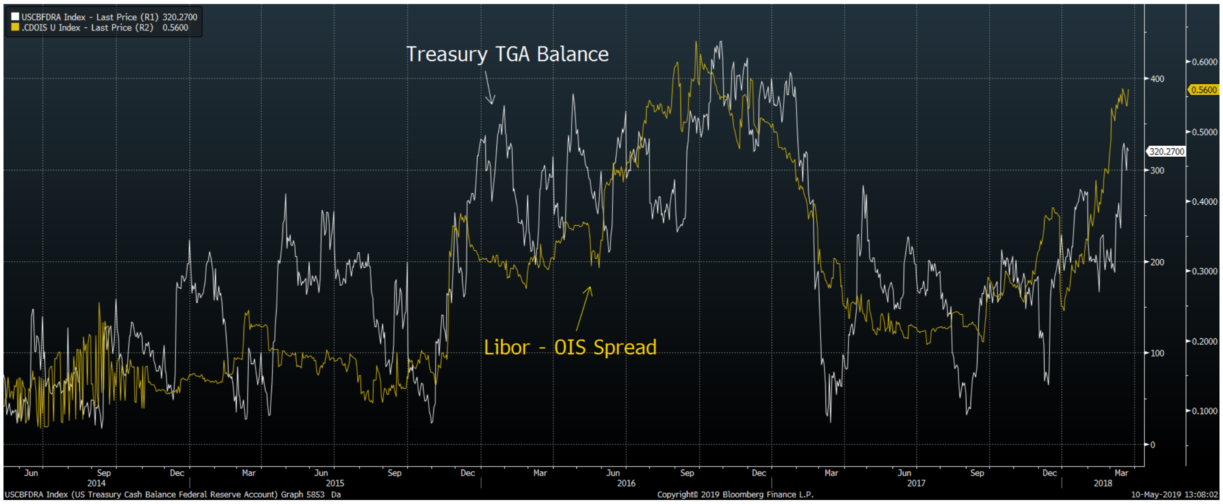
In August of 2015, the Treasury Borrowing Advisory Committee set new guidelines for the Treasury General Account (TGA), held at the New York Federal Reserve. The committee determined that under normal conditions the Treasury department should increase their cash deposits to at least $350 billion in order to be drawn down under special circumstances. Under the guidelines the funds can only be used as 1) a contingency for natural disasters, 2) when Treasury funding markets may be temporarily closed, and 3) ahead of reaching a debt ceiling limit, in order to prevent the unnecessary furlough of government employees (only for the debt ceiling not government shut downs like occurred to start the year).

The new TGA policies are having severe unintended consequences to the financial system. Since 2015, changes in the Treasury's TGA balance have had an outsized effect on financial conditions. When the Treasury is building their cash balance at TGA it drains reserves (i.e. liquidity) out of the financial system and away from banks and prime dealers that arbitrage various parts of the global dollar funding market. When Treasury is drawing down its TGA balance reserves are added to the system. The result has been wild swings in financial market liquidity as the TGA balance has been repeatedly raised and drawn down over the past several years.

From the end of 2015 to 2016, the TGA balance increased by $400 billion. Then at the begging of 2017, the Treasury reduced their cash balance by $400 billion and reduced their bill issuance by the same amount. Both developments were related to the extraordinary measures taken by the Treasury to avoid the debt ceiling (until Washington could make a deal to increase the debt ceiling).

Reserves were drained from the system when Treasury was building their TGA balance, which severely stressed money markets – the financial lifeblood of the economy. The opposite occurred in 2017 and the financial system was injected with a wave of liquidity.

In the following chart, we show the Treasury's TGA balance alongside the Libor/OIS spread – which we can use as a proxy for stress, or the amount of liquidity, in the banking system.



What is clear from the chart is that large swings in the TGA balance have an outsized impact on financial conditions. When Treasury is increasing its TGA balance it is building reserves, which is the same as the Fed doing quantitative tightening. While reducing the TGA balance is the same as quantitative easing.

The problem is that the Federal Reserve, not Treasury, is supposed to be the sole entity tasked with setting monetary policy. Further, Treasury's monetary policy actions (raising and draining TGA balance) were made for the sole purpose of providing policymakers enough time to agree on a deal to increase the debt ceiling and not on the basis of setting appropriate monetary policy for the financial system. In fact, Treasury was directly working against the Fed in 2017 when the TGA balances were reduced – injecting liquidity into the system – just as the Fed was conducting quantitative tightening. The liquidity injected into the system by Treasury far surpassed the liquidity being taken out of the system by the Fed. The financial markets ended up being awash in liquidity at a time when the Fed was trying to tighten monetary policy. The result is that from January 2017 – January 2018, the dollar index had one of the largest yearly declines in history and the S&P 500 was up 27%.

At the begining of 2018, Treasury reversed course and raised their TGA balance back to $400 billion, which drained liquidity from the financial system. However, this time they were working in the same direction as the Fed, who was also draining reserves via quantitative tightening. The result is that the S&P 500 fell 12% in 10 just trading days and a year and a half later the S&P 500 is below the level it hit in 2017.

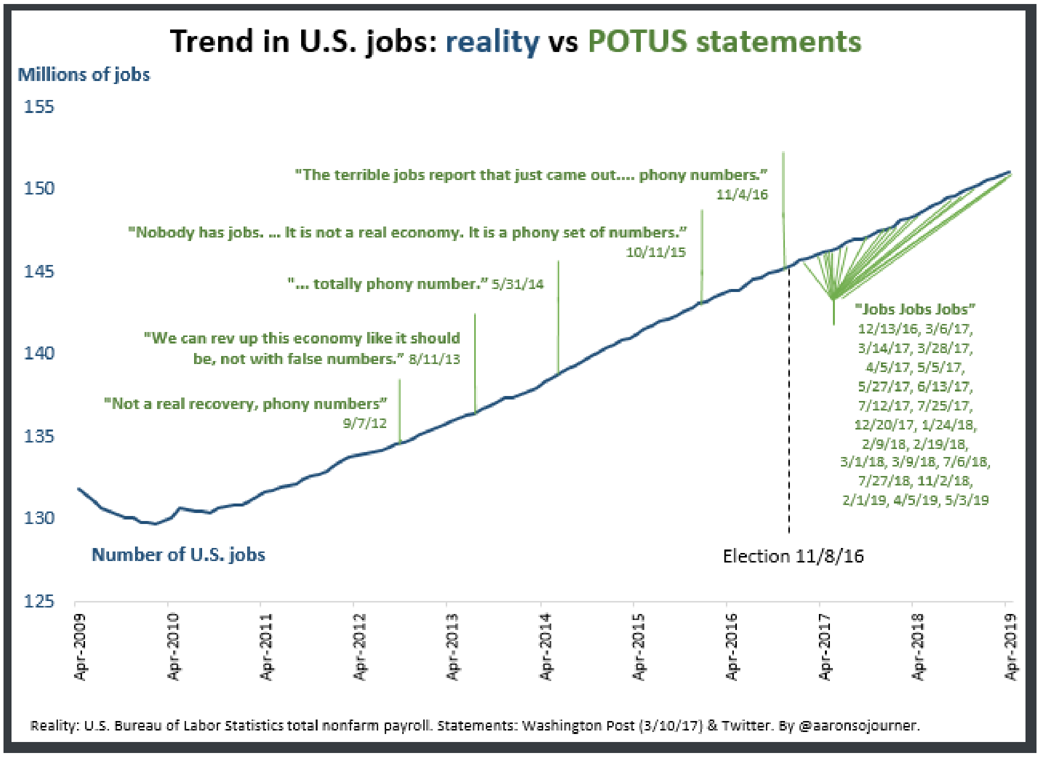
The TGA balance currently sits at $344 billion and the Treasury will once again start reducing its balance to avoid hitting the debt ceiling. Around $300 billion of reserves will be added to the banking system over the next few months. Once the debt ceiling is raised - likely in August or September - the Treasury will reverse and increase their TGA balance by $350 billion by year end – or the equivalent of a $1.3 trillion annualized quantitative tightening.

2019 will be another year where the Treasury department usurps the Fed's control over monetary policy and the financial markets will be along for the ride.

Economic Outlook

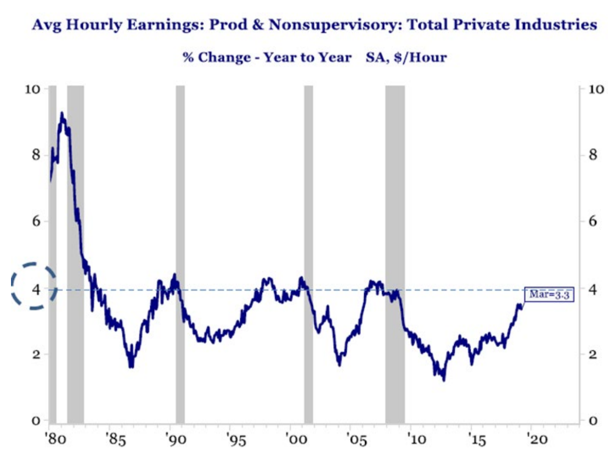
By Josh Husted

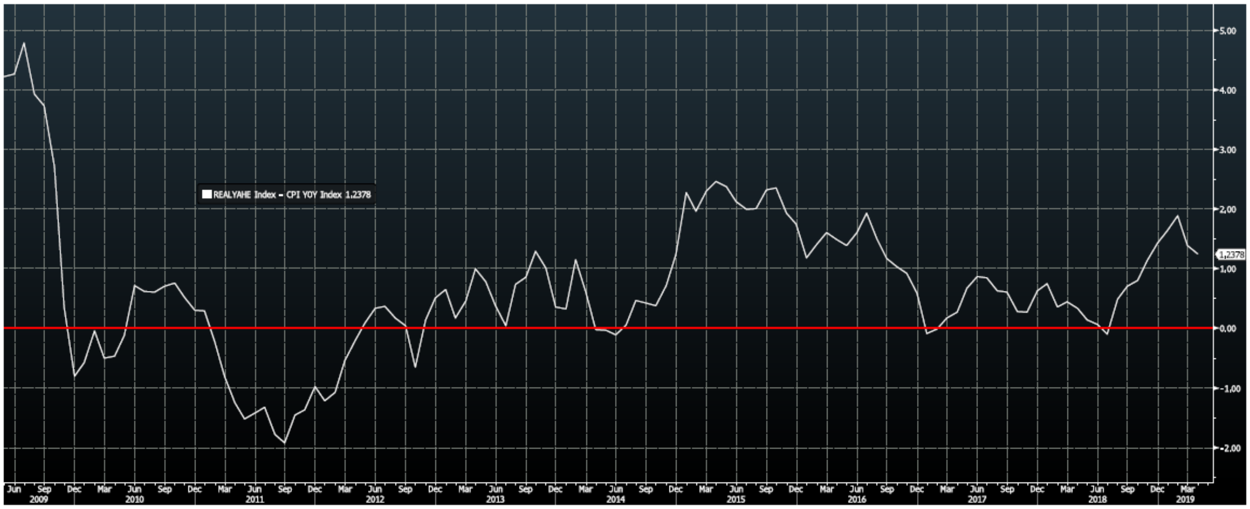
In 1969, Led Zeppelin's first two eponymous albums were released, giving the world timeless classics such as 'Whole Lotta Love,' 'Ramble On,' & 'Good Times Bad Times.' (A complete ranking of LZ's discography is outside the scope of this reading). Also in 1969, unemployment was hovering in the 3.5%'s- a feat not since achieved until our most recent quarterly number of 3.58%. As the band's mythology goes, the name Led Zeppelin stemmed from a humorous conversation among several musicians about their chances of going down like a lead balloon. We would certainly place the chance for success of today's economy at much better odds!



