Winslow, Evans & Crocker, Inc.[SM]

MARCH 2019

GLOBAL ECONOMICS & CAPITAL MARKET COMMENTARY

GLOBAL ECONOMICS
Douglas E. White, CFA
Chief Investment Office
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

BEAR MARKET INDICATOR CHECKLIST

Last November we created a checklist of key data points that give us an indication of the likelihood that we are approaching a bear market. This list looks for signs of an approaching recession, pressure on corporate earnings, inflation pressure that would trigger Fed tightening and signs that the market has become unsustainably euphoric. Periodically reviewing this checklist is a process that helps keep us from falling into an analytical rut as well as helping us to spot inflection points in the economic cycle. Our current review of this list, some elements of which we discuss below, leaves us in the camp that we are not approaching a bear market in equities.

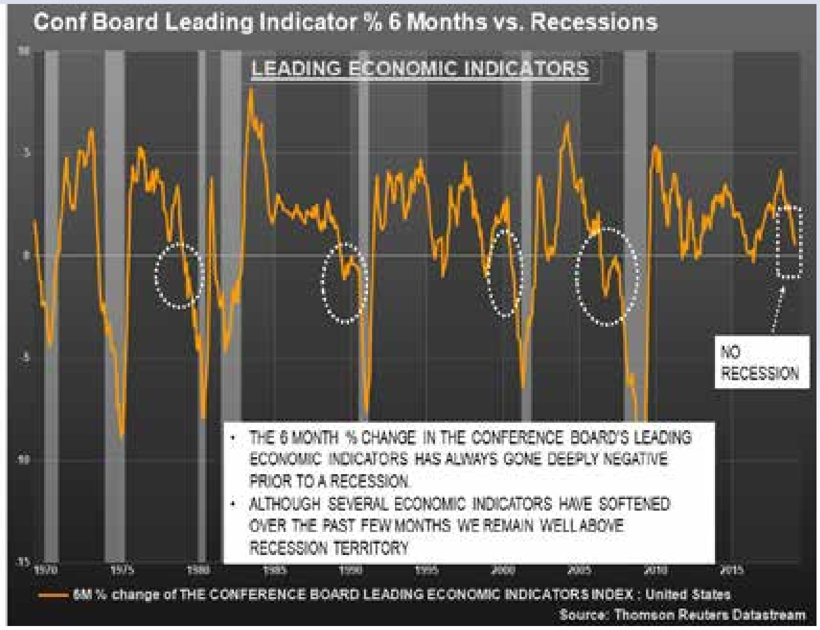
Recession Indicators

In our prior monthly reports we have emphasized that we see no evidence that a recession is imminent. This is important because, historically, the equity markets have peaked roughly six months prior to the start of a recession. Also, corporate earnings growth is almost always positive between recessions and therefore supportive of equities.

CHARTS 1-2

In Chart #1 we show the six month percent change in the Leading Economic Indicators put out by the Conference Board. The circled areas are points at which this indicator has gone deeply negative prior to the onset of a recession. At the current level, shown in the square box, this indicator remains positive despite the weakening in some economic data over the past two months. Another early signal of an impending recession resides in the initial unemployment claims. As shown in Chart #2 the bottoming of claims has historically preceded a recession. The most recent figures, however, have likely been distorted by the government shutdown and winter weather.

