Winslow, Evans & Crocker, Inc.[SM]

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GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

GLOBAL ECONOMICS

Douglas E. White, CFA
Chief Investment Officer
Executive Vice President
(617) 896-3518
dwhite@e-winslow.com

Rand Folta, CFA
Executive Vice President
(617) 896-3590
rfolta@e-winslow.com

INSTITUTIONAL TRADING

Fixed Income

Nomi Caperton
Managing Director
(617) 896-3526
ncaperton@e-winslow.com

David Strimaitis
Managing Director
(617) 896-3577
dstrimaitis@e-winslow.com

Equity

John Bridges
Managing Director
(617) 896-3524
jbridges@e-winslow.com

SETTLEMENT AND TRADING

OASYS: WYNS
MPID: WYNS
DTC: 0443
Clearing: Pershing, LLC.

SETTLEMENT AND TRADING

OASYS: WUAW
DTC: 0725
Clearing: Raymond James & Associates, Inc.

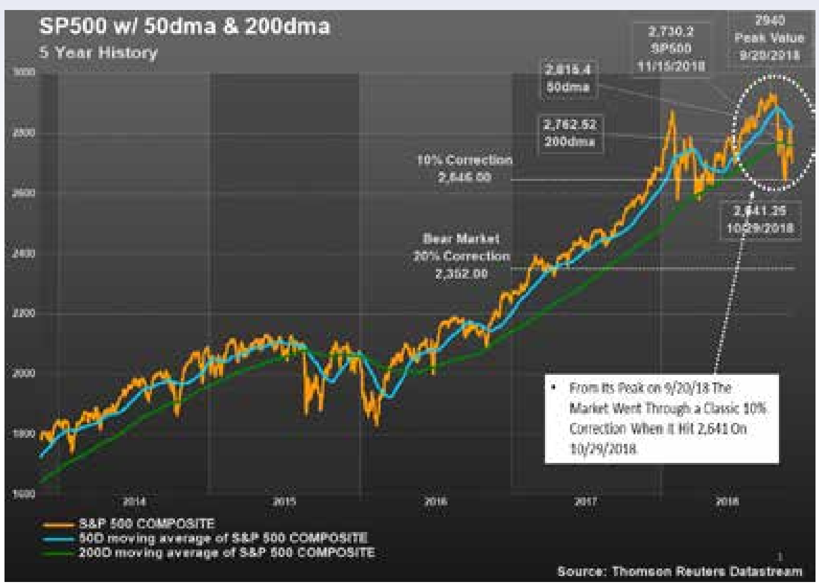
WINSLOW, EVANS & CROCKER

175 Federal Street, 6th Floor
Boston, MA 02110
Phone: (617) 896-3500
Member: FINRA/SIPC

Is The Equity Market Signaling An Impending Recession?

From late September to the end of October the S&P500 fell 10% from its peak value of 2,940 to 2,641 as shown in Chart #1. This is a classic correction in what we still believe to be an upwardly trending market. Corrections like this are often caused by issues that give rise to worries of an impending recession. Trade wars, slowing global growth, China, a strengthening US$ and rising interest rates are amongst some of the major issues pushing up market volatility.