Part of the strength of this economy has undoubtedly been the improving job market and subsequent wage inflation (albeit the latter has been later to the party).

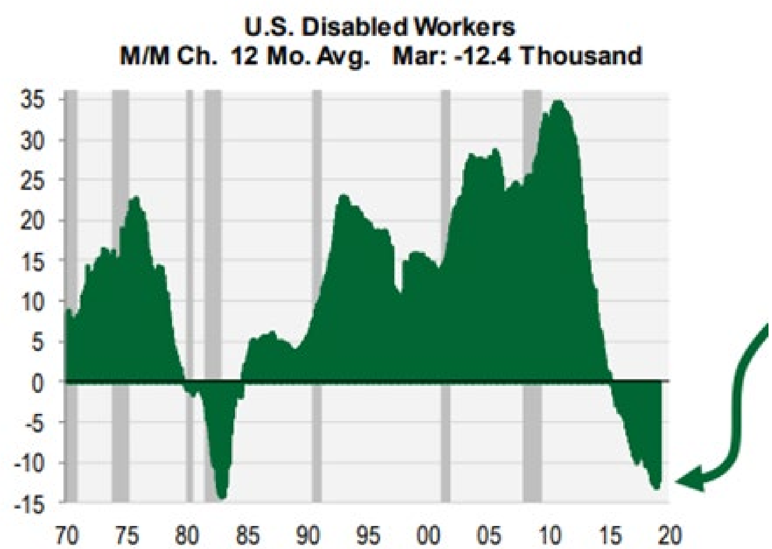
- Jobless claims are at historic lows- 8.27 per 10,000
- April's nonfarm payrolls increased by 263,000
- Average hourly earnings increased 3.6% in April



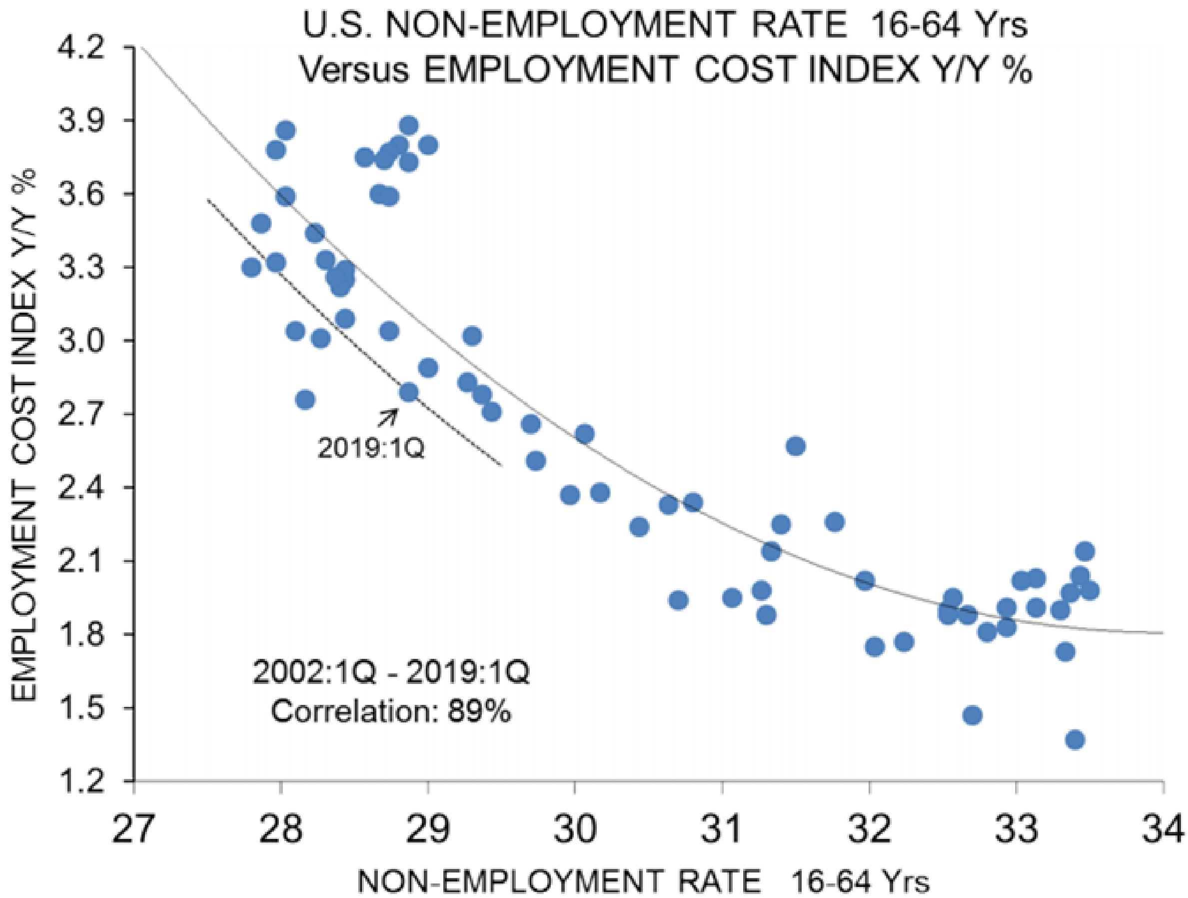


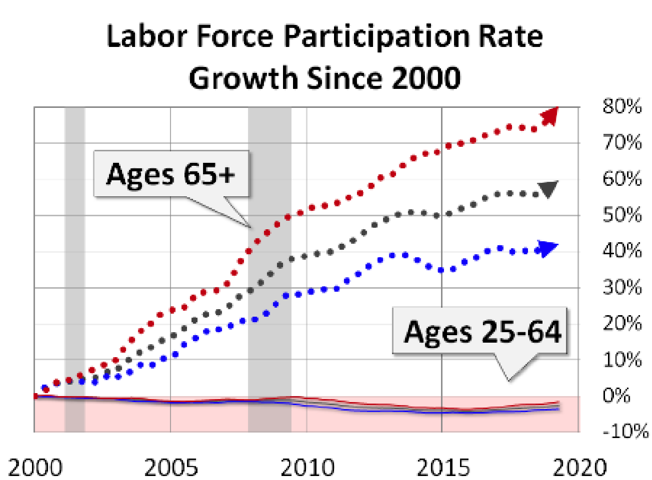
A point of interest upon which we would like to briefly expand is the slower than expected wage growth in this cycle. From a layman's perspective, you could expect to hear sentiment along the lines of, "I haven't gotten a raise in X years!" And truthfully, real wage stagnation and slower than expected growth in average hourly earnings has left many economists scratching their head. The chart above shows the US Average Hourly Earnings less Inflation to adjust for purchasing power.

In a simple supply and demand function, fewer unemployed workers should lead to wage growth as the demand for labor starts to reach the limits of supply. Since unemployment has been sitting at the lowest levels in decades, why haven't wages responded as expected? First, we would point to the measurement assumptions of "unemployment." The official stated measure is what economists refer to as U3 unemployment, when *people are without jobs and they have actively looked for work within the past four weeks.* This ignores the effect of slack in the labor market, failing to account for those working age people who have not been actively looking for a job in the past month, but could be incentivized to reenter the workforce when job prospects improve to a certain level.

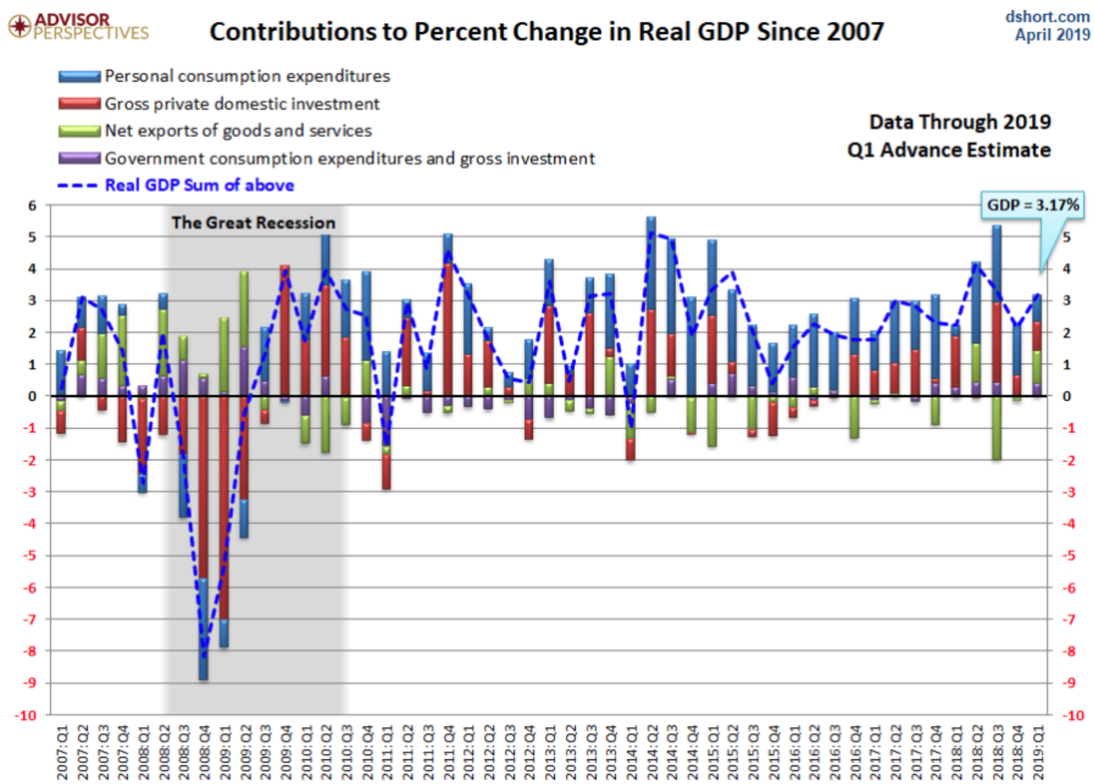


A measure of unemployment called "Non-employment" measures the % of working population that are either unemployed or not in the labor force. That measure is currently sitting at 28.9%. There is a clear statistical significance illustrated in the chart to your right that relates the non-employment rate to the employment cost index Y/Y. What this relationship tells us is that the labor market still has room to expand before wages begin to materially impact corporate profits.