1



2

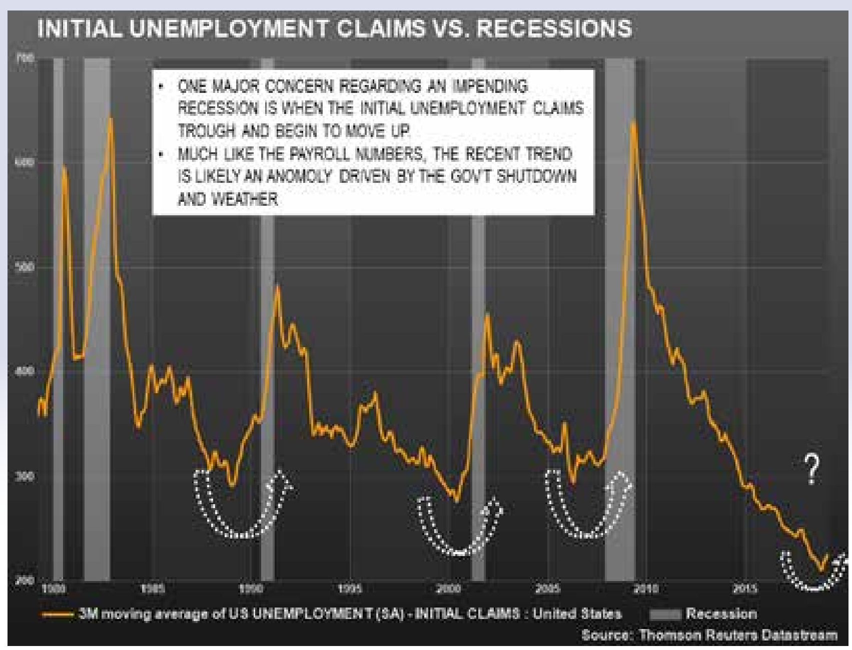
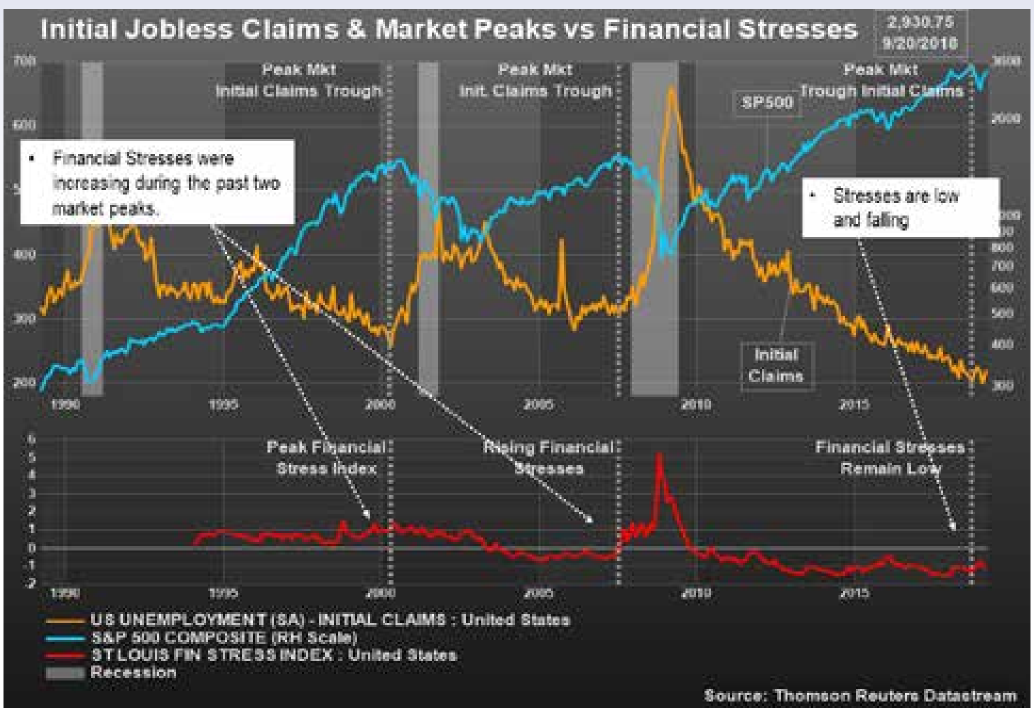


CHART 3

In Chart #3 we further examine these initial unemployment claims in the context of financial stresses during past periods as well as market peaks. In the bottom half of the chart is the St. Louis Fed financial stress index. This index, when positive and rising, indicates that financial conditions are becoming very tight within the economy and, conversely, when the index is negative and falling it is indicative of easy financial conditions. The top half of the chart has the initial unemployment claims line in gold and the S&P500 equity index in blue. The vertical dashed white lines have been placed at market peaks. In the prior two recessions it is clear that the market peaked as initial claims troughed AND as financial conditions in the economy were becoming much tighter. The third and last line is positioned at the most recent market peak which occurred September 20th 2018. Notice that the financial stresses were negative, i.e., easy at the time and as of this writing have become even easier. This is bullish for both the economy and the markets and leads us to the conclusion that the currently low unemployment claims are not signaling the onset of a recession.

