ECONOMIC AND POLITICAL UPDATE:

Robust Economic Growth – Real or Fake News?

Impending Recession – Real or Fake News?

FEBRUARY 2019

David B. Hanson, CPA CFA

Chief Executive Officer

CLERMONT WEALTH STRATEGIES

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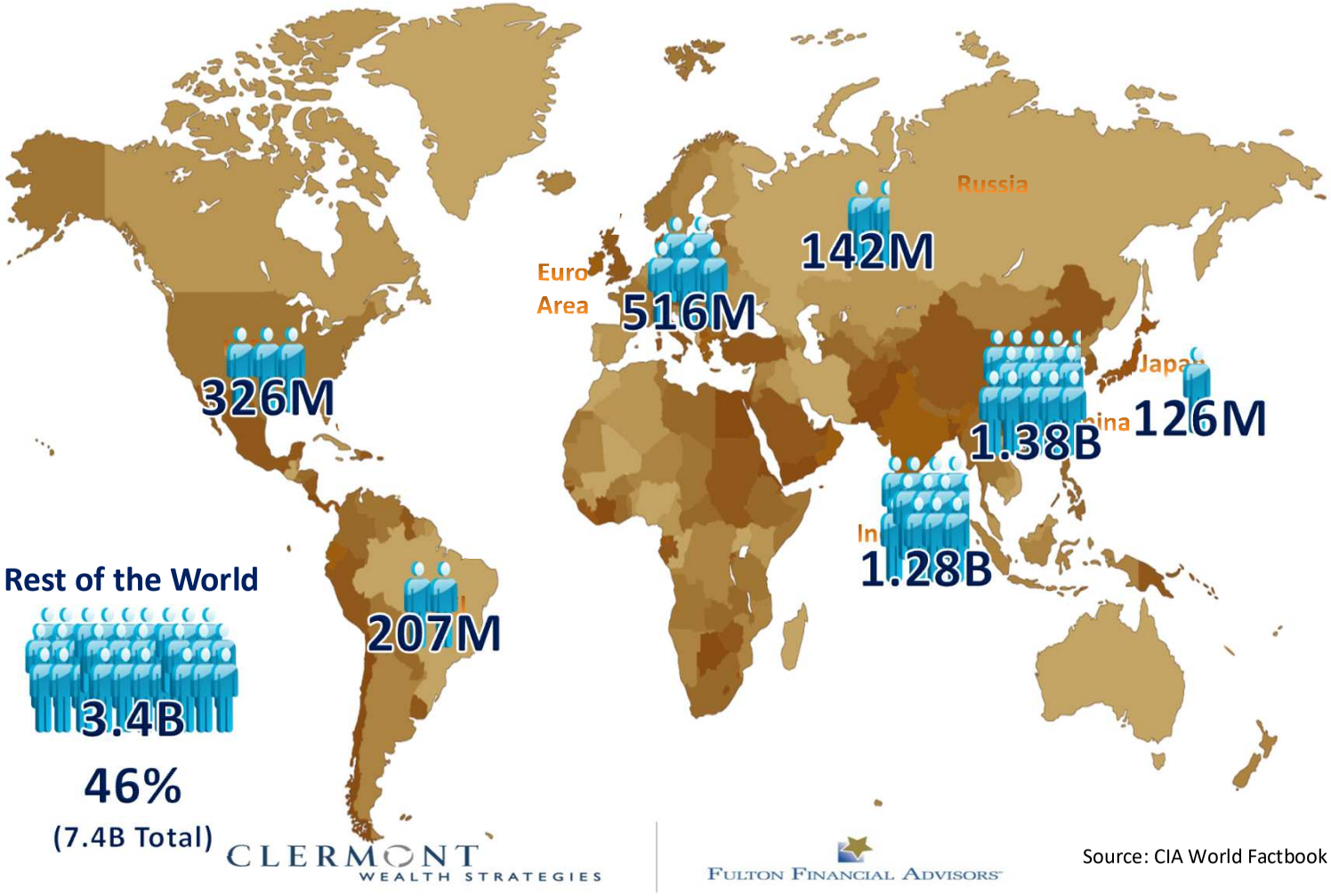
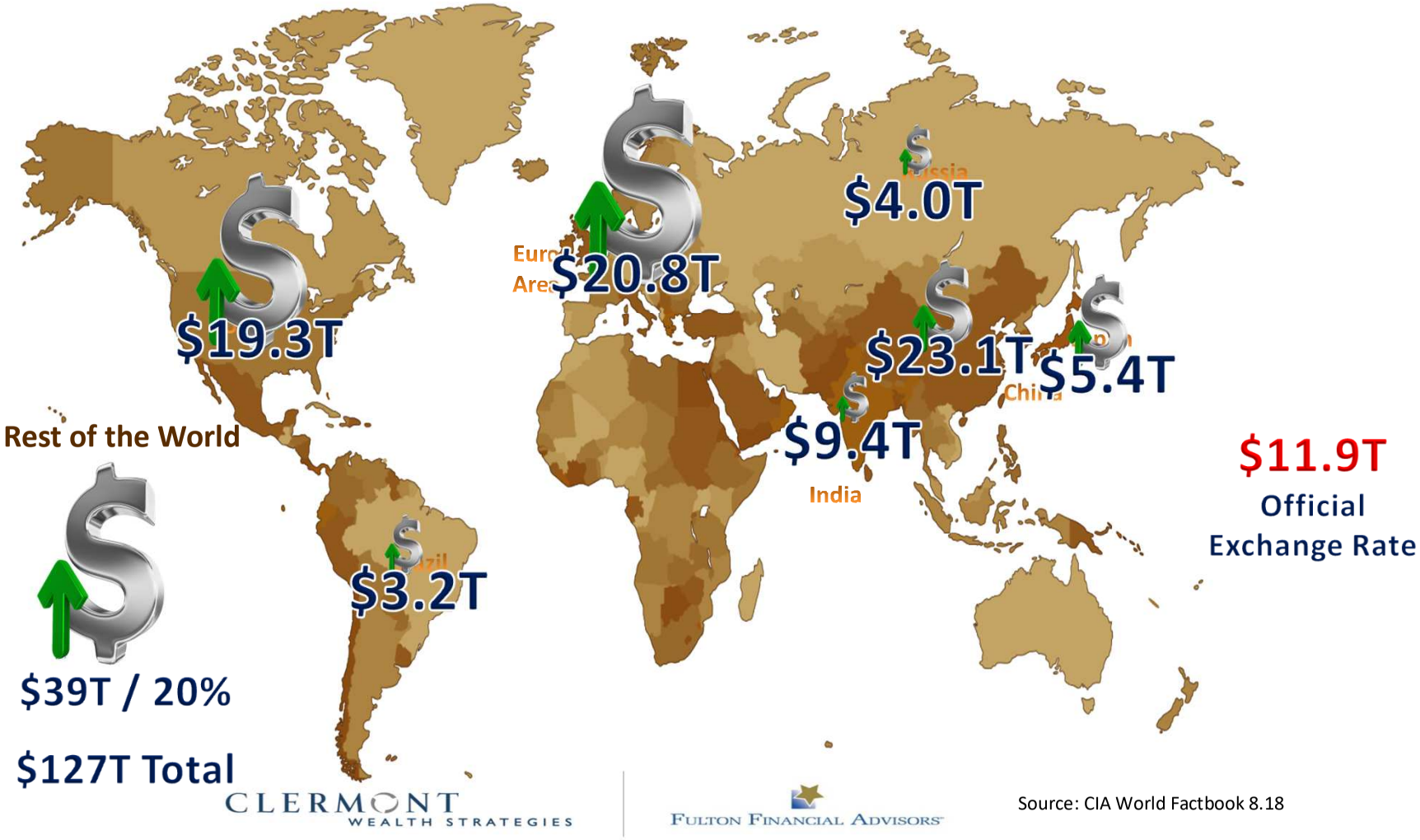
World Population Comparison



Source: CIA World Factbook 8.18

Global GDP Comparison (Purchasing power Parity – 2017 dollars)



