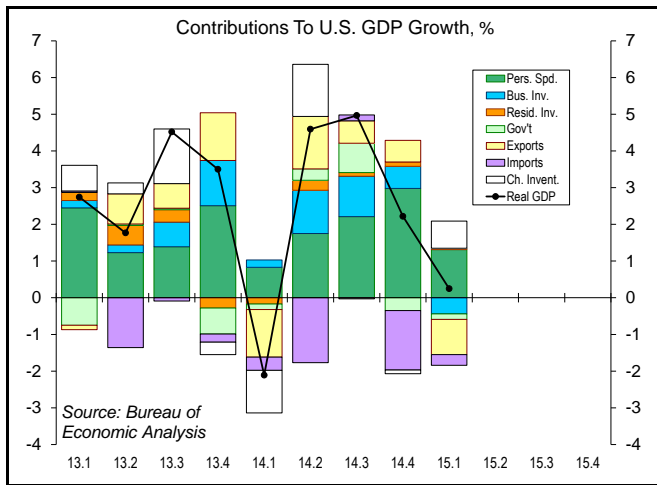


Monthly Economic Outlook

**Yikes! (but mediocre news may be “good” news)**

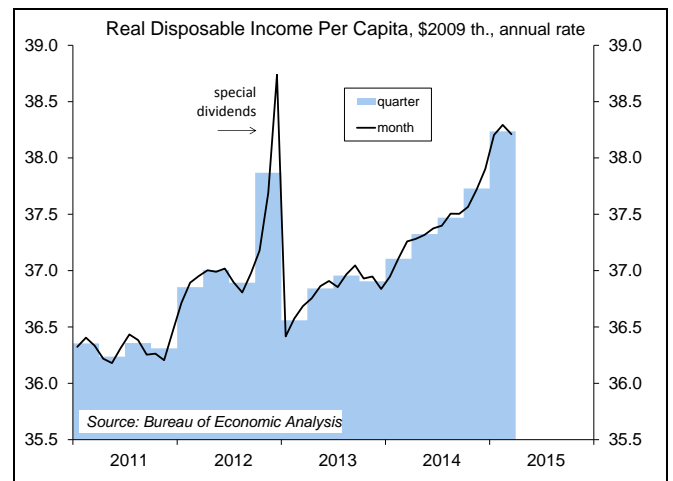
- GDP growth was weak in 1Q15. More importantly, the anticipated 2Q rebound appears likely to disappoint.
- The economic backdrop may be favorable for equities. The economy continues to recover but not so rapidly that the Fed will rush to take away the punch bowl.
- However, earnings growth remains an issue for the stock market and a sharp increase in bond yields in Europe has contributed to a similar rise in yields of long-term Treasuries.

Real GDP rose at a 0.2% annual rate in the initial estimate for 1Q15, as growth was restrained by a number of transitory factors. The winter weather wasn't as bad as it was a year ago, but it was worse than normal. Labor issues contributed to delays in supplies through West Coast ports. The contraction in energy exploration led to a modicum of job losses (often locally severe, but minor on a national level), and a sharp drop in business structures (mining structures, which include oil and gas, fell at a 48.7% annual rate). The stronger dollar supported growth in imports, which have a negative sign in the GDP calculation, and hit exports hard (net exports subtracted 1.3 percentage points from GDP growth - likely more in the revised estimate, due May 29). Inventory growth picked up.

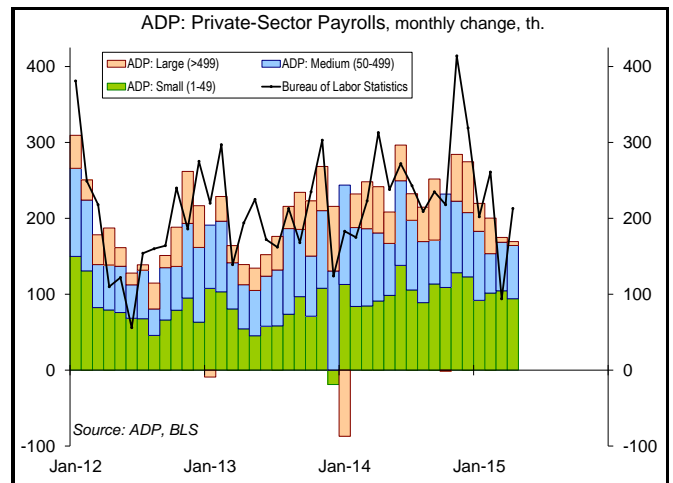


The estimate of first quarter growth is expected to be revised lower (that is, below 0%), as the March trade deficit was a lot wider than assumed in the advance estimate and inventory growth was not as strong as anticipated. Recent data reports suggest that the second quarter rebound in growth will be a lot lower than expected earlier. Bad weather and West Coast port issues are behind us, but the energy contraction and the strong dollar should continue to restrain growth in the near term. Consumer spending, which accounts for 70% of overall economic activity, appears to be on a lackluster-to-moderate trajectory, despite good job growth and low gasoline prices.