3

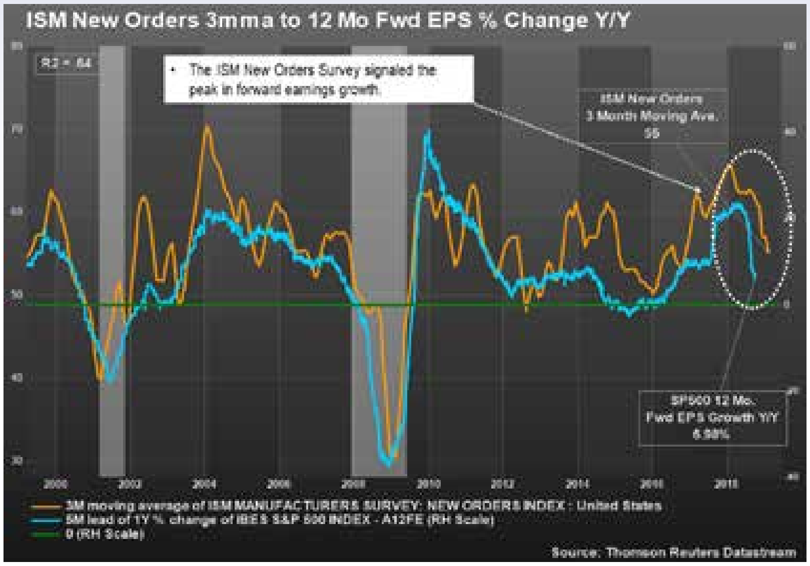


CHARTS 4-5

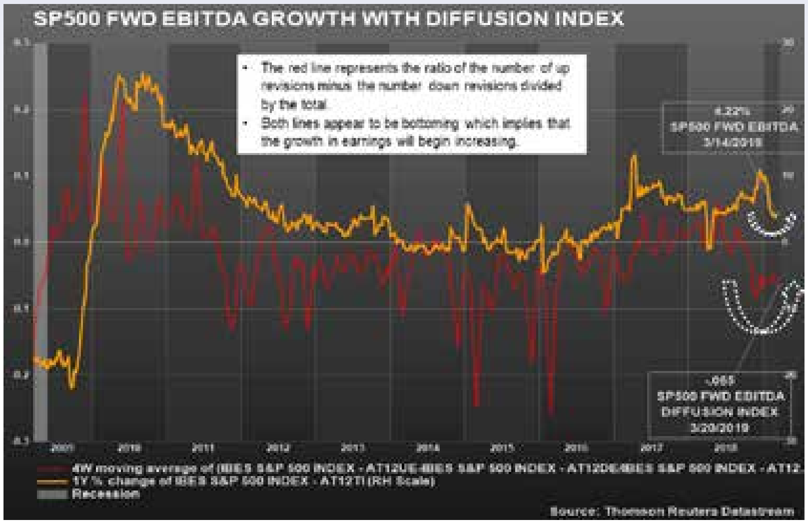
Pressure On Corporate Earnings

Having concluded that a bear market inducing recession is not imminent, we turn to other lead indicators that will give us some sense of future earnings growth. There is a very strong correlation between expected earnings growth and the New Orders component of the Institute for Supply Management's monthly survey shown in Chart #4. This indicator peaked in early 2018 as did the forecasted growth rate of corporate earnings. Although this was a likely contributor to the market correction in late 2018, the decline in earnings growth had been anticipated by most economists because of the one-off benefit from the lowering of corporate taxes. It is important to note, however, that the ISM New Orders number remains above 50, which indicates that new orders are still expanding. Although the earnings estimate growth rate has dropped significantly, it has stabilized. By examining EBITDA (earnings before interest, taxes, depreciation and amortization), we can eliminate the distortion created by the tax change. Chart #5 shows the expected growth in EBITDA and, as represented by the red line, the trend in estimate changes. Both of these indicate that the trend has very likely bottomed. Earnings have not collapsed.