1

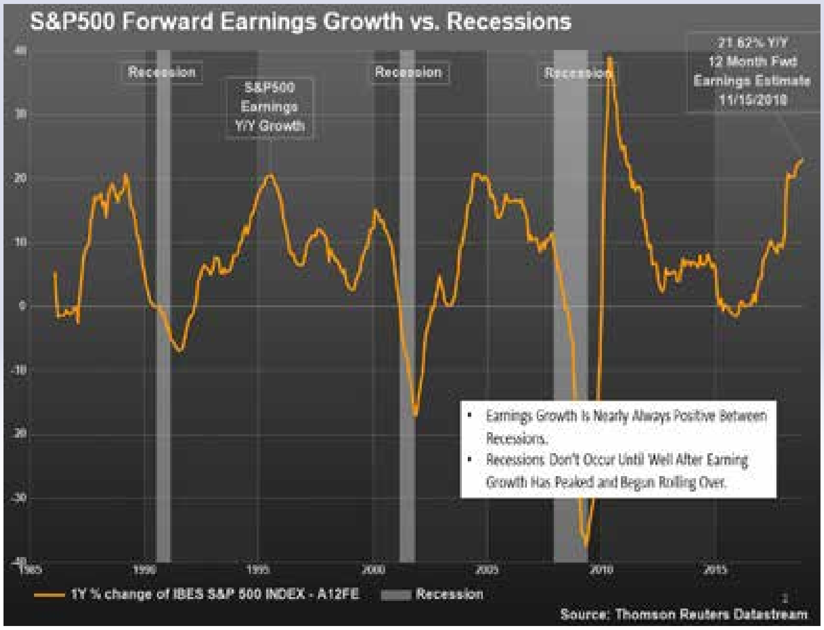


CHARTS 2-3

The major cause for the onset of a bear market, however, is an impending recession. Until that time, corporate earnings growth is almost always positive, as shown in Chart #2, and thus supportive of equities. In fact, earnings growth will typically peak well before the beginning of a recession. Knowing when the next recession will occur is therefore critical for avoiding an equity bear market.

Although it is impossible to know with certainty the timing of the next recession there are several critical indicators that, based on past performance, give us comfort that one is not imminent. One that we watch closely is the real, after inflation, effective Fed funds rate. Rising interest rate fears, as mentioned above, is one of the major factors causing the recent elevated volatility of the markets. In Chart #3 we can see that at current levels this rate is well below levels that have triggered past recessions.

2



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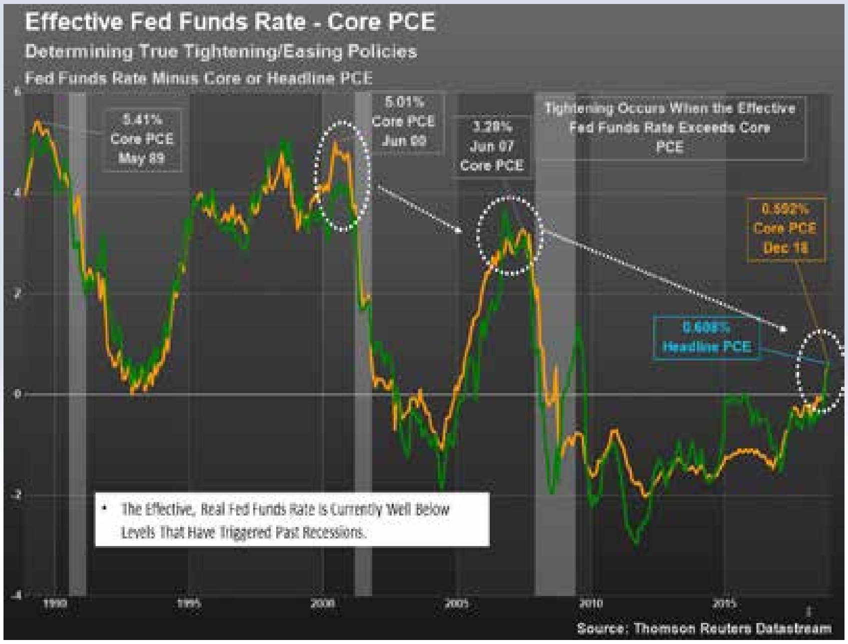

CHARTS 4-6

In addition to fears over rising interest rates there are concerns that our trade conflicts with Europe and, in particular China, will lead a slowdown in the US economy. Chart #4 clearly demonstrates the relationship between the elevated trade uncertainty index and the recent rise in market volatility. The leading economic indicators from the US Conference Board, however, give no indication that a recession is imminent, Chart #5. In this chart it is clear that the six month rate of change of this indicator has gone deeply negative prior to the past three recessions but remains well in positive territory today. In fact, one could make the argument that the recent correction in the market has significantly overshot changes in economic indicators. In Chart #6 you can see that the Institute for Supply Management Index(ISM), the gold line, has fallen modestly from its July peak of 61.3 and yet the stock market has rotated very aggressively into defensive stocks as indicated by the falling blue line. This rotation appears overdone given the minor decline in the ISM index, currently at 57.7, remains well in expansion territory above the 50 level.