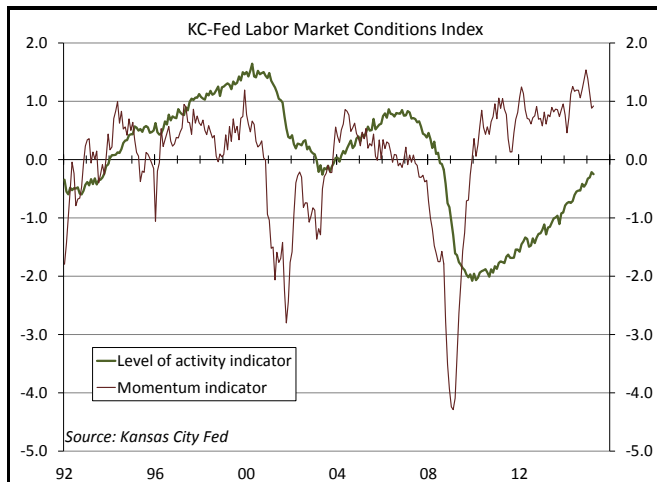
Lower gasoline prices were widely expected to support a strong pickup in consumer spending growth in 2015. That hasn't been the case. Inflation-adjusted personal income rose sharply in the first quarter. However, core retail sales (which exclude autos, building materials, and gasoline) rose 0.4% from November to April (up 4.0% y/y for the first four months of 2015). There are some signs that consumers may view low gasoline prices as temporary. A drop in gasoline prices is often said to be equivalent to a tax cut and spending is determined by long-term expectations of disposable income (temporary tax cuts do little to spur spending growth – they have to be viewed as permanent to do any good). However, while retail sales results have disappointed, the April report suggested mixed effects from gasoline. Spending at bars and restaurants rose 9.0% y/y in the first four months of the year. Auto dealership sales are up 8.0% y/y. In contrast, sales of general merchandise are up only 0.4% y/y. Sales of electronics are down 1.0% y/y.



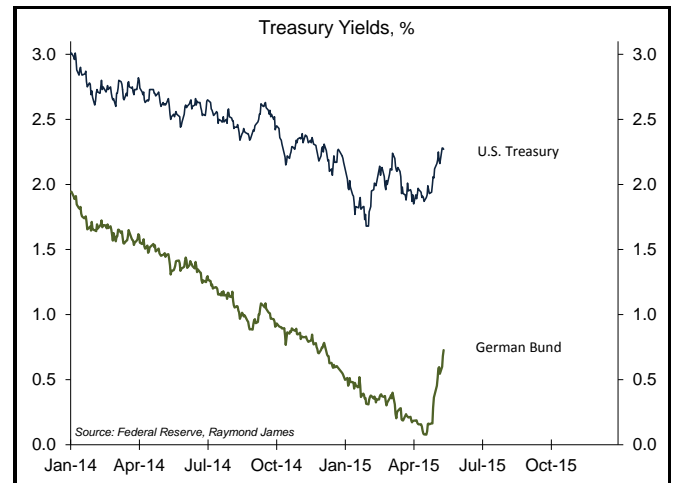
Nonfarm payrolls rebounded in April, from weather-related weakness in March. However, the trend has slowed.



ADP, a labor management firm, processes paychecks for over 400,000 U.S. businesses. Using a methodology similar to that of the Bureau of Labor Statistics, ADP published monthly estimates of private-sector payrolls. These figures generally track the official BLS figures over time, but the two often differ quite a bit from month to month. Importantly, the ADP figures provide a breakout by size of firm. Last year, increased hiring from smaller firms helped boost overall job growth. Recent reports suggested a slowing in the pace of hiring for large firms, but continued strong job additions for small and medium-sized firms. Larger firms may be restrained by the strong dollar and softness in corporate profits. Continued strength in hiring at small and medium-sized firms is a good sign.



While the pace of job growth has moderated, slack is being gradually reduced. The labor market remains a key factor in the Fed policy outlook. The data are consistent with an initial rate hike later this year (September, most likely), but a gradual pace of tightening is expected after that initial increase.



GDP growth in the first half of 2015 is on track to fall far short of the optimistic pace (3%+) seen at the start of the year. By mid-March, Fed officials had projected a less aggressive path of interest rate increases over the next several quarters. That view has helped keep long-term interest rates low. However, bond yields have risen in recent weeks. Part of the increase reflects an improved growth outlook for Europe (still not strong, but better). The threat of deflation has decreased. Some may see this as leading the European Central Bank to cut short its asset purchase plans (remember, with quantitative easing, it's the total amount of securities to be purchased that matters, not the monthly pace). However, that's unlikely to coincide with what the ECB will actually do (we'll hear from ECB President Draghi following the June 3 monetary policy meeting).