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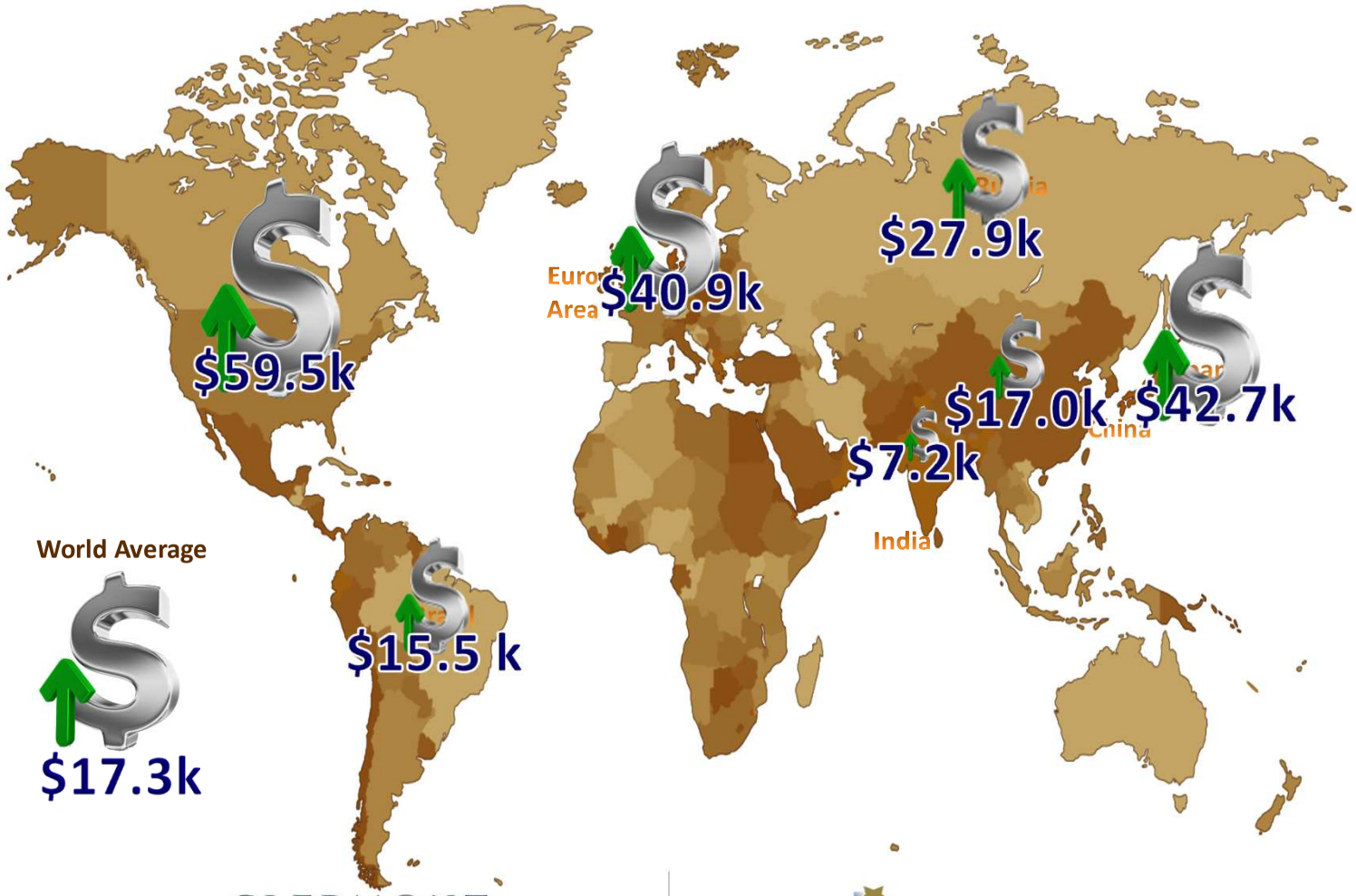
Source: CIA World Factbook 8.18



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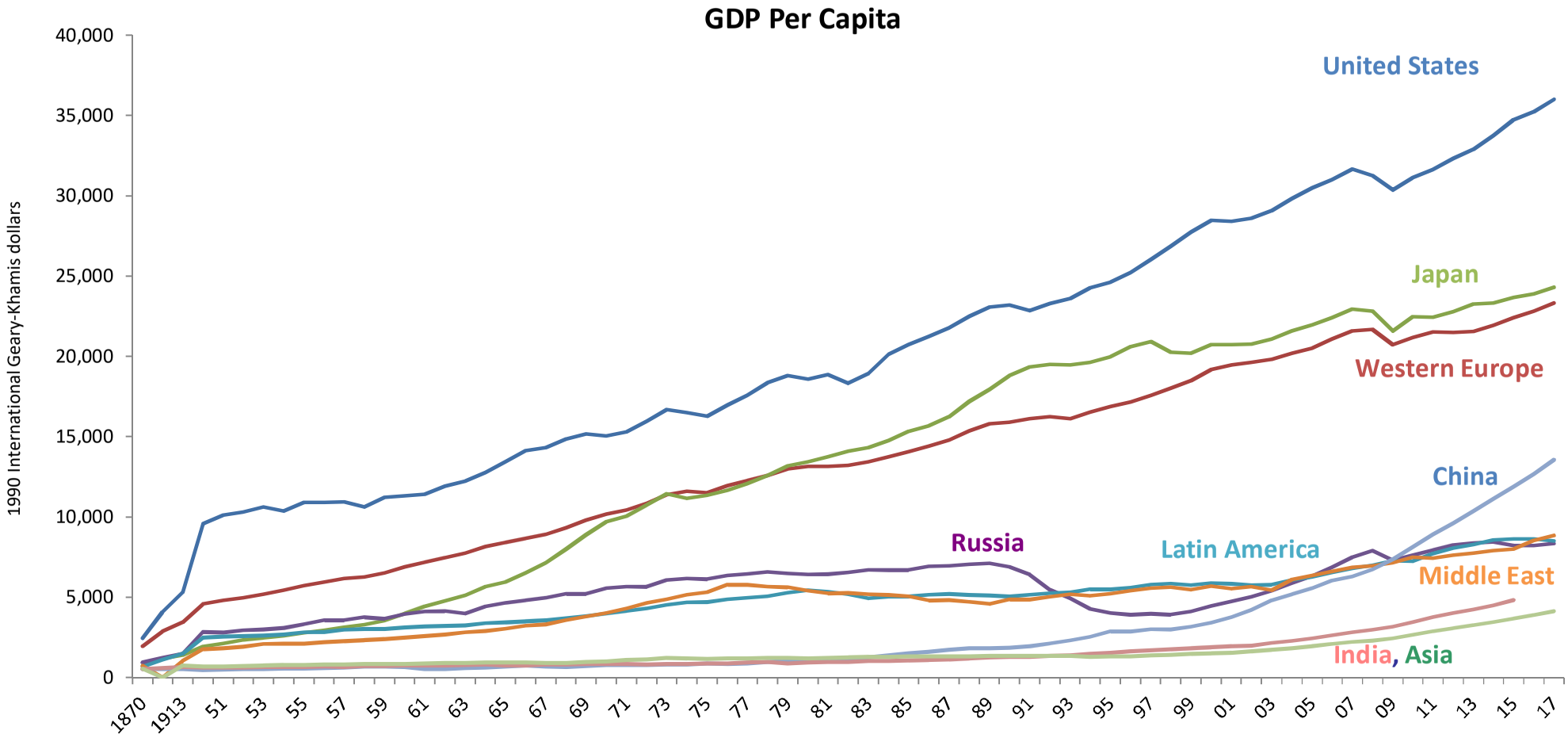
Source: CIA World Factbook 8.18