4



5

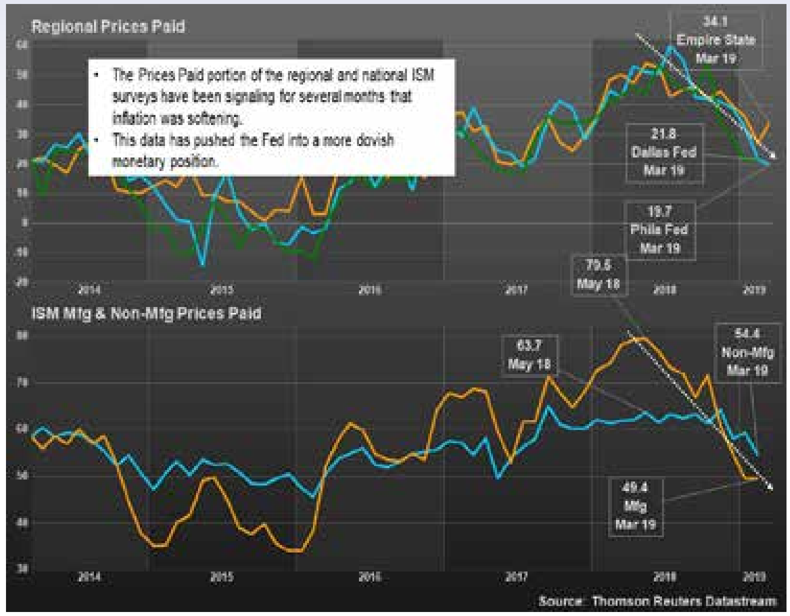


CHARTS 6-7

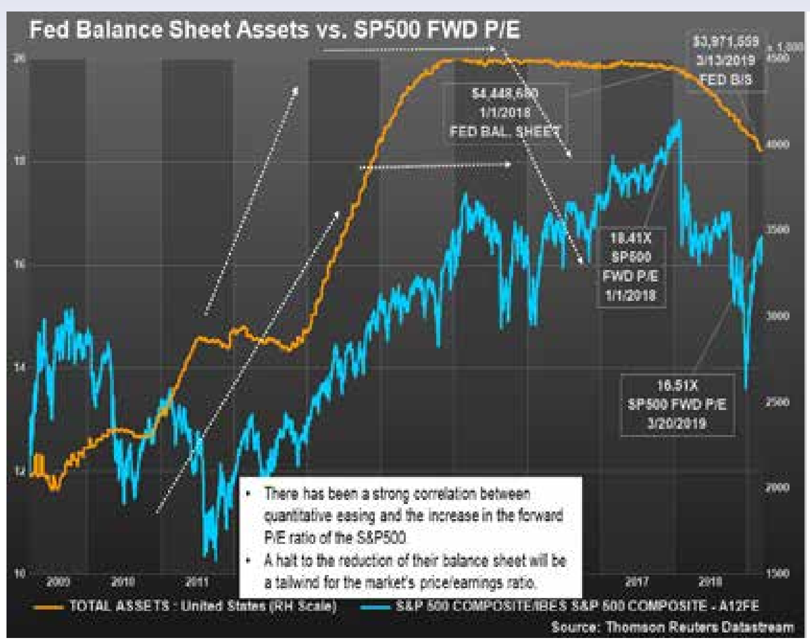
Inflation Pressure

Rapidly rising inflation would put the Federal Reserve in the position of having to raise interest rates and tighten money supply. All of our leading indicators have been signaling that inflation is softening, Chart #6. As we now know from Chairman Powell's speech on the 20th of March the Fed has also concluded that inflation is quiescent and announced that they will not be raising rates for the balance of 2019 and may only do so once in 2020. Additionally they announced that they would slow the drawdown of their balance sheet, Chart #7. Both of these actions are beneficial to equities.