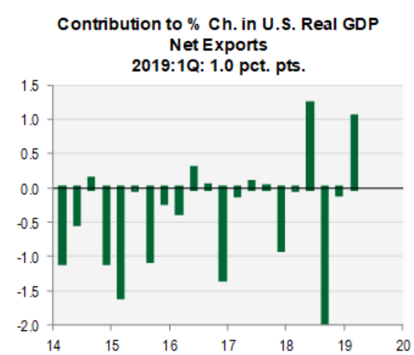




Other potential explanatory factors we find interesting are the gig economy, increasing employee spend on benefits, and the reduced presence of labor unions. The chart to your left illustrates what age cohorts have been reentering the workforce since 2000. Since January 2000, the participation rate for all the elderly has soared by 59.6 percent and for elderly women by 80.4 percent.

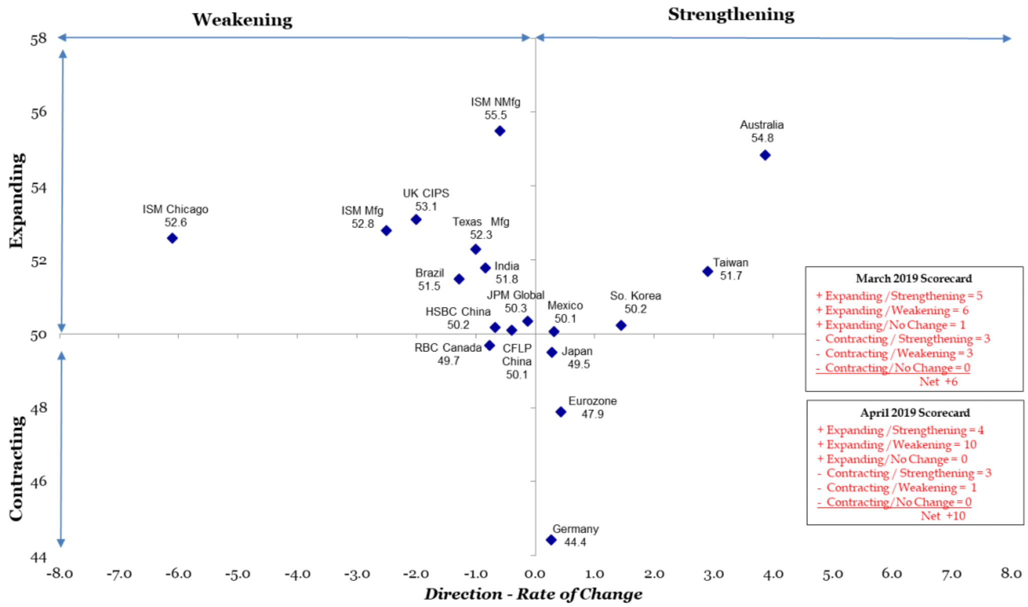


US GDP growth surprised to the upside this quarter as concerns over the government shutdown were offset by strength in exports and inventories. This is only the 2nd time in the last 21 quarters that trade has contributed over 1% to GDP. If trade continues to remain a support, a rebound in consumer spending from the shutdown could propel a strong Q2. Easing financial conditions, solid income growth, and strong consumer sentiment should all fuel real consumer spending and housing.



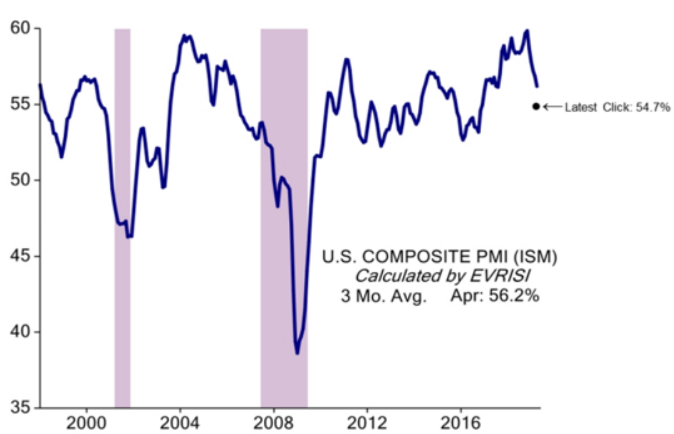
Of particular importance, productivity recorded a strong click at 2.4%- the highest since 2010. We are especially optimistic about this data point as it represents an opportunity to accelerate potential GDP growth. When the labor force participation rate is expanding simultaneously with the productivity rate, that 1-2 punch is especially potent for potential GDP. As an added bonus, Potential GDP growth fueled by these two drivers can help keep inflation tamped down and reduce the need for any Fed intervention.

It seems as if the tax cuts & repatriation relief had their intended effect as 2018 was the 4th largest year over year increase for S&P 500 Capex. A capex-fueled productivity boom should help to reduce the impact of wage inflation and further extend this cycle to historic lengths. Net domestic investment (ie, investment after depreciation) in the U.S. has moved sideways for a decade. This trend matters because there's still likely pent-up demand, even in year 10 of this cycle.



Global PMIs are still expansionary, albeit survey data continues to identify a trend of slowing growth. In April, the ISM Manufacturing PMI recorded its lowest reading since October 2016 raising concerns about near term growth. While manufacturing is a lower % of the worldwide economy, it is valuable as a leading indicator of the state of the global economy.

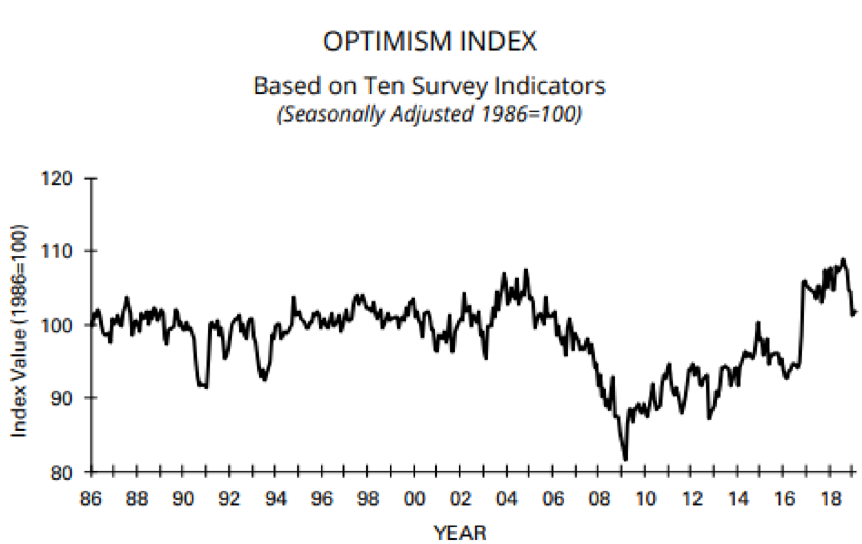
- Eurozone economy PMIs are bimodal as a mix of contracting and expanding economies saw a net contraction for the 3rd consecutive month.
- UK expansion slowed while posting its 33rd month of growth.
- China remained in weak expansion for a 2nd consecutive month.
- India saw its 21st consecutive month of expansion
- South Korea inverted positively after 5 months of contraction
- Canada contracted & Mexico rose slightly as they both continue to lag US manufacturing



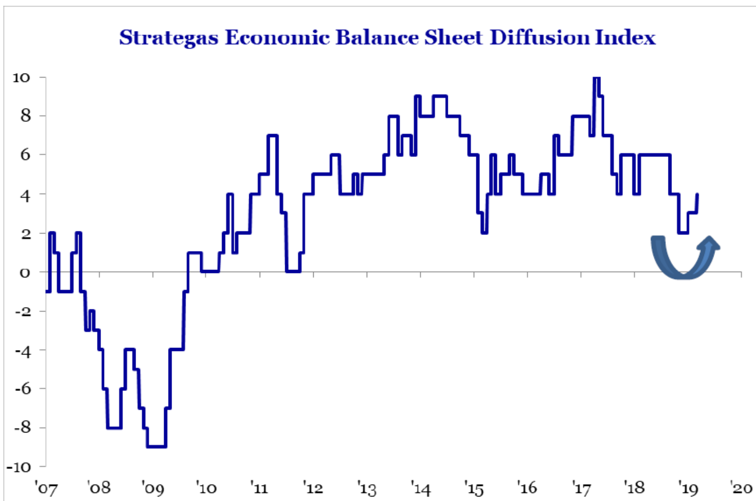
- Of note, the weakest US econ data came from the ISM PMI at 54.7%, missing forecasts
- There was plenty of significant stronger data in the mosaic that helped quell investor fears
- However, continued directional divergence between the S&P 500 and PMI can be cause for consternation. In theory, one has to be "pulled" back to the other

When we think about what could be better about this economy, one facet of the economic mosaic that comes to mind is a psychological one- optimism. What is it about the current economy that is still making business owners uneasy (other than the usual culprits?) We suspect that the unpredictability of trade dynamics could be playing a role. Tariffs can be a useful tool in the toolbox for managing trade imbalances and leveling a playing field; however, we are cautious on how beneficial the net outcomes can be when implemented via tweet with little notice. US companies operate on a global scale with complex market dynamics, and if asked, would most likely prefer that the executive branch reach for a scalpel instead of a sickle. Surveys of CEO confidence (above) and small business optimism (below) are trending towards pre-election levels. The more comfortable CFOs are with future market dynamics, the more they are willing to start writing checks.

OVERVIEW - SMALL BUSINESS OPTIMISM



We conclude our discussion of the economic update with a visual holistic view of the economy compiled by one of our research providers, Strategas. It is always a profitable exercise to take a step back and block out the daily noise. Compared to other periods of time in our nation's history, we are in the midst of a strong and prolonged economic expansion with few signs of imminent danger. While not every data point we track is trending in the same direction (they rarely are), we remain constructive on the health of the US economy and its ability to drive strong returns. As always, we will continue to closely monitor risk factors and adjust our views accordingly.



Assets	Neutral	Liabilities
Credit Environ	Housing	Nonres Constr
Cons Spending	Govt Deficit	
Employment	Trade Deficit	
Cons Conf	Wage Inflation	
Capex Eqp	Price Inflation	
	Interest Rate Env	
	Mfg	
	Business Conf	

Economic:	Mar '18	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar '19
Assets	7	7	7	7	7	7	5	5	3	3	4	4	5
Liabilities	1	1	1	1	1	1	1	1	1	1	1	1	1
Net	6	6	6	6	6	6	4	4	2	2	3	3	4

RSA PORTFOLIO STRATEGY

Interest Rates and Fixed Income Strategy

By Lance Lachney

At the time of our last meeting, risk assets were enjoying a nice run as monetary policymakers adopted a more dovish stance emphasizing patience and data dependence. Ten-year treasury yields remained range-bound during the first couple months of the calendar year, providing healthy returns to investors who ventured into riskier sectors of the fixed income market. During the middle of March, treasury securities began to strengthen on the heels of falling yields in Europe as the European Central Bank lowered its estimates for economic growth and inflation. Domestically, there was also a huge drop in nonfarm payroll growth in what has been a pretty solid employment picture for some time.