Global GDP Per Capita Comparison 1870 – 2017



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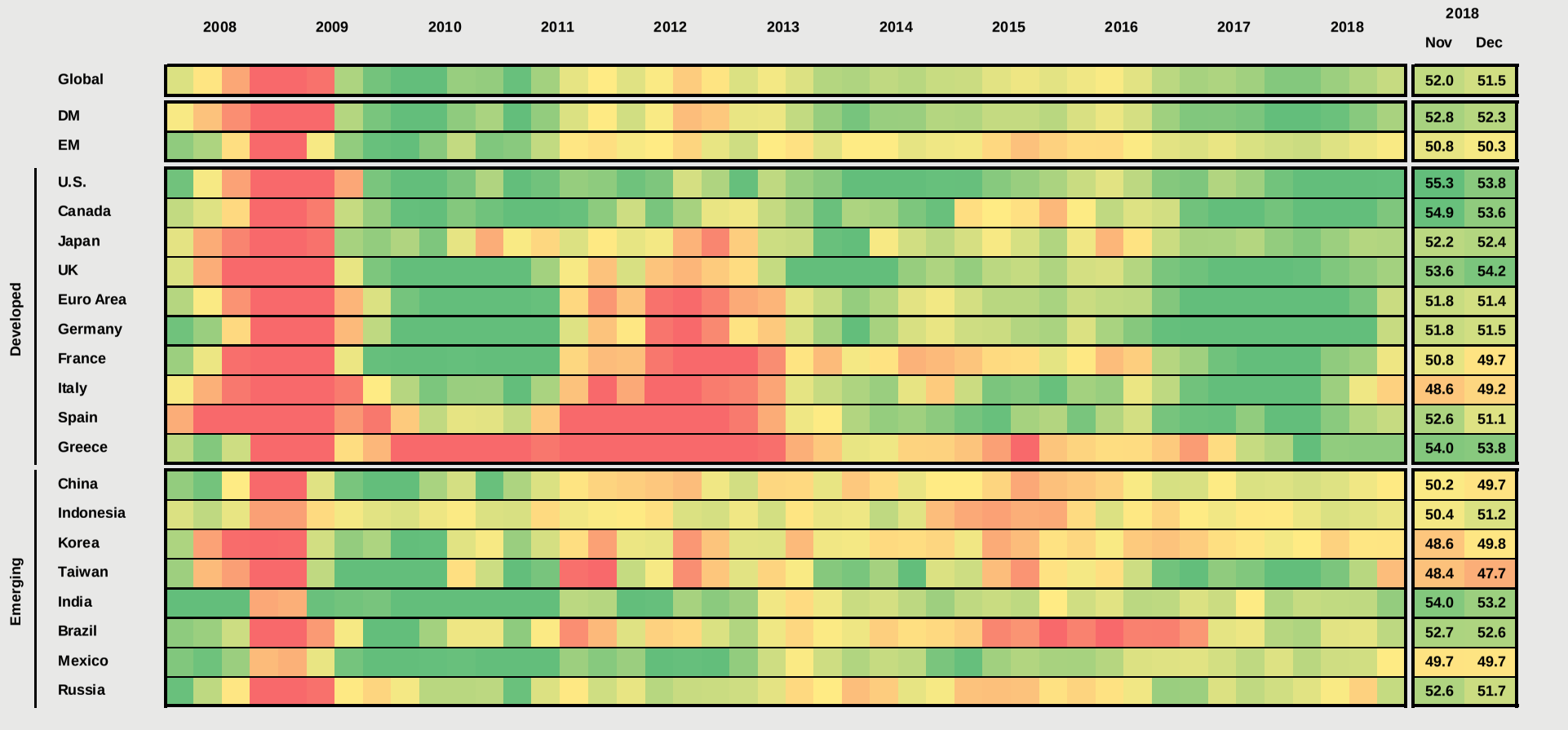
Global Overview of Momentum

Global Purchasing Managers' Index for manufacturing, quarterly



		2018 Nov	2018 Dec
	Global	52.0	51.5
	DM	52.8	52.3
	EM	50.8	50.3
Developed	U.S.	55.3	53.8
Developed	Canada	54.9	53.6
Developed	Japan	52.2	52.4
Developed	UK	53.6	54.2
Developed	Euro Area	51.8	51.4
Developed	Germany	51.8	51.5
Developed	France	50.8	49.7
Developed	Italy	48.6	49.2
Developed	Spain	52.6	51.1
Developed	Greece	54.0	53.8
Emerging	China	50.2	49.7
Emerging	Indonesia	50.4	51.2
Emerging	Korea	48.6	49.8
Emerging	Taiwan	48.4	47.7
Emerging	India	54.0	53.2
Emerging	Brazil	52.7	52.6
Emerging	Mexico	49.7	49.7
Emerging	Russia	52.6	51.7

Source: JP Morgan Asset Management
FFA Investment Management

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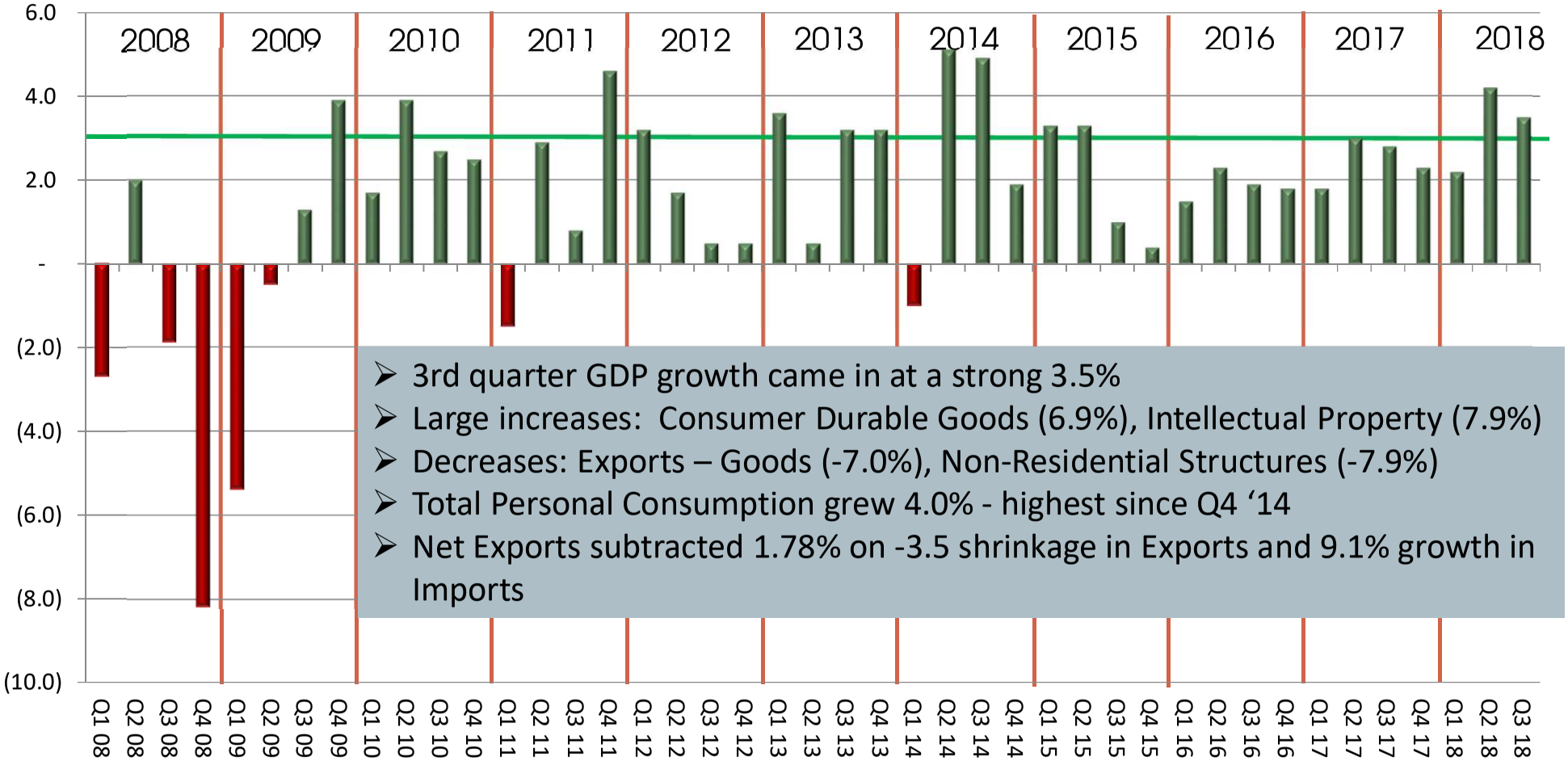
- Global Context and Overview
- Recap of Recent U.S. GDP Growth
- Tariffs and Trade Wars
- Economic Gear Box
  - Consumer and Small Business Confidence
  - Employment
- Inflation, Interest Rates, Energy, and Crypto-currency
- Capital Markets
- Washington…