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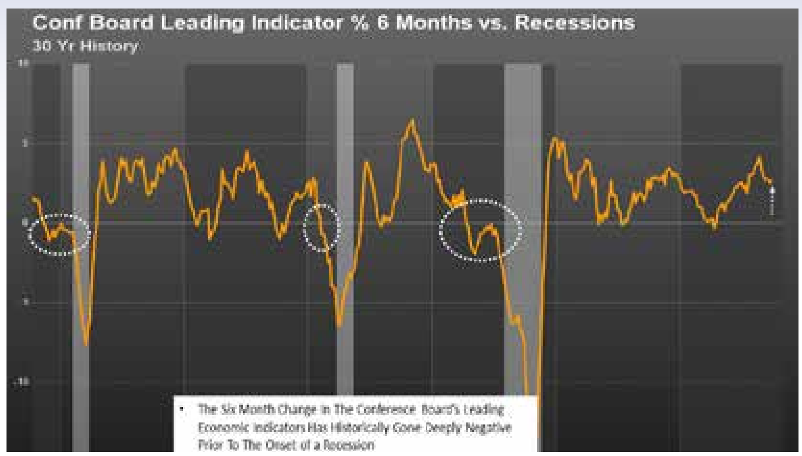

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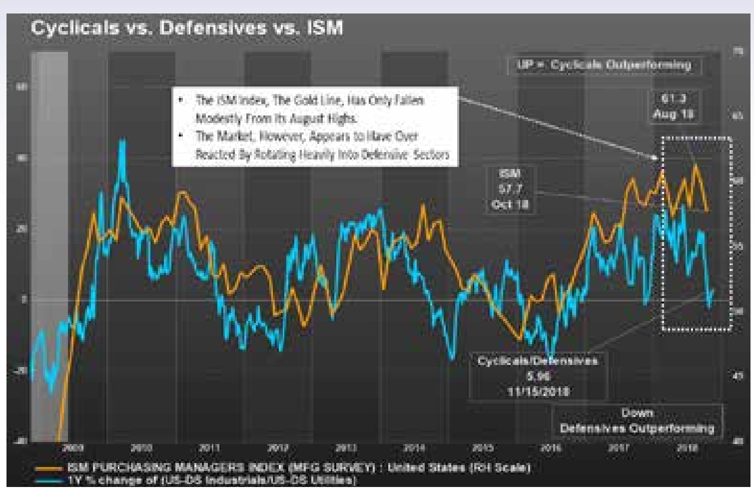

CHART 7-8

We also watch inflation closely as an indicator of what the Federal Reserve might do with the level and pace of interest rate increases. So far the US has been in a “Goldilocks” environment because of the surprisingly modest increase in inflation given that the labor markets and economy are so strong, Chart #7. Also, as shown in Chart #8, the leading indicators of inflation have been essentially flat for most of 2018.