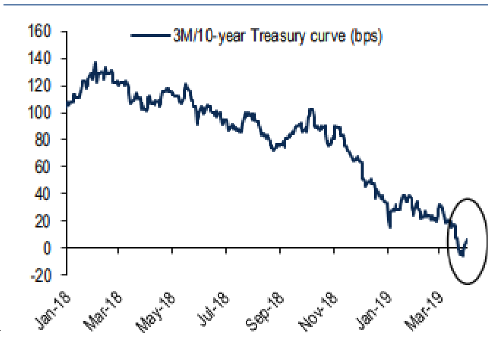
Figure 3: March decline in 10-year Treasury yields was the biggest since the Brexit vote in 2016

Source: BofA Merrill Lynch Global Research, Bloomberg

At its March meeting, the Federal Open Market Committee left policy rates unchanged. However, it threw in the towel on further rate hikes this year from its projections and announced that balance sheet reduction would conclude in September. These dovish adjustments moved treasury yields approximately 15bps lower out the curve. This, coupled with weak European PMI numbers, allowed the spread between the front end of the curve and the 10yr to invert, historically an indicator of recession in the future. However, investment grade spreads showed their resiliency, tightening a basis point or two to their lowest levels of the year. The 3-month/10yr curve moved back into positive territory by the end of the month, but not before 10yr yields experienced their biggest drop since June 2016. Investment grade debt returned approximately 2.50% during the month, backed by the strong rally in treasury securities.

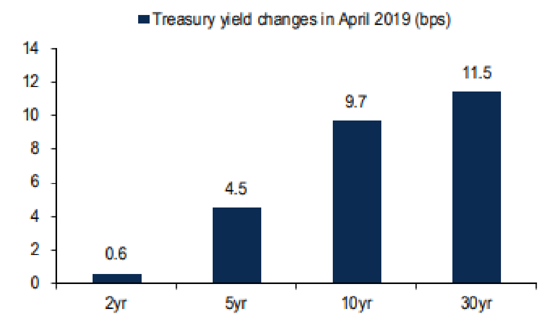
Better global economic news and a rebound in payroll employment here at home, allowed risk assets to find firmer ground in early April. In the first half of the month, treasury yields rose approximately 15bps across the curve. Corporate spreads continued to tighten during this time, while high yield debt regained its position at the top of the performance pyramid. Spread movement in the latter half of the month was muted, but interest rates within the belly of the curve moved lower. While macro conditions improved in April, weaker than expected inflation data and consumer spending were cause for concern. The underlying theme

Figure 4: Treasury curve inverted in March



Source: BofA Merrill Lynch Global Research, Bloomberg within fixed income that has continued to endure is that investors will reach for yield as long as earnings are decent and the outlook for rates is benign.

Figure 3: ... leading to a meaningful bear steepener in rates



Source: BofA Merrill Lynch Global Research, Bloomberg

The FOMC left short term interest rates unchanged at its third straight meeting on May 1st. Policymakers noted that while the economy is solid, consumer spending and business investment has slowed. It was Chairman Powell's press conference that garnered the most attention, stating that while overall and core inflation had declined, the committee believed the drop to be "transitory". He also highlighted that patience was needed given the global economic backdrop and that he did not see a strong case for an interest rate move in either direction. These comments and his need to witness a "persistent" drop in price stability to consider a rate cut, quickly pushed treasury yields higher. The implied probability of a rate cut as early as next year dropped accordingly.

Trading activity on the fixed income side has been fairly limited over the last couple of months. Purchases within the mortgage space have been made in the higher-coupon 20yr sector. These MBS additions were executed at favorable spread levels as way to reinvest prepays and increase duration at the margin. The fund has also carried out two treasury swaps during this time. The first coming in late March where profits were taken on a 2023 position that was added to last October. Those proceeds were reinvested into 2020 and 2042 maturities. The combination of these two securities provide a yield that is approximately 20bps higher than a bullet with a similar duration profile. The other swap simply extended out three years from a 2039 maturity. This trade allowed the fund to pick up an additional 12bps and add duration ever so slightly to a sector in the steepest part of the curve. In the corporate bond market, the RSA purchased a couple of safe names in the short end of the curve offering returns in the 3.25% vicinity over the next few years. More recently, the fund has purchased a couple of insurance names in the 10yr space trading at a discount to their peers at spread levels of 125-130bps over treasuries.

Market volatility faded quickly after the turmoil in late March. The short-lived inversion and the lack of severity to it, reduces the likelihood of a recession near term. Last week, the market received another favorable employment report with 236,000 jobs being added. The unemployment rate also fell to 3.6%, while wage pressures remained subdued. Uncertainty on the trade front is hurting risk assets this week. As one would expect, treasuries have been a beneficiary as investors hedge their positions with safe assets. While the rhetoric is likely a negotiating tactic to solidify a better deal with China, it does muddy up the water in an already tepid global outlook. While the bond market continues to believe the next move by policymakers will in fact be a rate cut, the new issue market for corporate debt remains wide open. The primary market has printed $20bn deals on back-to-back days. Going forward, volatility is likely to rebound as we move into summer with so many questions surrounding the global economy unanswered.

Domestic Equity Strategy

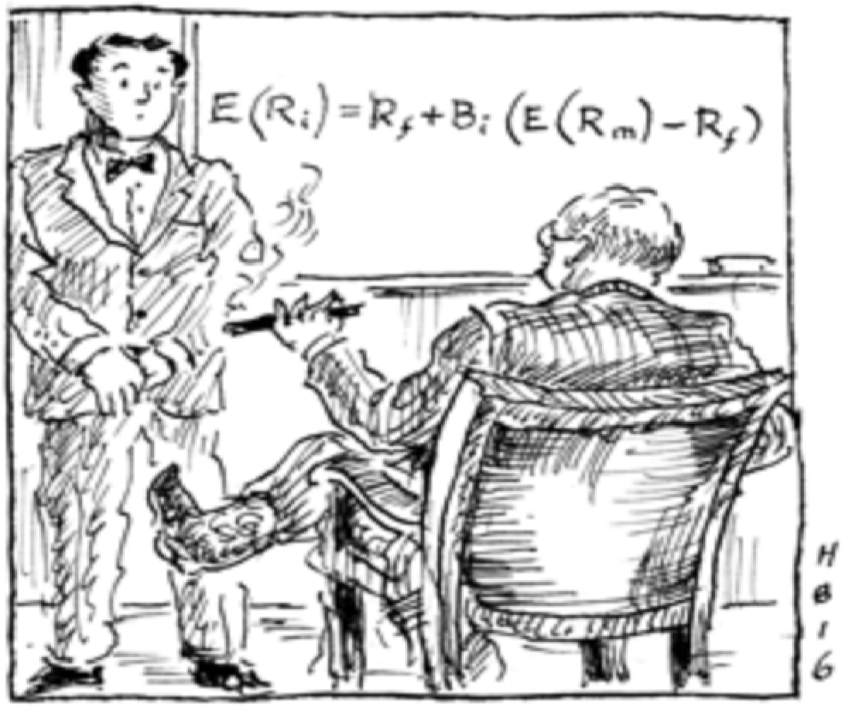
By Kevin Gamble

The performance of the U.S. equity market fiscal year-to-date can best be described by the letter V. This V shape has been fairly deep on both sides of the formation. The down move into the Christmas Eve low was characterized by a hawkish Fed, a government shutdown with seemingly no end in sight, and international trade uncertainty with looming threats of increasing tariffs. In a very dramatic shift (almost as if the waters simply parted), these storm clouds became dry land in calendar 2019 as the Fed turned neutral, the government reopened, and the market foreshadowed the potential for a meaningfully positive trade deal between the United States and China. The net of all this has allowed the S&P 500 to once again regain all-time high territory (albeit by a small margin) and continue its bull run following a very difficult first quarter to the fiscal year.

Exhibit 1: S&P 500 Performance Fiscal Year-to-Date

Source: Bloomberg

What I would like to accomplish in this strategy piece is to outline the top 10 things that we as an investment team think you as a board member should know about the current state of the U.S. equity market. Will the dramatic V-shaped market pattern prove to be an epic recovery or an epic "bull trap" as we move through the remainder of our fiscal year?



"Son, let's keep this real simple.
Up is good, down is bad."

Source: Strategas

RSA Top 10 list

1) The bull market is now 10+ years in the making – We are not in the early innings

While it is very difficult to know exactly how long a bull market cycle will last, it is safe to say that we are no longer in the early innings of the bull market. The debate at this point really is to how mature we are in the bull and how high can it go? The difficulty for investors is that the late innings of a bull market cycle can oftentimes produce the greatest percentage gains, so moving toward a defensive posture too early can prove to be a big mistake for returns.

We do recognize that a vibrant IPO market, unemployment rates at all-time lows, a growing number of companies pushing the $1 trillion market cap level (Microsoft, Apple, Amazon, and Google) and increasing trend following among investors are all characteristics of a market entering the second half of the ballgame.

As an example of the staggering math of the law of large numbers, a 5% move higher in Apple from current levels adds a level of market capitalization greater than all of the assets of the RSA! It will be very difficult to grow these large market cap ships from current levels. These market cap behemoths are aircraft carriers at this stage and probably should consider dramatically increasing their dividend yields to investors.

Exhibit 2: The Typical Maturing Business Cycle Dance

Here We Go,
Economy Good,
Rates Go Up,
Earnings Go Up,
Rates Go Up,
Economy Better,
Rates Go Up,
Economy Great,
Rates Go Up,
NEW ERA THINKING!
Yield Curve Inverts
No Problem!
Bear Market Starts
RECESSION
The End

Source: ISI

2) Trump sees the U.S. equity market as his scorecard

We think it is important to note that President Trump sees the U.S. equity market as somewhat of a scorecard for the success of his administration. While most past Presidents have eschewed themselves from attaching their success or failure to the market (for the obvious reasons that markets can oftentimes be bigger than any one person), President Trump (in a continuation of his non-traditional ways) has embraced the stock market success since his election.

While it is admittedly debatable, we see the President's focus on the stock market as a positive thing for investors on the margin as he will likely continue to do what is in his power to make market friendly decisions on the whole. This should be a positive for equity investors to have the President in their camp of higher market prices.