Three Overarching / Recurring Questions:

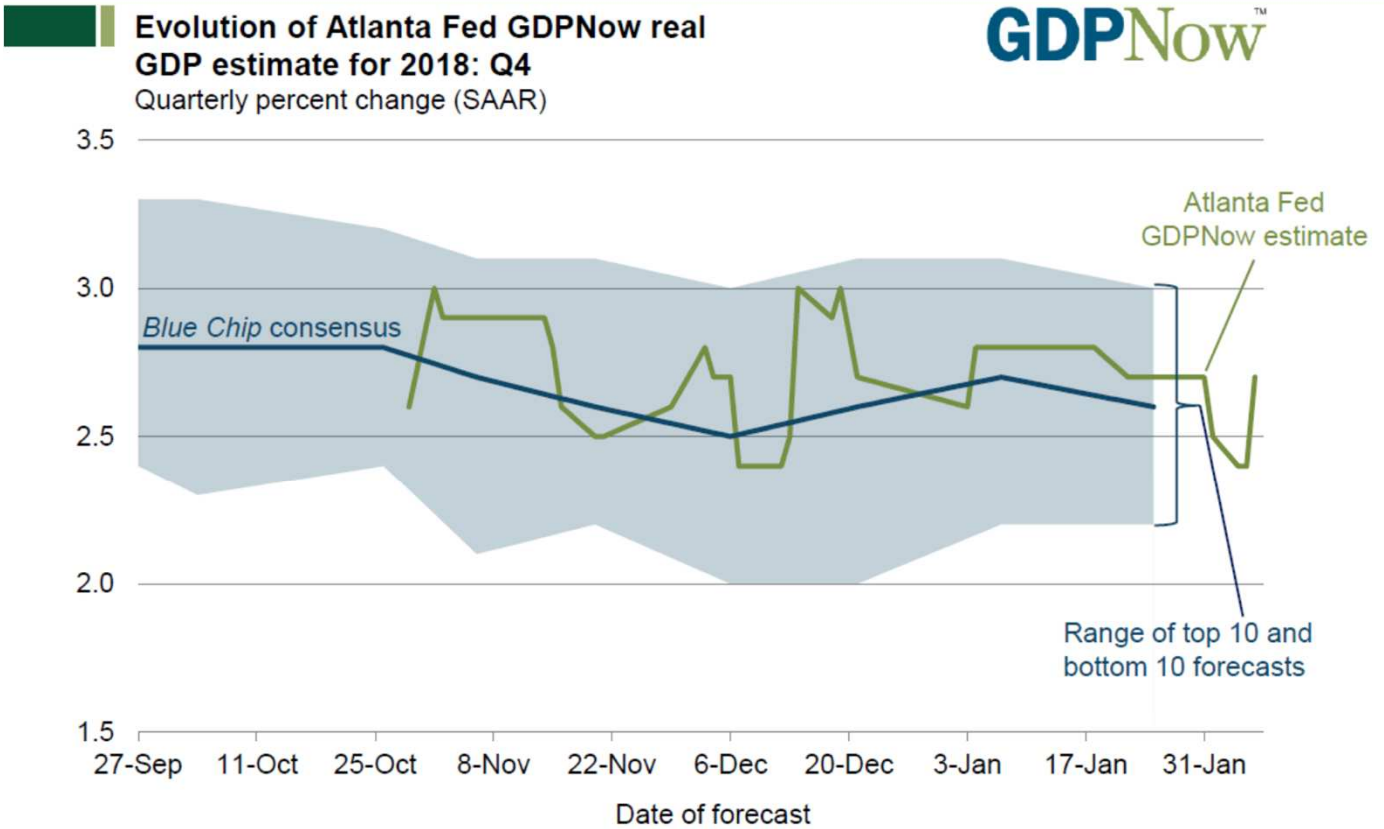
- How likely is a near term recession?
- How likely is a near term stock market correction?
- What storm clouds are on the long term horizon?

1. **D**emographics
2. **D**isparity of Income
3. **D**eficits
4. **D**isaster (Geopolitical)

QUARTERLY GDP



- 3rd quarter GDP growth came in at a strong 3.5%
- Large increases: Consumer Durable Goods (6.9%), Intellectual Property (7.9%)
- Decreases: Exports – Goods (-7.0%), Non-Residential Structures (-7.9%)
- Total Personal Consumption grew 4.0% - highest since Q4 '14
- Net Exports subtracted 1.78% on -3.5 shrinkage in Exports and 9.1% growth in Imports



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*

Note: The top (bottom) 10 forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

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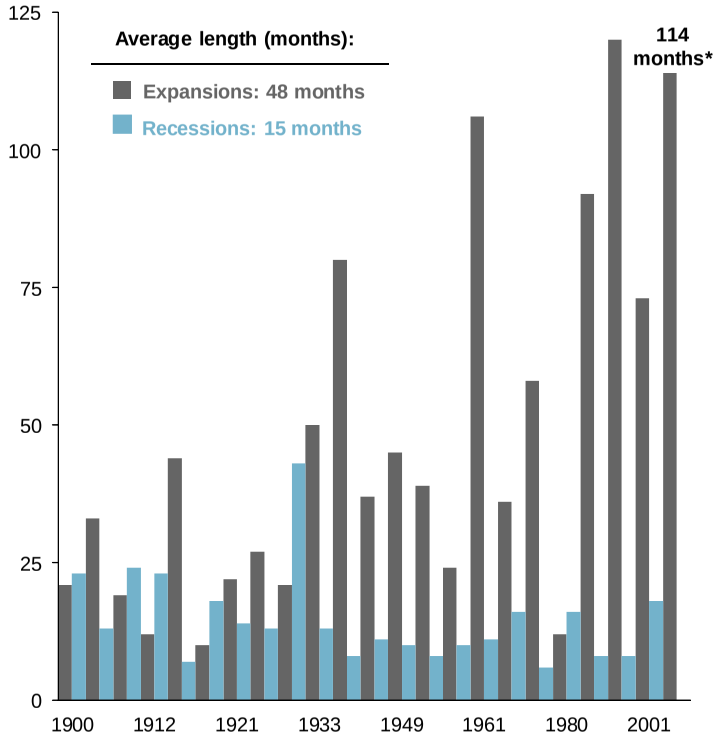
VERY L O N G…….

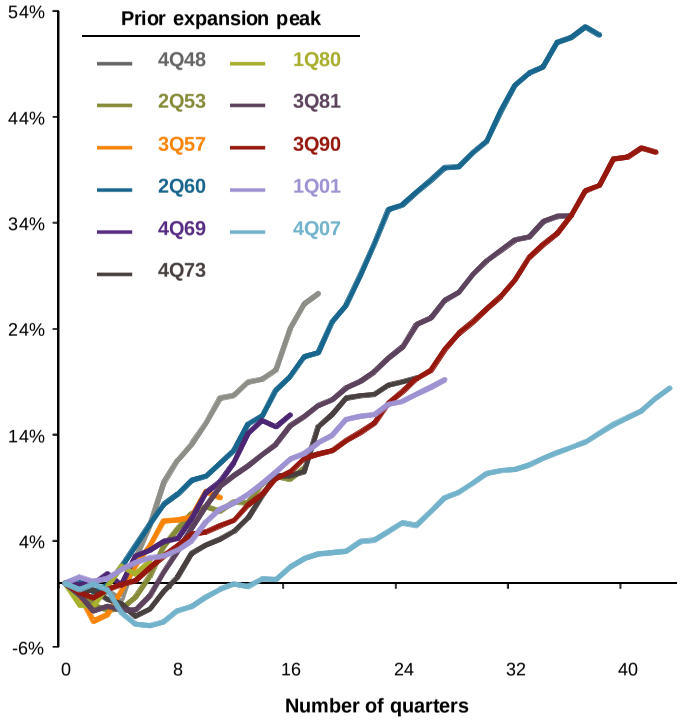
Length of economic expansions and recessions



BUT VERY weak…….