Over the next few months, U.S. investors will face uncertainty on a number of fronts: the strength of the economy; Federal Reserve policy; and what's happening in the rest of the world. However, there's still room for optimism.

	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	2014	2015	2016
GDP (↓ contributions)	-2.1	4.6	5.0	2.2	0.2	<b>1.2</b>	<b>2.7</b>	<b>2.7</b>	<b>2.6</b>	<b>2.6</b>	2.4	<b>2.1</b>	<b>2.5</b>
consumer durables	0.2	1.0	0.7	0.5	0.1	<b>0.1</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	0.5	<b>0.3</b>	<b>0.3</b>
nondurables & services	0.6	0.8	1.5	2.5	1.2	<b>1.3</b>	<b>1.5</b>	<b>1.4</b>	<b>1.4</b>	<b>1.4</b>	1.2	<b>1.5</b>	<b>1.4</b>
bus. fixed investment	-0.1	1.2	1.1	0.6	-0.4	<b>0.3</b>	<b>0.7</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>	0.6	<b>0.4</b>	<b>0.6</b>
residential investment	-0.2	0.3	0.1	0.1	0.0	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>	0.1	<b>0.2</b>	<b>0.2</b>
government	-0.2	0.3	0.8	-0.4	-0.2	<b>0.2</b>	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	0.0	<b>0.1</b>	<b>0.2</b>
Domestic Final Sales	0.7	3.4	4.1	3.3	0.7	<b>2.2</b>	<b>3.2</b>	<b>2.9</b>	<b>2.8</b>	<b>2.7</b>	2.3	<b>2.6</b>	<b>2.8</b>
exports	-1.3	1.4	0.6	0.6	-1.0	<b>0.1</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	0.4	<b>0.1</b>	<b>0.4</b>
imports	-0.4	-1.8	0.2	-1.6	-0.3	<b>-0.7</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	-0.6	<b>-0.6</b>	<b>-0.6</b>
Final Sales	-1.0	3.2	5.0	2.3	-0.5	<b>1.6</b>	<b>2.8</b>	<b>2.6</b>	<b>2.5</b>	<b>2.5</b>	2.2	<b>2.5</b>	<b>2.5</b>
ch. in bus. inventories	-1.2	1.4	0.0	-0.1	0.7	<b>-0.4</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	0.1	<b>0.2</b>	<b>0.0</b>
Unemployment, %	6.7	6.2	6.1	5.8	5.6	<b>5.4</b>	<b>5.2</b>	<b>5.1</b>	<b>5.0</b>	<b>4.8</b>	6.2	<b>5.3</b>	<b>4.8</b>
NF Payrolls, monthly, th.	193	284	237	324	184	<b>210</b>	<b>200</b>	<b>190</b>	<b>190</b>	<b>190</b>	260	<b>207</b>	<b>183</b>
Cons. Price Index (q/q)	2.1	3.0	1.2	-0.9	-3.1	<b>2.2</b>	<b>1.8</b>	<b>1.8</b>	<b>1.9</b>	<b>1.9</b>	1.6	<b>0.1</b>	<b>1.9</b>
excl. food & energy	1.8	2.4	1.4	1.5	1.7	<b>1.9</b>	<b>1.8</b>	<b>1.8</b>	<b>1.8</b>	<b>1.9</b>	1.7	<b>1.7</b>	<b>1.8</b>
PCE Price Index (q/q)	1.4	2.3	1.2	-0.4	-2.0	<b>1.8</b>	<b>1.6</b>	<b>1.6</b>	<b>1.7</b>	<b>1.7</b>	1.3	<b>0.3</b>	<b>1.7</b>
excl. food & energy	1.2	2.0	1.4	1.1	0.9	<b>1.6</b>	<b>1.6</b>	<b>1.6</b>	<b>1.7</b>	<b>1.7</b>	1.4	<b>1.3</b>	<b>1.7</b>
Fed Funds Rate, %	0.07	0.09	0.09	0.10	0.11	<b>0.13</b>	<b>0.17</b>	<b>0.38</b>	<b>0.42</b>	<b>0.65</b>	0.09	<b>0.20</b>	<b>0.79</b>
3-month T-Bill, (bond-eq.)	0.1	0.0	0.0	0.0	0.0	<b>0.0</b>	<b>0.1</b>	<b>0.3</b>	<b>0.4</b>	<b>0.7</b>	0.0	<b>0.1</b>	<b>0.8</b>
2-year Treasury Note	0.4	0.4	0.5	0.5	0.6	<b>0.6</b>	<b>1.1</b>	<b>1.5</b>	<b>2.0</b>	<b>2.3</b>	0.5	<b>1.0</b>	<b>2.4</b>
10-year Treasury Note	2.8	2.6	2.5	2.3	2.0	<b>2.2</b>	<b>2.4</b>	<b>2.6</b>	<b>2.9</b>	<b>3.0</b>	2.5	<b>2.3</b>	<b>3.1</b>