Exhibit 3: S&P 500 Performance Since Election of Trump

Source: Bloomberg

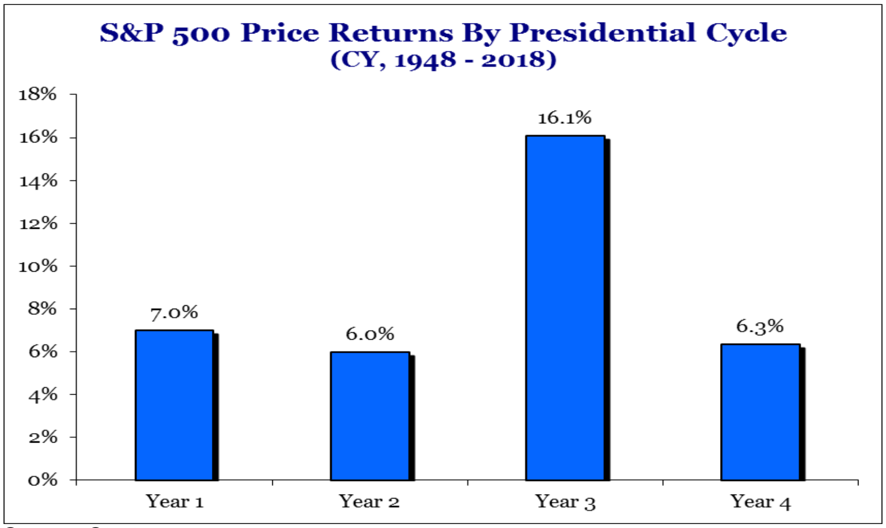
3) We are in the 3rd year of the presidential cycle with an incumbent President facing reelection

We think it is important to note that we are currently in the 3rd year of the presidential cycle as this year has historically produced the best gains in markets. The reason for this is incumbent Presidents facing reelection tend to push pro-growth measures to make sure things are going well for their reelection chances the following year.

An example is President Trump continuing to pound the Federal Reserve chairman on the lack of inflationary pressures and the need to cut rates 100 bps and continue the QE program of expanding the Federal Reserve balance sheet. Another example would be the pursuit of a bi-partisan $2 trillion national infrastructure package that all would agree is badly needed with the big question being how to pay for it?

We think investors should be careful about being too cautious on markets in this expanding and stimulative political environment.

Exhibit 4: Third Year Presidential Cycle Performance

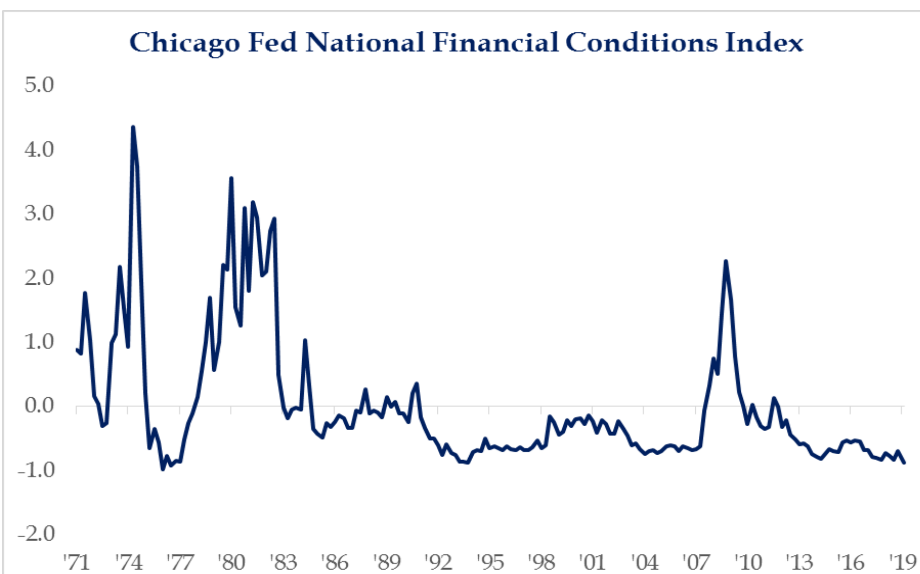


Source: Strategas

4) Credit conditions remain supportive of growth

Credit conditions are certainly one of the most important things to monitor in a maturing bull market as oftentimes they will send off a warning signal prior to any major correction in equity markets. At this point, credit conditions are still relatively loose and supportive of future market gains, but are worth monitoring closely moving forward.

Exhibit 5: Chicago Fed National Financial Conditions Index



Source: Strategas

5) We live in a technology driven world

Like it or not, we live in a technology driven world and that is likely to only increase moving forward. Technology is by far the largest and most important sector of the equity market and justifiably so as more and more profits are coming from the sector. In addition, the sector has allowed the market multiple to expand as tech companies have significantly higher returns on capital than the general market and thus command greater multiples of both current and projected earnings.

Exhibit 6: NASDAQ 100 Market Cap and Profits as a % of the S&P 500

Source: Bloomberg

Technology companies continue to be disruptors to current inefficient industries as well. An obvious example would be how Amazon has disrupted the retail landscape to the point at which indoor malls are now being turned into office space. Another example would be the effect of ride sharing services such as Uber and Lyft on the taxicab industry.

5G technology is coming in the communications equipment space as this will likely be a transformative change to speed and latency in the networks allowing for further technological disruption. 5G continues to be a focus for the current administration as far as staying ahead of other nations (mainly China) in the quest to rollout this technology.

6) Earnings are still growing

Equity returns basically come down to the level of earnings and the earnings multiple. If earnings are growing, this is a big positive for projected returns as the earnings multiple would have to compress to prevent positive returns so long as the expected growth come to fruition! As long as earnings are moving up, it becomes much more difficult for markets to go down. Markets go up 75% of the time and this percentage is even higher if earnings are moving up, so odds remain in favor of the bulls.

Exhibit 7: S&P 500 Forward Earnings Projections and Ratios

SPX Index | 96) Actions | 97) Settings | Consensus Overview

S&P 500 Index

Periodicity A | Flavor F12 | View Growth | Currency USD

Measure	Actual	F12 Est	Growth	Y+1 Est	Growth	Y+2 Est	Growth
1) Earnings Per Share	152.92	171.71	12.29%	185.12	7.81%	203.18	9.76%
2) EPS Positive	153.57	171.84	11.90%	185.21	7.78%	203.28	9.76%
3) Cash Flow Per Share	213.65	244.88	14.62%	258.97	5.76%	278.63	7.59%
4) Dividends Per Share	55.37	76.81	38.71%	62.01	-19.26%	65.22	5.17%
5) Book Value Per Share	855.81	914.39	6.85%	985.98	7.83%	1128.14	14.42%
6) Sales Per Share	1346.84	1426.77	5.93%	1463.08	2.54%	1527.05	4.37%
7) EBITDA Per Share	258.37	296.19	14.64%	312.29	5.44%	333.72	6.86%
8) Long Term Growth	0.00	8.53	0.00%	0.00	0.00%	0.00	0.00%
9) Net Debt Per Share	447.99	522.09	16.54%	485.79	-6.95%	342.76	-29.44%
10) Enterprise Value Per Share	3411.72	3502.47	2.66%	3465.87	-1.05%	3312.32	-4.43%

Valuation Measure	Actual	F12 Est	Y+1 Est	Y+2 Est
11) Price/EPS	18.84	16.78	15.57	14.18
12) Price/EPS Positive	18.76	16.77	15.56	14.17
13) Price/Cash Flow	13.49	11.77	11.13	10.34
14) Dividend Yield	1.92	2.67	2.15	2.26
15) Price/Book	3.37	3.15	2.92	2.55
16) Price/Sales	2.14	2.02	1.97	1.89
17) Price/EBITDA	11.15	9.73	9.23	8.63
18) EV/EBITDA	13.20	11.52	10.92	10.22
19) Net Debt/EBITDA	1.73	1.51	1.43	1.34

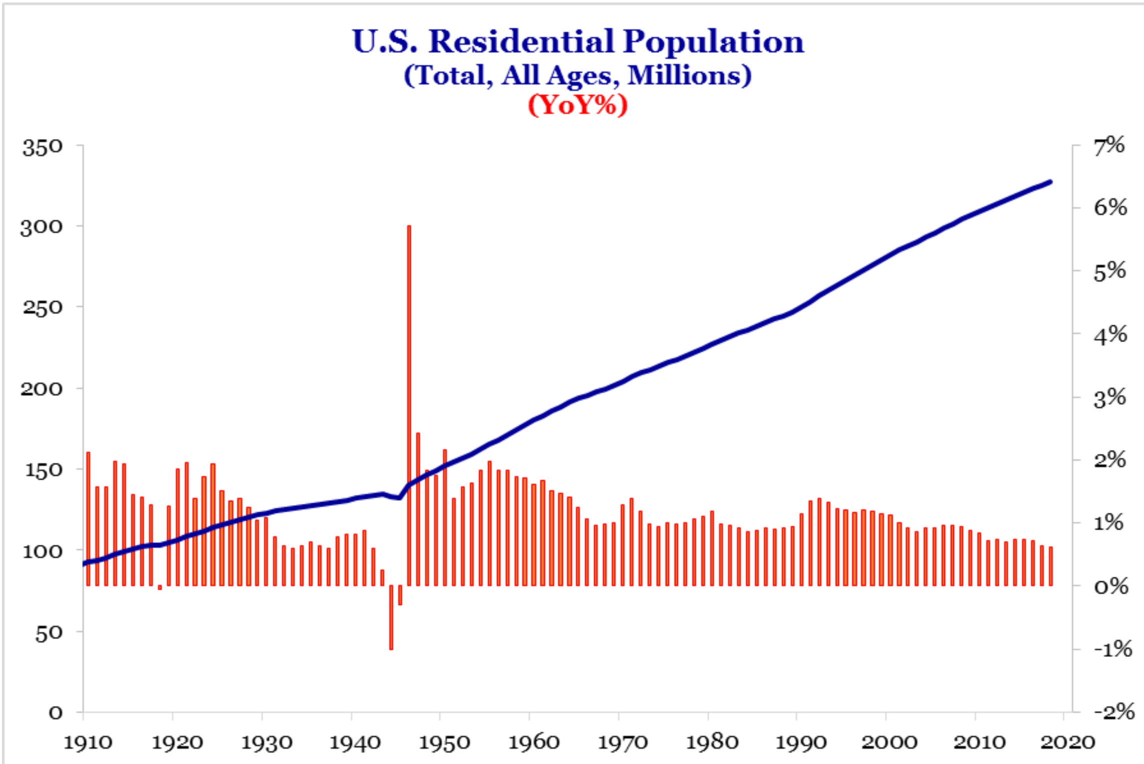
Source: Bloomberg

7) U.S. population continues to grow, but the growth rate continues to slow

General population growth is important for the continuation of both GDP and stock market growth. We don't need to look any further than Japan to see what the lack of population growth can do to equity markets over time. Importantly, the U.S. population has continued to grow and now stands at 327 million people.