6



7

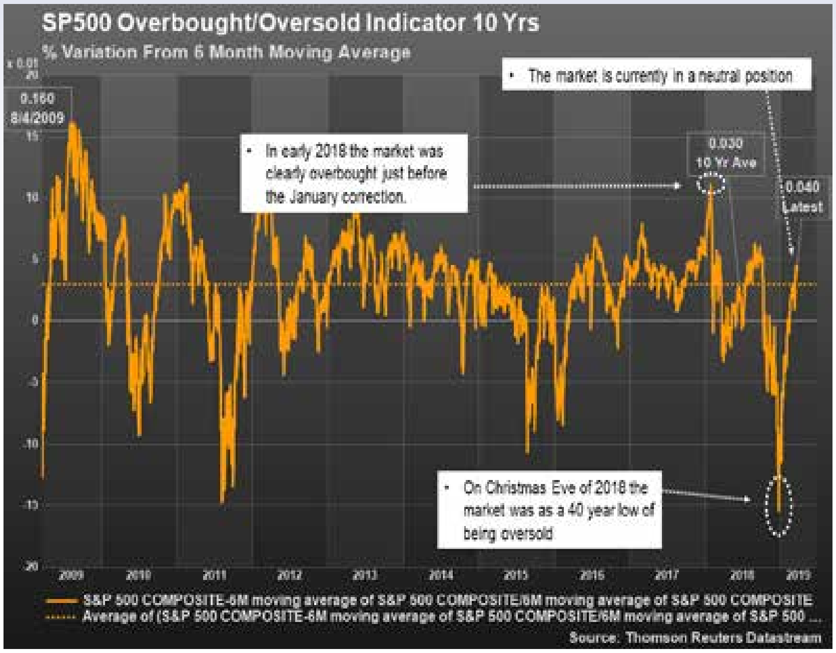


CHARTS 8-9

Excessive Market Euphoria

There are several indicators that we examine to determine if the market has become excessively exuberant. The first is the overbought/oversold index shown on Chart #8. This chart clearly shows that the market is in a neutral position but also clearly indicates the extreme overbought and oversold conditions that have occurred since early 2018 which led to major market reversals. Another useful indicator is the market's volatility adjusted forward price/earnings ratio shown in Chart #9. This indicator is calculated by dividing the market's forward P/E ratio by the daily volatility indicator known as the VIX. Once again, this chart illustrates that the market is currently just above neutral territory. This indicator also confirms the prior two extreme overbought and oversold conditions illustrated by Chart #8.

8



9

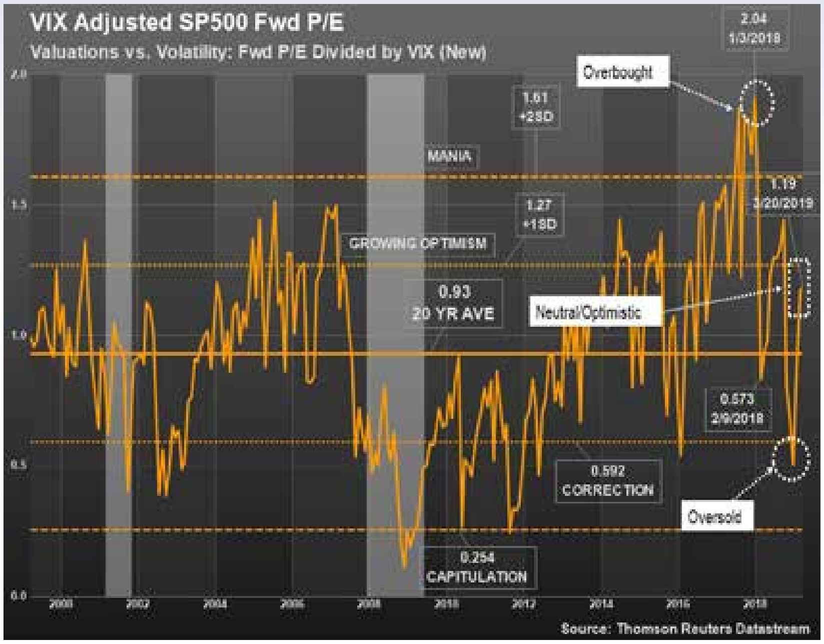


CHART 10

Finally, we examine our equity risk premium model to determine whether or not the market is over or undervalued relative to its historical relationship with the 10 year US Treasury bond yield. Chart #10 reveals that the market's earnings and dividend yield is about 100 basis points above its 20 year average spread above the Treasury yield. This indicates that the market is mildly inexpensive on a relative basis. It is also worth noting that the market's yield has traded below this average during the prior two cycles.

In conclusion, our indicators are not pointing to any near term recession risks even though some of the recent economic data has weakened a bit. This weakness may well have been due to the government shutdown, the slowing of global growth and the temporary increase in financial stresses late last year. Our long-standing position that inflation has been abating was confirmed by the Fed's announcement on March 20th that there would be no further rate increases this year. Finally, the market does not give any indications of being excessively euphoric as illustrated by our overbought/oversold and valuation models.

Please speak with your investment advisor if you have any questions.

10