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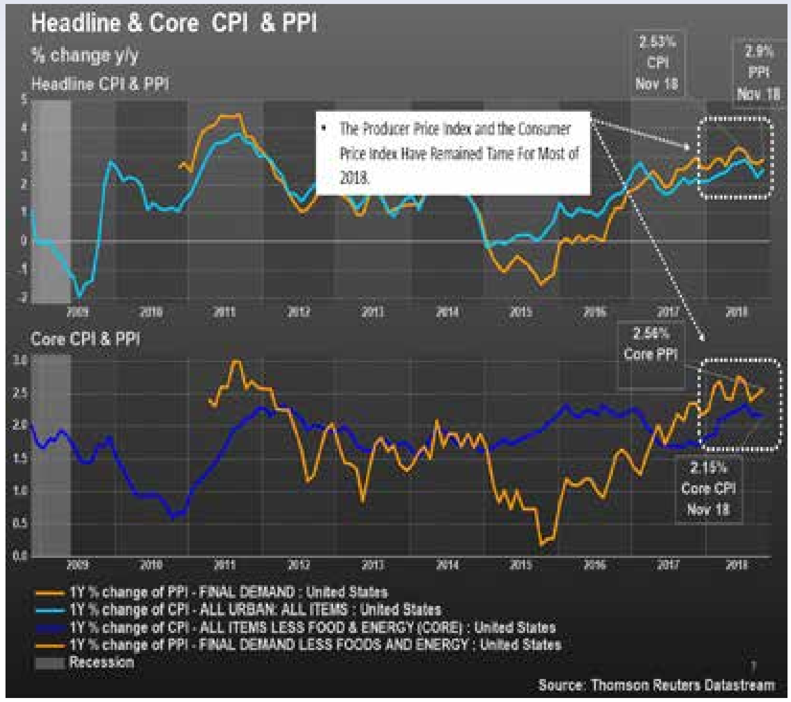

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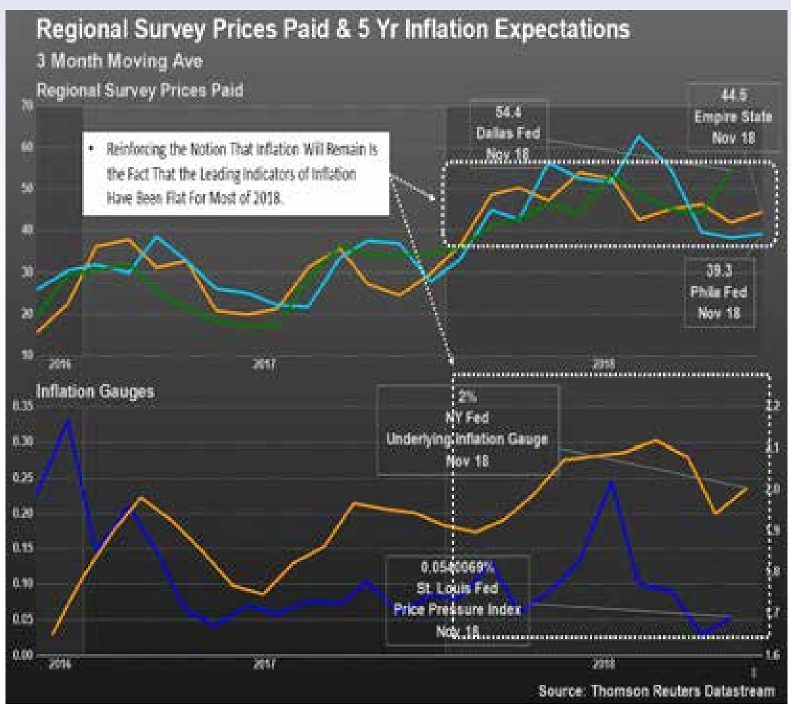

CHART 9

Although the next recession for the US economy appears to be at least a few years away there are some storm clouds that present a more immediate threat to corporate earnings. The first and most important is the slowing in global economic growth as indicated by the declining leading indicators shown on Chart #9. Clearly, the initiation of tariffs and the threat of further trade wars have been a major contributing factor. This is a concern that has been voiced by many CEO's of international companies during their third quarter earnings reports. Additionally, the trade weighted US $ has been rising this year which is also causing concern for US companies with large exporting businesses. If the central banks of Europe and Asia begin to ease monetary policy to boost domestic economic growth it will further strengthen the US $ which may lead to further trade tensions.

In summary, we see that the US economy remains well removed from a recession but will likely experience more modest growth caused by the headwinds of slowing global growth and a strengthening dollar.

Please see your investment advisor if you would like to discuss how these comments may impact your portfolio.

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