There are some warning signs on this front though as the growth rate has slowed to an 80-year low of 0.62%. We have not had annual population growth exceed 1% since the year 2000.

Exhibit 8: Size and Growth Rate of U.S. Population Over Time



Source: Strategas

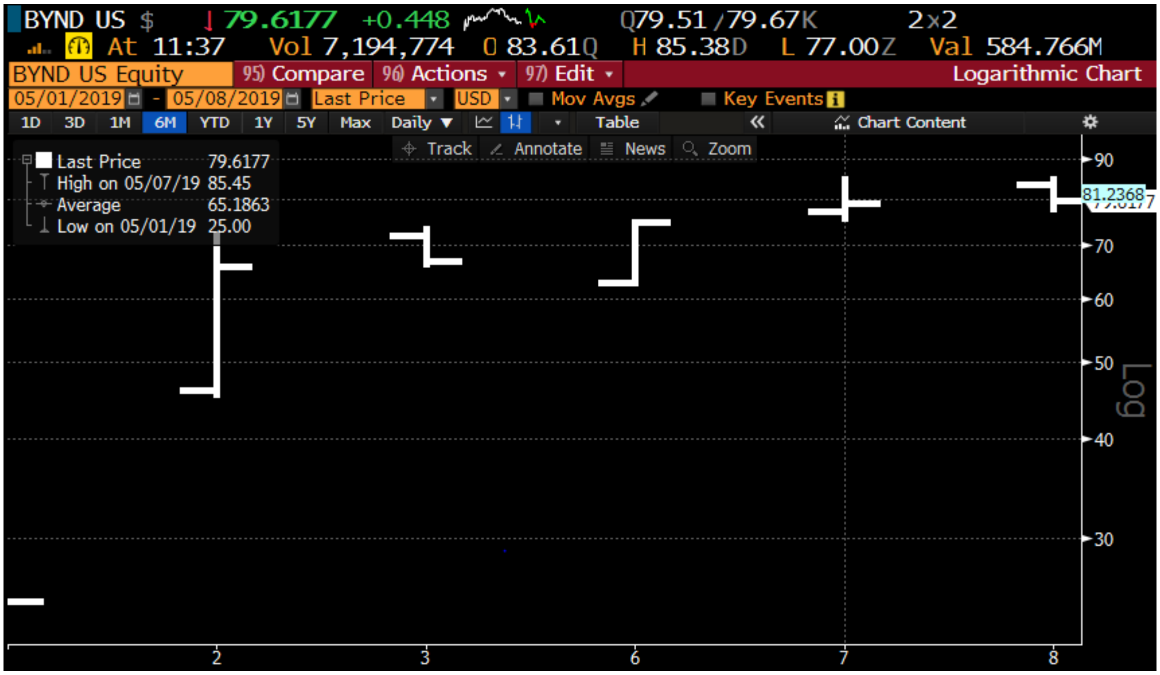
The growth rate within the U.S. continues to be a story as well as population is currently shifting away from high tax states which have been badly hit by the SALT deduction caps of the latest tax bill and toward states in the South and West which are more tax friendly. According to the Brookings Institute, among the 14 states which grew population last year, all except South Dakota were located in the South and West. On the downside, Illinois lost population for the 5th straight year.

8) Prominent private companies are now coming public through IPOs

When floods of new companies start accessing the public markets through IPOs, our radar as investors goes up as this activity tends to coincide with later stage bull markets. These companies obviously try to access the markets when conditions are favorable and valuations are elevated. This activity adds supply to the market for investors which can put a damper on market gains, but overall the deals have been reasonably well received to date by the current marketplace.

Beyond Meat, Uber, Lyft, Pinterest, Zoom are just a few of the recent companies to seek to access the public equity markets. We expect there to be more to follow in the coming months given these initial successes. Just this past week, 15 companies were scheduled to price including six biotech companies, a government contractor, an industrial engineering company, a Texas bank, a Russian job site and an office REIT.

Exhibit 9: Price Chart of Beyond Meat



Source: Bloomberg

9) A trade deal is likely priced into the market at current levels, but a meaningfully positive deal might not be

A big part of the recovery of the equity market in 2019 has been on the backs of hopes for a meaningful trade deal between the world's two largest economies, the United States and China. We have written often in the past about the great bull case for the world being a symbiotic rebalancing of the U.S. and Chinese economies, with the U.S. GDP composition moving less consumption based and more investment and savings based while the Chinese economy basically does the opposite thus unleashing the large potential spending power of the emerging middle class consumer in China.

President Trump and his administration seem to get this potential. Investors are simply waiting to see what a potential trade deal will look like, but the market action of companies which would stand to do well (large multinational companies) has been relatively favorable in 2019 to date.

10) There are some warning signs worth monitoring closely at this stage in the market and business cycle

The biggest risk to the marketplace will always be the unknown. What CNBC is talking about is likely already well understood by all the relevant marketplace participants. What we try to do as an investment team is monitor any warning signs which may pop up in the marketplace from the yield curve to credit conditions to stock action in relevant companies and sectors.

A few reasonable concerns are the general level of debt in society relative to GDP output (this debt includes everything from student loans to mortages to auto loans to credit cards to federal debt), the fact that charge offs recently hit a seven year high in the credit card industry and rose to 3.82% of all credit card debt in the first quarter of 2019, and something is not right with DB which is an important bank for the German and European economies (after the Lehman debacle domestically, we have our radar up for potential problems in the large money center banks!).

Exhibit 10: DB Chart

Source: Bloomberg

In addition to the above risks, there is the obvious risk that instead of moving toward a productive trade deal as the market has been anticipating, it is possible that trade talks break down and nothing positive materializes. This would likely not be in the best interest of the parties at the negotiating table, but is certainly a possibility.

Equity Strategy Moving Forward

We continue to think that we are in a maturing bull market that admittedly does have some risk associated with it. We continue to try to sift through what is short term noise and what is meaningful as we seek to better understand the current economic relationship between the world's two largest economies. Some certainty on the trade front should really go a long way toward confidence in the corporate board rooms of Fortune 500 companies operating on a global basis.

We continue to look for quality companies which have strong balance sheets and cash flows providing a margin of safety, look for attractive M&A candidates as the general backdrop for M&A of slow organic growth and low interest rates remains supportive of continued merger activity, and look for companies which are not as labor intensive as there is mounting pressure at the labor line with many companies raising their minimum wage threshold to $15/hour.

International Equity Strategy

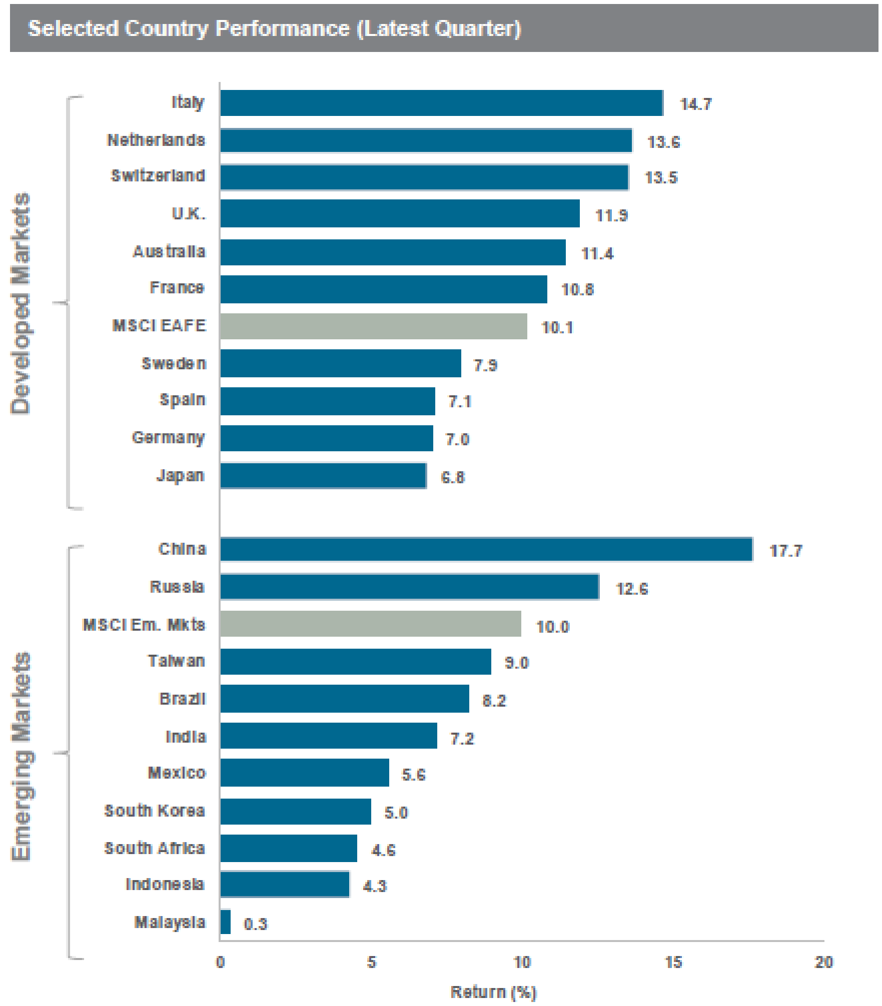
By Steve Lambdin

The first quarter of 2019 was a complete reversal of fortunes from the previous quarter as most major central banks made a surprise pivot and adopted a stimulative posture in an effort to combat a weakening growth outlook. Investors gave a roaring seal of approval of this message and pushed many markets significantly higher. This move was in the face of increased geopolitical risks of the China/U.S. trade negotiations as well as the continuing Brexit saga gripping the European region. The trade dispute between China and the U.S. continued to be the central issue facing most investors in the quarter. We saw a complete whipsaw of information flow surrounding these trade tensions. Just when we thought we were very near an agreement, things just seemed to fall apart via a tweet from President Trump. So at this point at the end of the quarter, no agreement has officially been reached and further tariff implementation seems to be closer to fruition. As for Brexit, a deal was not inked with the European Union (EU) by the late March deadline and a new timeframe for an agreement has been pushed out to early summer. We are still not very optimistic that an agreement will be reached by then, as both sides seem far apart. The key takeaway from the first quarter was the decelerating growth profile in most parts of the world as manufacturing data points look weak in spite of the aggressive accommodative measures implemented by the U.S. Fed, The European Central Bank (ECB), and the Back of China (BOC). This was a welcomed relief to most investors as equities were a popular destination for assets.