Strength of economic expansions

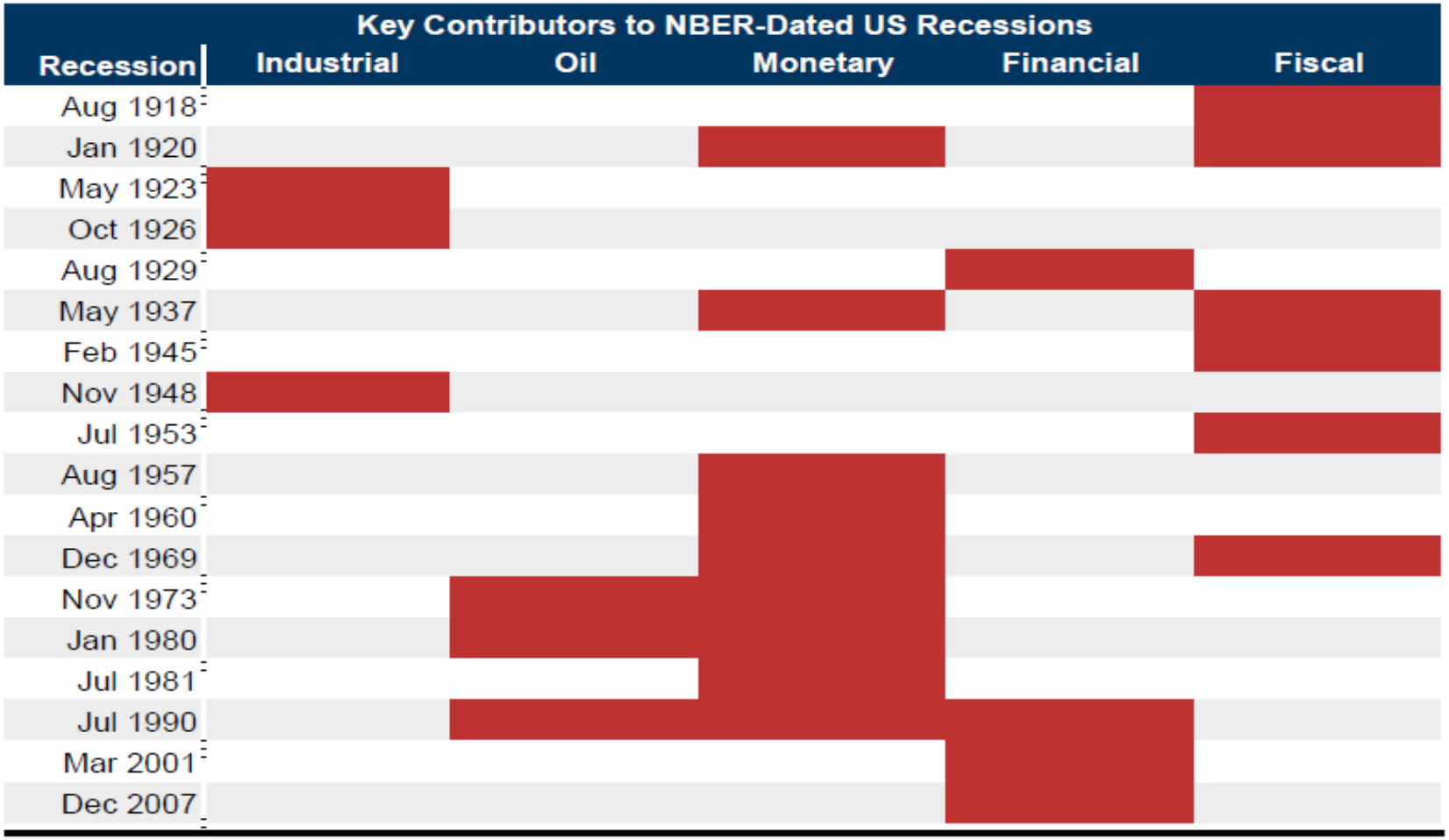
Cumulative real GDP growth since prior peak, percent



Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through December 2018, lasting 114 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/cycles/ and reflect information through December 2018. Past performance is not a reliable indicator of current and future results.

Guide to the Markets – U.S. Data are as of December 31, 2018.

CAUSES OF U.S. RECESSIONS SINCE WWI



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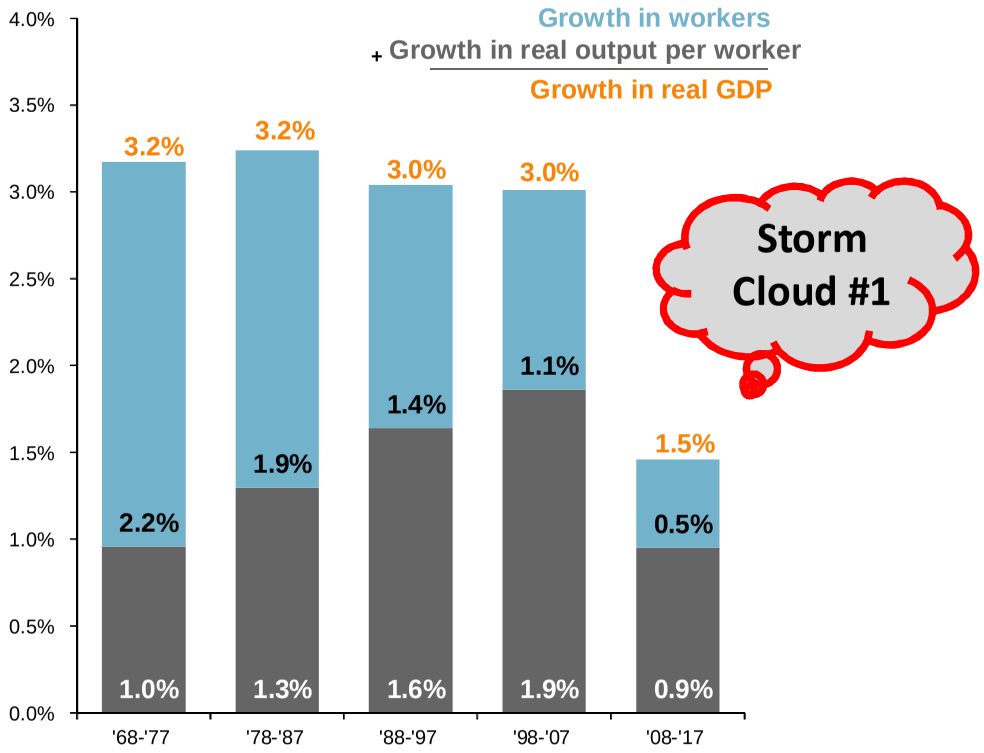
Source: Goldman Sachs, FFA Investment Management

Economic Heatmap

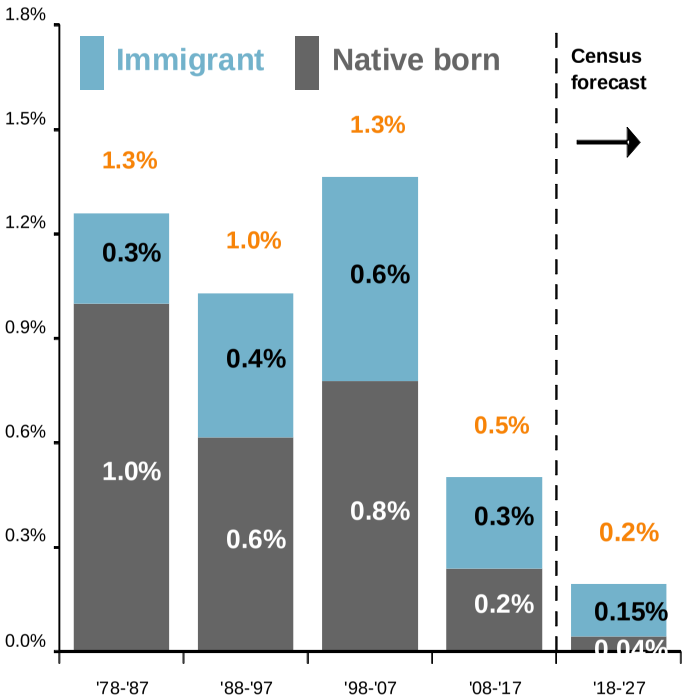
	2017											2018											
	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Real consumer spending (y/y)	2.0%	3.0%	2.6%	2.5%	2.3%	2.4%	2.3%	2.4%	2.6%	2.8%	2.7%	2.5%	2.4%	2.2%	2.5%	2.6%	2.7%	3.0%	3.1%	2.7%	3.0%	2.8%	2.8%
Light vehicle sales (mil.)	17.32	16.72	16.97	16.7	16.59	16.69	16.03	18.47	17.98	17.4	17.76	17.07	16.96	17.4	17.07	16.81	17.38	16.68	16.6	17.4	17.5	17.4	17.5
Housing starts (000's)	1288	1189	1165	1122	1225	1185	1172	1158	1265	1303	1210	1334	1290	1327	1276	1329	1177	1184	1280	1237	1217	1256	1256
ISM Mfg.	57.6	56.6	55.8	55.5	56.5	56.6	58.9	60	58.4	57.7	59.4	59.6	60.7	59.3	57.9	58.7	60	58.4	60.8	59.5	57.5	58.8	54.3
ISM Non-mfg.	57	55.6	57.6	57.3	57	55.1	55.5	58.7	59.7	57.1	56.3	59.4	59.1	58.7	57.2	58.9	58.7	56.7	58.8	60.8	60	60.4	58
Durable goods orders (y/y)	-2.1%	5.7%	-0.3%	5.2%	15.3%	3.4%	5.1%	8.2%	2.9%	8.9%	8.0%	7.4%	12.3%	8.2%	11.6%	10.4%	1.8%	10.5%	13.4%	6.1%	8.2%	4.9%	4.9%
Unemployment rate (%)	4.7%	4.4%	4.4%	4.4%	4.3%	4.3%	4.4%	4.2%	4.1%	4.2%	4.1%	4.1%	4.1%	4.0%	3.9%	3.8%	4.0%	3.9%	3.8%	3.7%	3.8%	3.7%	3.9%
Nonfarm payrolls (000's)	200	73	175	155	239	190	221	14	271	216	175	176	324	155	175	268	208	165	286	119	274	176	312
Jobless claims (000's)	235	241	242	253	251	243	238	254	234	239	248	234	217	242	211	223	232	219	205	207	215	233	233
Avg. hourly earnings (y/y)	2.7%	2.6%	2.5%	2.5%	2.5%	2.5%	2.6%	2.8%	2.3%	2.5%	2.7%	2.8%	2.6%	2.6%	2.6%	2.8%	2.8%	2.8%	3.0%	2.8%	3.2%	3.1%	3.2%
S&P 500 EPS (NTM est.)	$129	$129	$130	$130	$130	$131	$131	$131	$133	$134	$134	$154	$156	$156	$158	$159	$160	$161	$162	$162	$164	$164	$162
S&P 500 Sales (NTM est.)	$1,216	$1,210	$1,210	$1,211	$1,211	$1,217	$1,215	$1,211	$1,229	$1,234	$1,233	$1,292	$1,303	$1,298	$1,308	$1,310	$1,315	$1,328	$1,331	$1,334	$1,344	$1,346	$1,340
S&P 500 net margin (%)	8.9%	9.1%	9.2%	9.2%	9.3%	9.3%	9.3%	9.2%	9.2%	9.2%	9.2%	9.1%	9.1%	9.4%	9.4%	9.5%	9.7%	9.7%	9.8%	10.1%	10.1%	10.1%	10.5%
Headline CPI (y/y)	2.7%	2.4%	2.2%	1.9%	1.6%	1.7%	1.9%	2.2%	2.0%	2.2%	2.1%	2.1%	2.2%	2.4%	2.5%	2.8%	2.9%	2.9%	2.7%	2.3%	2.5%	2.2%	1.9%
Core CPI (y/y)	2.2%	2.0%	1.9%	1.7%	1.7%	1.7%	1.7%	1.7%	1.8%	1.7%	1.8%	1.8%	1.8%	2.1%	2.1%	2.2%	2.3%	2.4%	2.2%	2.2%	2.1%	2.2%	2.2%
Headline PCE deflator (y/y)	2.2%	1.9%	1.8%	1.6%	1.5%	1.5%	1.5%	1.8%	1.7%	1.9%	1.8%	1.8%	1.9%	2.1%	2.0%	2.3%	2.3%	2.4%	2.2%	2.0%	2.0%	1.8%	1.8%
Core PCE deflator (y/y)	1.9%	1.6%	1.6%	1.6%	1.6%	1.5%	1.4%	1.5%	1.6%	1.6%	1.6%	1.6%	1.7%	2.0%	1.9%	2.0%	2.0%	2.0%	1.9%	2.0%	1.8%	1.9%	1.9%

GDP Growth Outlook – The impact of demographics

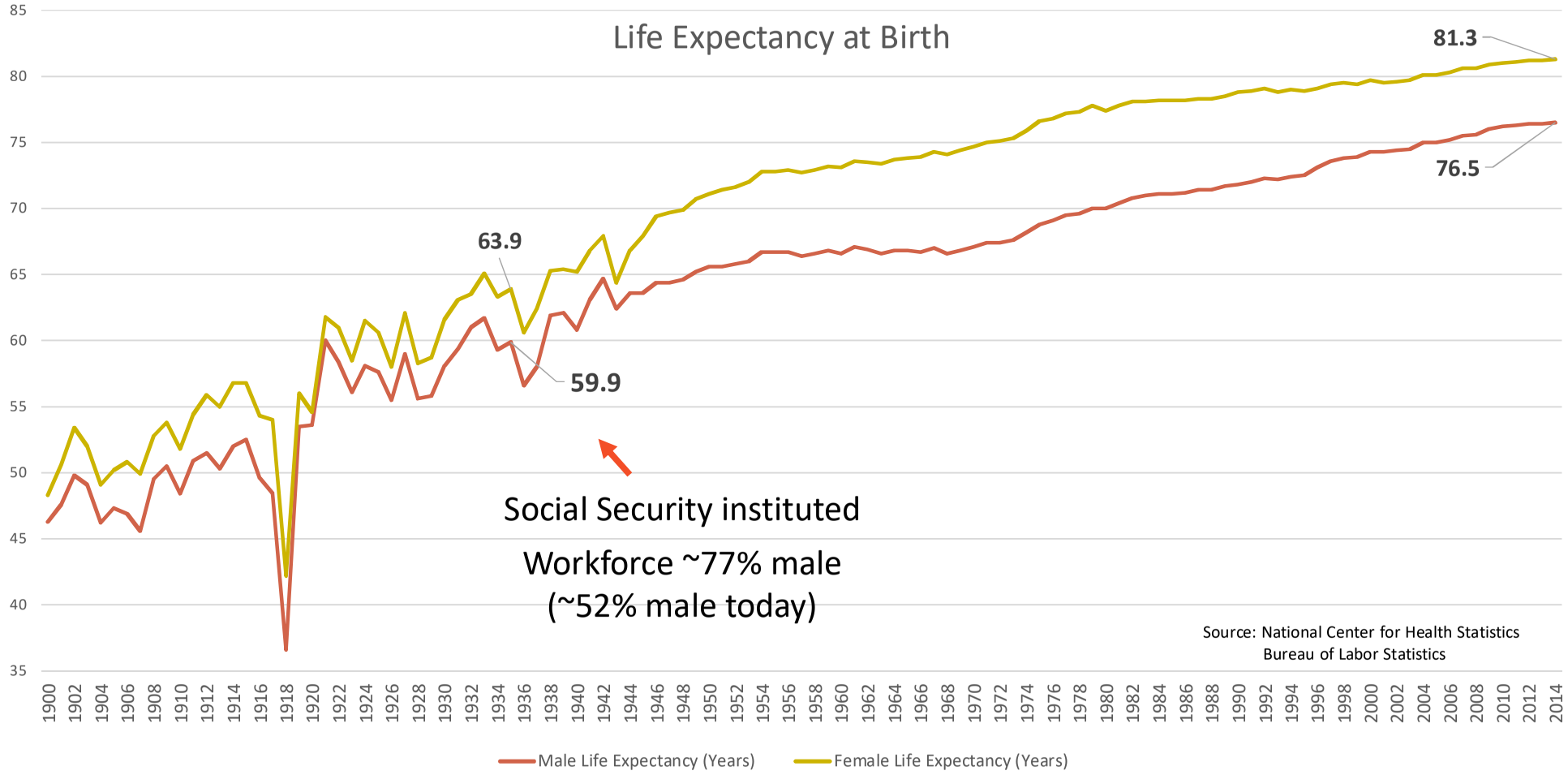
Drivers of GDP growth
Average year-over-year % change



Growth in working-age population
Percent increase in civilian non-institutional population ages 16-64



Source: J.P. Morgan Asset Management; (Top left) Census Bureau, DOD, DOJ; (Top left and right) BLS; (Right and bottom left) BEA.
GDP drivers are calculated as the average annualized growth in the 10 years ending in 4Q of the last year. Future working age population is calculated as the total estimated number of Americans from the Census Bureau, per the March 2018 report, controlled for military enrollment, growth in institutionalized population and demographic trends. Growth in working age population does not include illegal immigration; DOD Troop Readiness reports used to estimate percent of population enlisted.
Guide to the Markets – U.S. Data are as of June 30, 2018.