	March 2019		1Q 2019		YTD 2018	
Equity index returns (%)	U.S. dollar	Local currency	U.S. dollar	Local currency	U.S. dollar	Local currency
S&P 500	1.9	1.9	13.6	13.6	–4.4	–4.4
MSCI ACWI	1.3	1.6	12.2	12.3	–9.4	–7.7
MSCI ACWI ex USA	0.6	1.3	10.3	10.5	–14.2	–10.6
MSCI World	1.3	1.6	12.5	12.6	–8.7	–7.4
MSCI Emerging Markets IMI	0.9	1.4	9.7	9.6	–15.0	–10.5
MSCI EAFE	0.6	1.3	10.0	10.6	–13.8	–11.0
MSCI Europe	0.6	2.0	10.8	11.6	–14.9	–10.6
MSCI Pacific	0.7	0.3	8.5	9.0	–12.0	–11.7

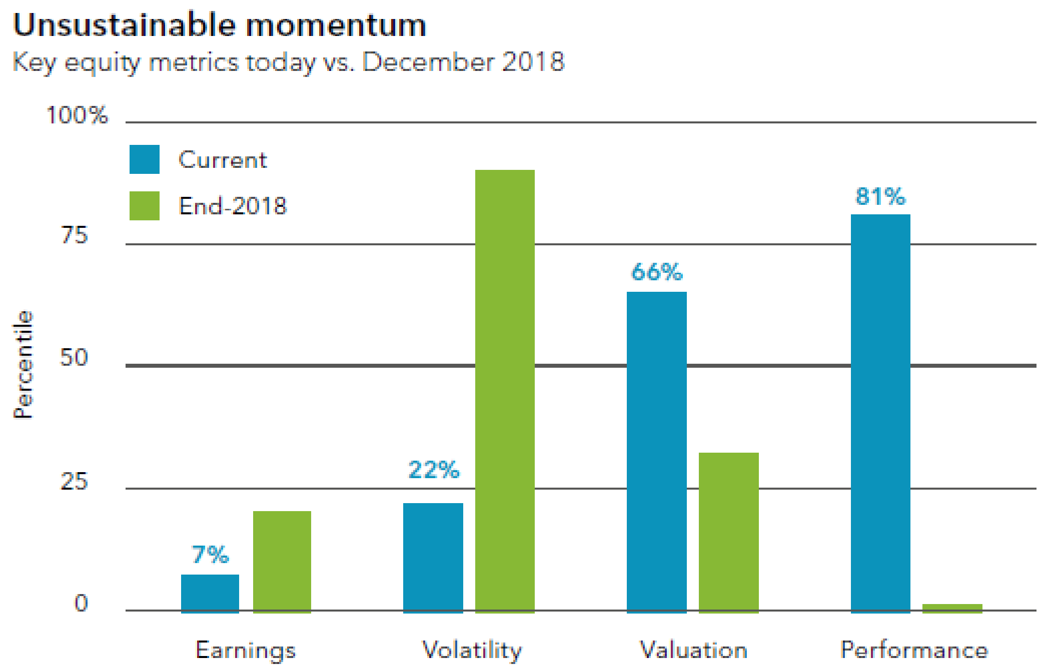
Source: RIMES and Capital Group World Markets Review Q1 2019

The MSCI EAFE Index (net dividend) and the MSCI Emerging Markets Index returned +10% and +9.9% respectively during the first quarter of 2019 vs. +13.6% for the S&P 500 Index. As with most widespread global "risk on" environments, U.S. stocks led the way. However, we saw very healthy gains in almost all regions around the globe. The U.S. dollar was just a tad stronger in the quarter, but again was not a major detractor from performance. The European region was a bit stronger than the Asian region as the U.K. equity market was quite strong and Japanese equities were not as strong as other Asian countries. All economic sectors posted positive returns, but Technology, Energy, and Industrials fared better as they are more cyclically oriented than most other sectors. Crude oil staged a nice rebound in the period, rising +32%, in a complete rebound from the previous quarter.



Sources: Baird Market Chart book; Morningstar Direct; MSCI

So far the second quarter of 2019 thru early May, global equities have been oscillating between being flat to slightly positive, depending on the daily news flow. Most of the daily news flow still surrounds trade rhetoric with China as well as the weakening global economy. We just don't have a good clue as to how far we are from a Chinese trade agreement at the moment. As for the global economy, we continue to see weak economic data points, mainly on the manufacturing side, as non-manufacturing readings seem to be holding up a bit better. The MSCI EAFE Index is up about +1% and the MSCI Emerging Markets Index is down approximately -1.1% through early May, vs. +1.8% for the S&P 500 Index. Clearly, investors still feel more comfortable holding U.S. stocks at the moment.

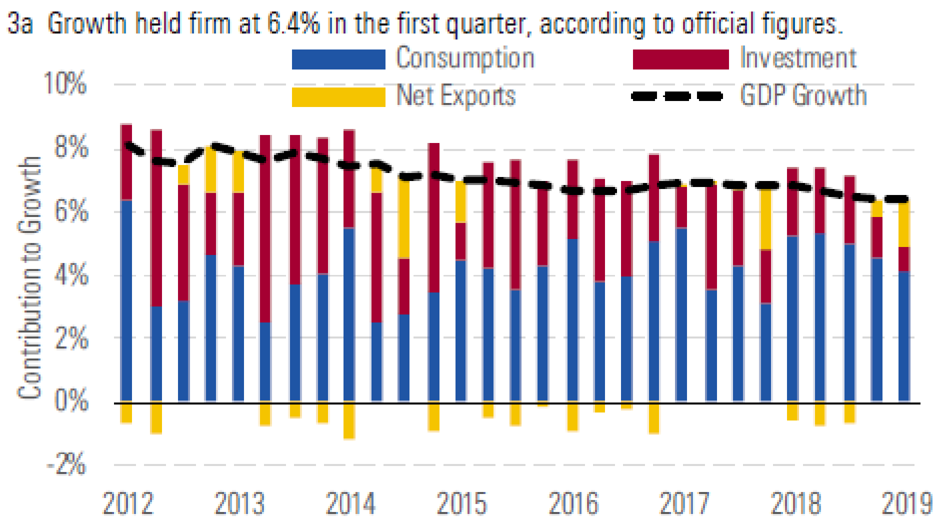


Sources: Blackrock Global Investment Outlook Q2 2019; Thomson Reuters; MSCI; CBOE

Asia Update

Equities in the Asian basin rebounded in the first quarter as the global "risk on" trade was alive and well in this region as investors embraced the pivot in the U.S. Fed's stance on future rate increases. This was in the face of a clearly slowing economy in Japan. The MSCI Pacific region rose +9% on the heels of very strong equity markets in Hong Kong, Australia, and New Zealand, while the Japanese equity lagged the overall Pacific region average. Overall, Japan's economic data points seemed weak and indicative of a slowing economy. Chinese equities were very strong on the hopes of a trade agreement with the U.S., rising nearly +18% in the period.

China's economic growth managed to break the recent pattern of weakening growth as first quarter GDP rose +6.4% from a year earlier, which was flat from the previous quarter. This is one of the first signs of stabilization in this region in some time and a reversal from economic readings in January. This was a key blow to President Trump's trade negotiations as he was touting a Chinese slowdown in the first quarter. This could present a slight twist to trade talks going forward, but probably not to a great degree. This quarter's growth will probably solidify growth in this economy of at least +6% for all of 2019, especially as new stimulus measures kick in over the next few months. This will probably put a bit of a temporary halt to China's efforts to deleverage as credit growth looks to rebound. Surveying a few of the key economic data points from the quarter, industrial production rose +6.5% in the first quarter on the heels of a strong March report, which saw better than expected auto production. Fixed asset growth managed to meet expectations as first quarter growth came in at +6.3%, a slight acceleration from early 2019 levels. Net exports were surprisingly strong, as March rose +21% in U.S. dollar terms, as strength was seen in manufacturing exports as well as falling oil prices which curtailed growth in the import bill. This was a surprise in the face of tariffs imposed last October by the U.S. Retail sales growth remained very steady as first quarter sales were up +8.3% from a year earlier, which was in-line with the previous quarter. CPI rose a bit more than expected as March CPI rose +2.3% from a year earlier, as food inflation picked up from higher meat prices. We would not be surprised to see a cut in the required reserve ratio (RRR) by monetary policy leaders in an effort to keep stimulus measures pumping through the economy during the current trade negotiations with the U.S. No doubt, this will be the focal point for most global investors over the coming weeks and months and this could easily set the direction for global equities during this timeframe.



Sources: Morningstar

Even though we won't see Japan's first quarter GDP release until later in May, we do expect a weak reading. We see the economy here posting slower growth from the previous quarter as we have not seen two consecutive quarters of growth in this economy in almost two years. Exports fell in March for the fourth consecutive month as a weakening global demand picture is weighing heavily here. Most of the damage is from trade with China and Europe. As a result, industrial production remained in a slump as March production fell -.9% from the previous month. Many see this as somewhat temporary and see this key statistic rebounding at some point in the second quarter. We are not too sure of this as trade issues continue to persist between the U.S. and China in addition to fresh talks between Japan and the U.S. Japan's leading economic index continued to languish in the quarter as February's reading of 97.4 still remains near the weakest reading in a few years and is a real problem for the economy here. The Bank of Japan (BOJ) kept its short term rate at -.10% and is still targeting a 10-year government bond target yield at 0% at its April meeting. The BOJ monetary policy should remain very easy over the next several months, which is nothing new.

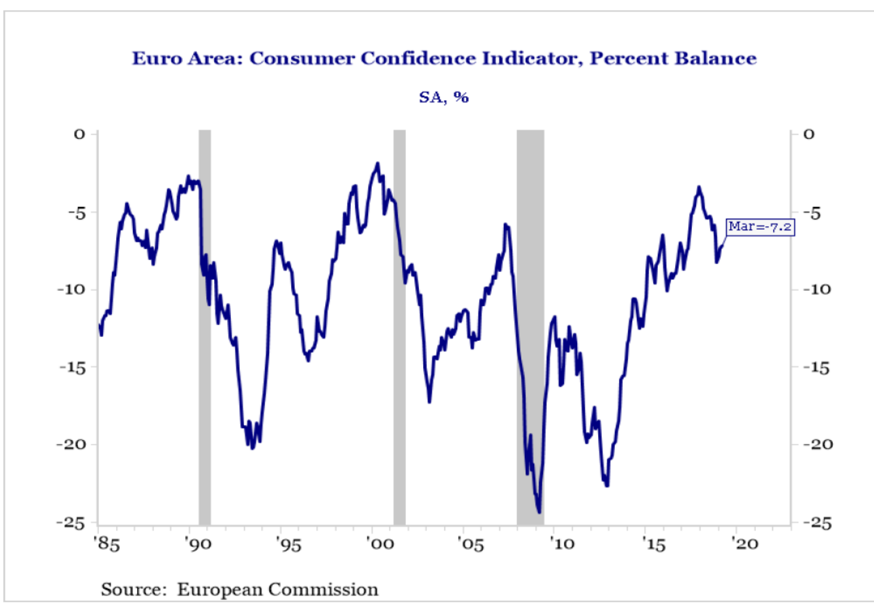
Consumer confidence continued to spiral downward as March's reading fell to 40.5, which is a three year low in this statistic. We need to see this pick up from these levels to get more positive on the outlook here. The labor market remains very tight as the jobless rate inched up very slightly to 2.5% in March, while the jobs-to-applicant ratio stayed at 1.63, very near a historical record. Trends in employment statistics here are like what we see in other developed markets around the globe. Economic prospects remain very challenging at best. This will probably remain so until we get some type of resolution on trade agreements between the U.S. and China as well as the U.S. and Japan. In addition, the proposed increase in the value added tax (VAT) scheduled for October is certainly not helping. We probably need to see additional stimulus measures before and after this increase. We see this as the key wildcard for this region over the near term.