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TARIFFS AND TRADE WARS

Economic Impact of Announced Tariffs

Historically, Protectionism has resulted in:

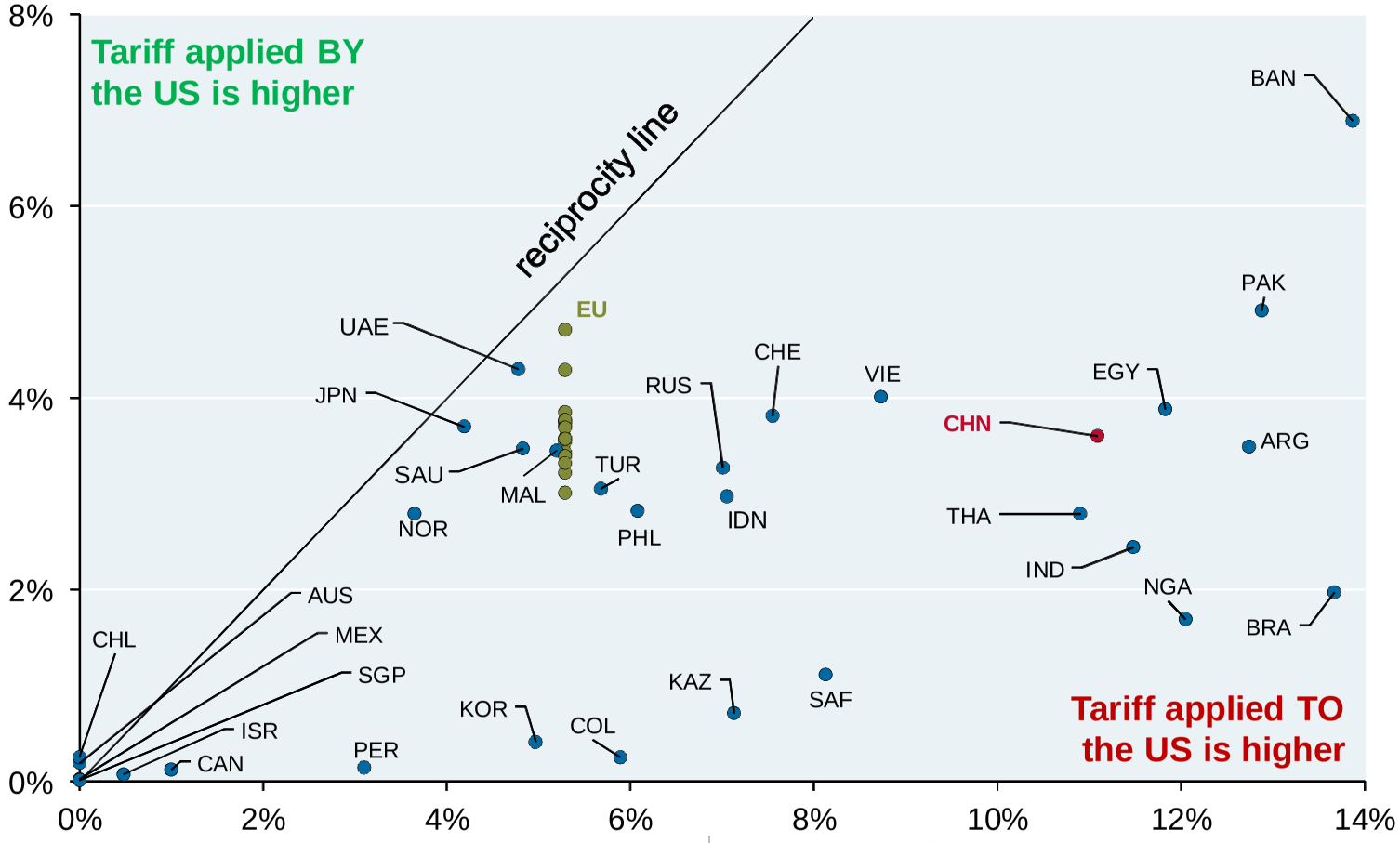
- Slower economic growth
- Less efficient allocation of resources
- Reduced productivity growth
- Higher inflation

These tariffs will likely lead to:

- Higher prices
- Higher costs and margin pressure
- Employment losses
- No positive impact to GDP, potentially larger trade deficit

TRADE WAR – THE LONG GAME?

A general lack of tariff reciprocity



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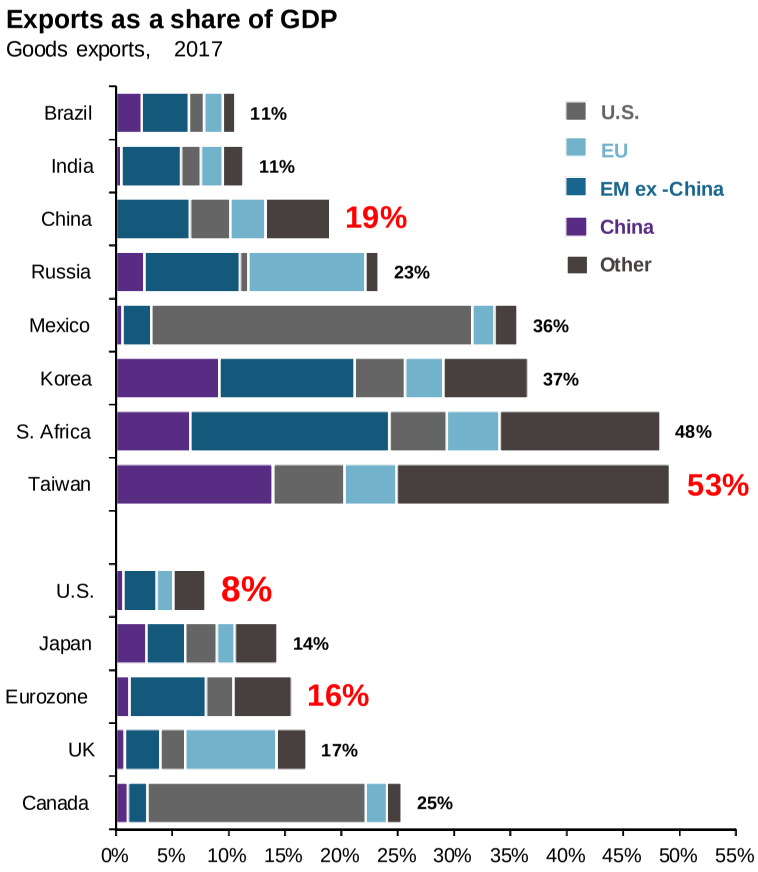
Trade War – Who Has the Most to Lose?



Source: FactSet , J.P. Morgan Asset Management; (Left) Netherlands Policy Analysis; (Right) IMF. *Guide to the Markets – U.S.* Data are as of September 30, 2018.