Sources: Evercore ISI

Europe Update

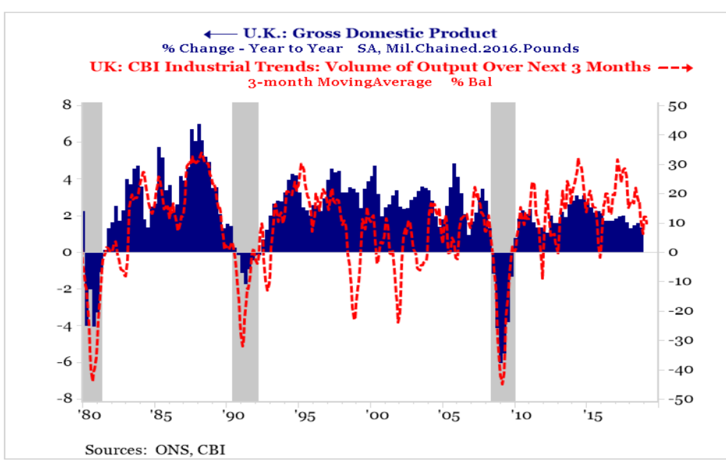
European stocks shook off signs of a slowing economic climate and failed Brexit deadlines to stage quite a rebound in conjunction with the rest of the world in the first quarter of 2019. The ECB provided the bulk of good news for investors as they announced a stimulus program aimed at a weakening economic backdrop. They vowed to maintain negative interest rates through the end of the year and provide cheap loans to the banking system in an effort to encourage more lending by the banks. Stocks and bonds both soared on the news. Cyclically oriented sectors were the best performers in the period as they stand to benefit the most in such a scenario. Ten-year bond yields plummeted on the news as well. The MSCI European Index (ex. U.K.) rose +10.5% in the quarter as all sectors moved higher in the period. The Italian and Dutch equity markets were particularly strong as they rebounded nicely from the depths of the previous quarter.

The European economy continued to limp along at a slow pace of growth as first quarter GDP only rose by +.4% from the previous quarter, or +1.2% from the year earlier period. This was a slight uptick in growth from the fourth quarter. The Italian economy was able to shake off negative growth in the previous quarter and the Spanish economy surprised to the upside. However, the Eurozone economy still remains very weak with little change expected over the next few months. Eurozone industrial production held its own in February as it fell -.2% from a month earlier, or -.3% from a year earlier. This was actually a bit better than expected and probably helped GDP to be not as bad as feared in the period. The index of executive and consumer sentiment continued to move downward as it fell to 104.0 in April, which was the lowest levels in nearly three years. Businesses are increasingly more pessimistic about production expectations and order books thus far into the year. This is especially so in Germany's key automobile sector. Retail sales staged a small rebound in the quarter as first quarter sales were up +2.3% from a year earlier. However, the trend in sales weakened throughout the period as March was the weakest month in the period. This does not set up well to start the second quarter. Core CPI was reported to be up +.8% in March from the year earlier, still indicating very little inflation in the economy. The ECB continued to cut its growth forecast as it made its fifth cut to expected 2019 growth in the period and we see little to no chance of any interest rates hikes all the way out to early 2020. We believe this has been communicated well by the ECB. Things continue to improve on the employment front as the March unemployment rate fell to 7.7%, which is another fresh new low since the great recession. This is one of the few good economic data points in this region. Nothing has really changed in our view of the Eurozone economy over the last couple of months as we still see the region as very weak and fragile at the moment. Perhaps once trade deals can get done, coupled with some type of resolution on Brexit, then investors could become more positive on the economy here. This will probably be an environment where it will be hard for equities to perform well in.



Source: Strategas; EU Commission

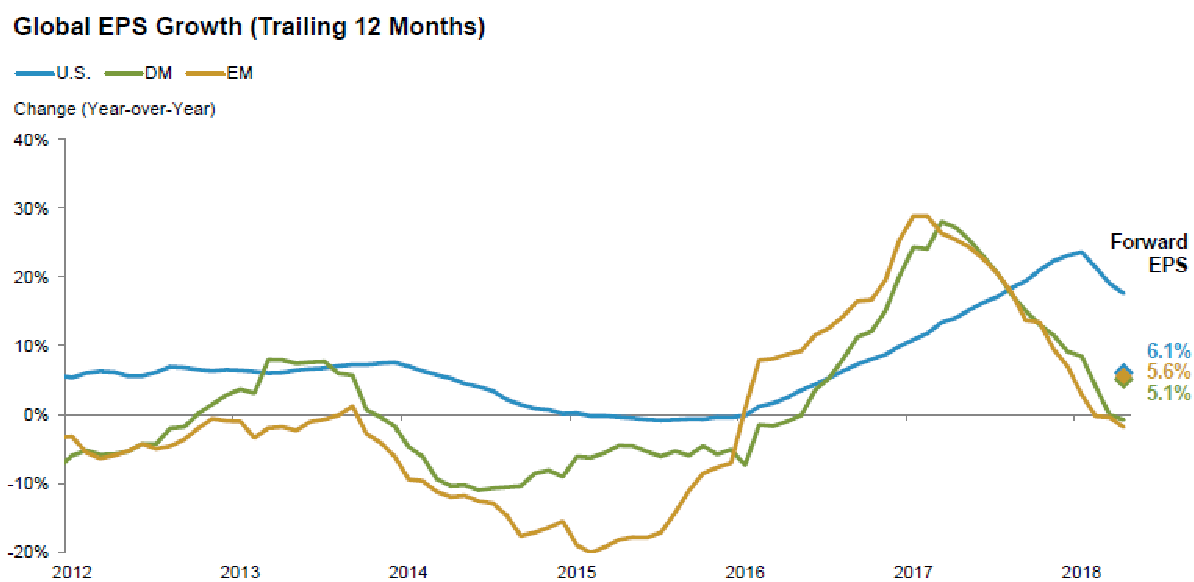
Brexit negotiations continue to be the main event in the U.K. at the moment. Theresa May's plan was defeated in the British Parliament on March 29 and has forced lawmakers to come up with other measures for a solution. May is rushing to come up with a solution for the political deadlock by May 23, before the European elections. We still are not very optimistic that a solution will be reached by and believe a new deadline will be pushed out. Investors will remain watchful for developments on this front in the coming weeks. Even in the face of these Brexit perils, The MSCI U.K. Index returned +12.3% in the first quarter on a U.S. dollar basis and was the best performing major region in the MSCI EAFE Index. This was a pleasant surprise as most investors didn't see this coming. For the most part, the economy here still looks to be in slow growth mode. Even though official first quarter GDP will not be released until later in May, most expect the economy to grow around +.5% from the previous period, or +1.8% from the year earlier period. It's hard to see much better than this in the current environment. Industrial production rebounded somewhat in early 2019 as January and February posted monthly growth of +.7% and .6% respectively, after five straight months of decline to end 2018. This was encouraging on the margin. Retail sales also pointed higher in early 2019 as March sales rose +1.2% from the previous month. We have seen three straight months of gains in retail sales to start the year. Core CPI remains about where it has been for several months as March's reading of +1.8% from a year earlier still remains well below the official Bank of England (BOE) targeted rate. At its recent early May meeting, the Monetary Policy Committee (MPC) voted to maintain its benchmark interest rate at .75%, while maintaining its bond purchase target of 435 billion pounds, including 10 billion in corporate bonds. As we see in other parts of the world, there is just no need to raise interest rates over the near term as the global economy seems to be slowing down on the margin. The first quarter unemployment rate looks to have fallen to another multi-decade low of 3.9%. Employment increased by another 179,000 workers in the quarter with ending employment at yet another new record of 32.7 million workers. Wage growth has remained steady lately as wages grew by +3.4% in the three month period ending in February. Overall, the employment situation looks very steady.



Sources: Strategas; ONS; CBI

Emerging Markets

Emerging market equities were strong in the first quarter as Chinese equities staged a nice rebound, rising nearly +18% as economic readings were better than many feared, additional government stimulus actions surprised many, and prospects for a trade agreement with the U.S kept investors interested. Outside of China, Russian and Indian equities were strong as news flow from these countries was well received by investors. Overall, the MSCI Emerging Markets Index rose +10% in the quarter, which surprised us a bit when considering many of the issues facing these countries. We expect these equities to be volatile over the next few months as trade negotiations between China and the U.S. will bring on heightened risks. Also, earnings growth expectations have been coming down, which we find concerning going forward.



Sources: Fidelity Market Update Q1 2019

International Equity Activity/Strategy

Looking out into the next few months, we see the same issues still facing investors now as just a few months back. The trade war with China still has no resolution while many measures in the global economy are slowing down a bit and look somewhat exhausted. However, we now have another round of stimulative central bank actions looking to come save the day. How all of this pans out is almost anyone's guess. But we do believe if we can get some type of positive trade agreement with China, this could bring some comfort to investors and continue to usher in a period where equities can continue to do well. We also still see a recession as a ways off, but do recognize we could be getting closer by each passing quarter. Any decline in U.S. or global growth expectations could spell trouble for equity investors. Progress on Brexit will probably be painfully slow as well, which could handicap the European economy until some resolution comes into play. Perhaps we will know more as the summer progresses. With these issues in mind, we expect nearly all central banks to be very patient in an effort not to disrupt or derail the global economy. These are powerful allies to have on your side in the current environment.

We continue to remain active with our put writing on EEM since our last update and expect to continue to be going forward in an effort to bring in some current income and add further to this asset class after an extended period of under-performance lasting several years. Premiums for doing this strategy still look attractive in the current low interest rate environment. Our current allocation to Emerging Market equities is approximately 2.7% of total assets and approximately 10.4% for MSCI EAFE equities across our TRS, ERS, and JRF portfolios. *(Credit is given to the following entities for charts provided: EU Commission, Thomson Reuters, CBOE, MSCI, Capital Group, RIMES, DataInsight, China NBS, Capital Economics, Bank Of England, Bloomberg, Blackrock, Strategas, ONS, CBI, Markit, Baird Market Chartbook, Fidelity Investments (AART), ISM, IMF, Baird Market Update, MSCI, Factset, Evercore ISI, John Hancock Global Market Outlook, China National Bureau of Statistics, and Morningstar Direct)*