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CONSUMER AND SMALL BUSINESS

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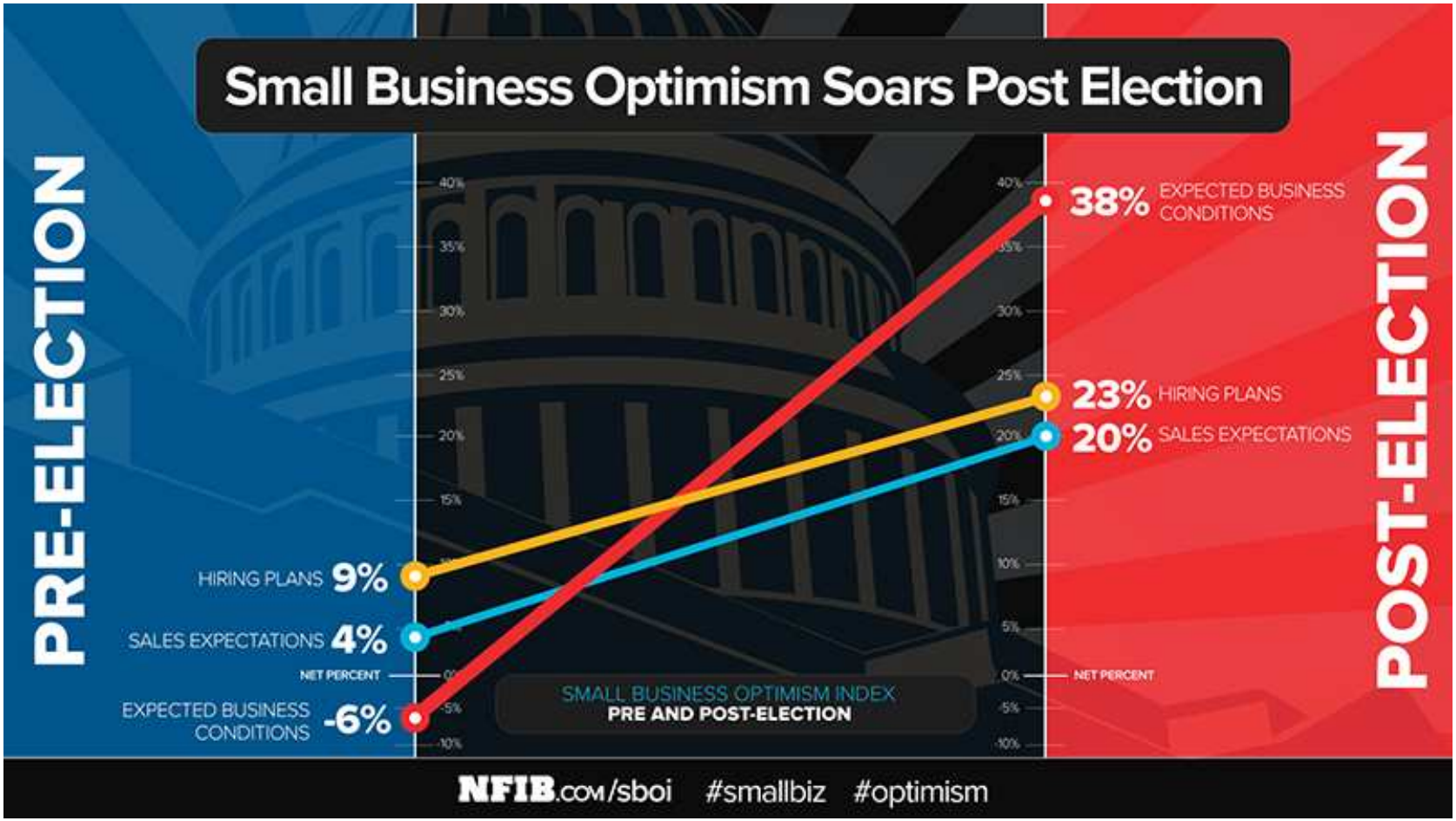
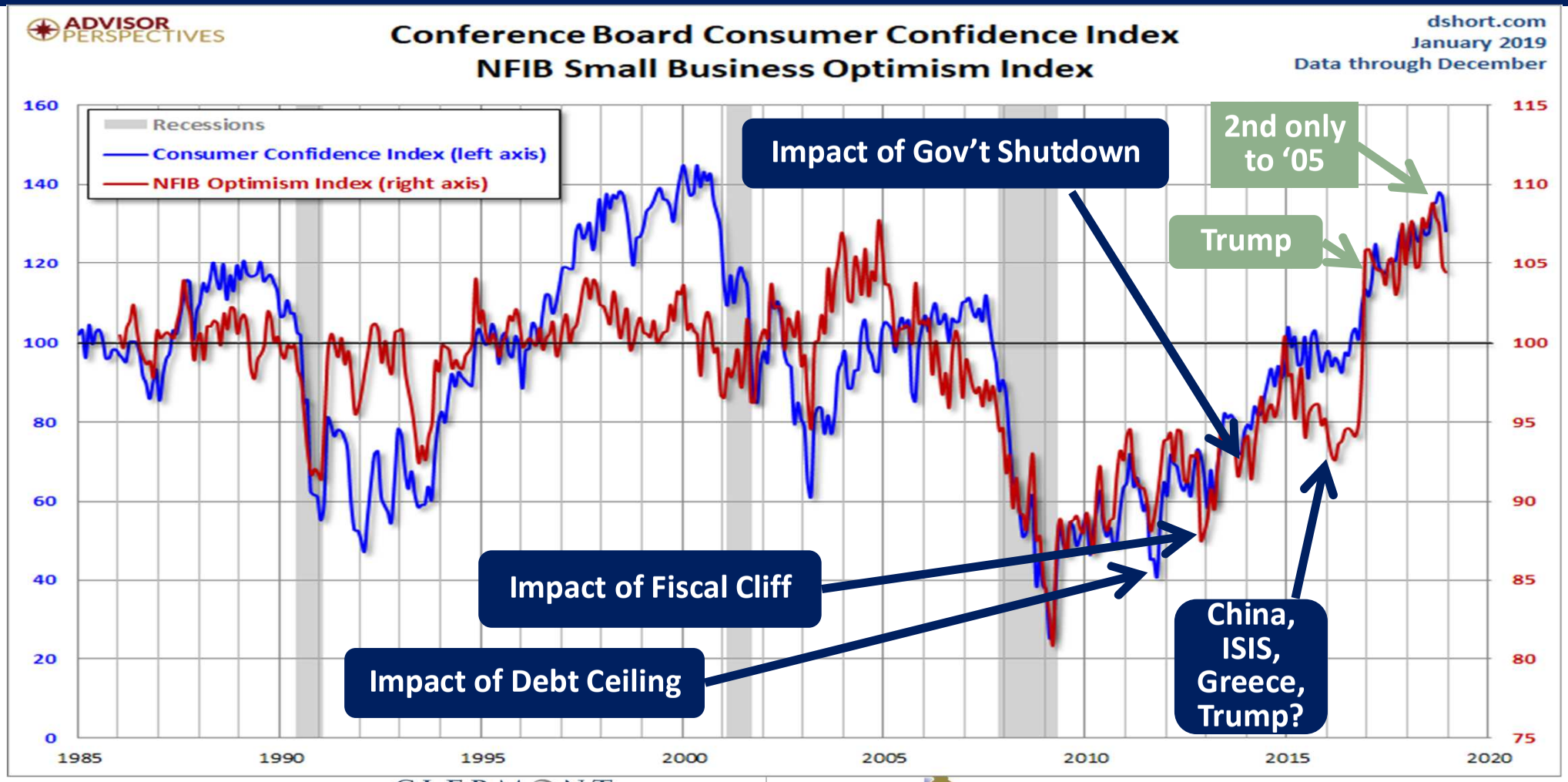

Small Business Optimism Soars Post Election
PRE-ELECTION
POST-ELECTION
HIRING PLANS 9%
SALES EXPECTATIONS 4%
EXPECTED BUSINESS CONDITIONS -6%
NET PERCENT
38% EXPECTED BUSINESS CONDITIONS
23% HIRING PLANS
20% SALES EXPECTATIONS
NET PERCENT
SMALL BUSINESS OPTIMISM INDEX
PRE AND POST-ELECTION
NFIB.com/sboi #smallbiz #optimism

CONFIDENCE HAS SLOWLY RECOVERED.... ....BUT TOOK SOME BODY BLOWS IN RECENT MONTHS



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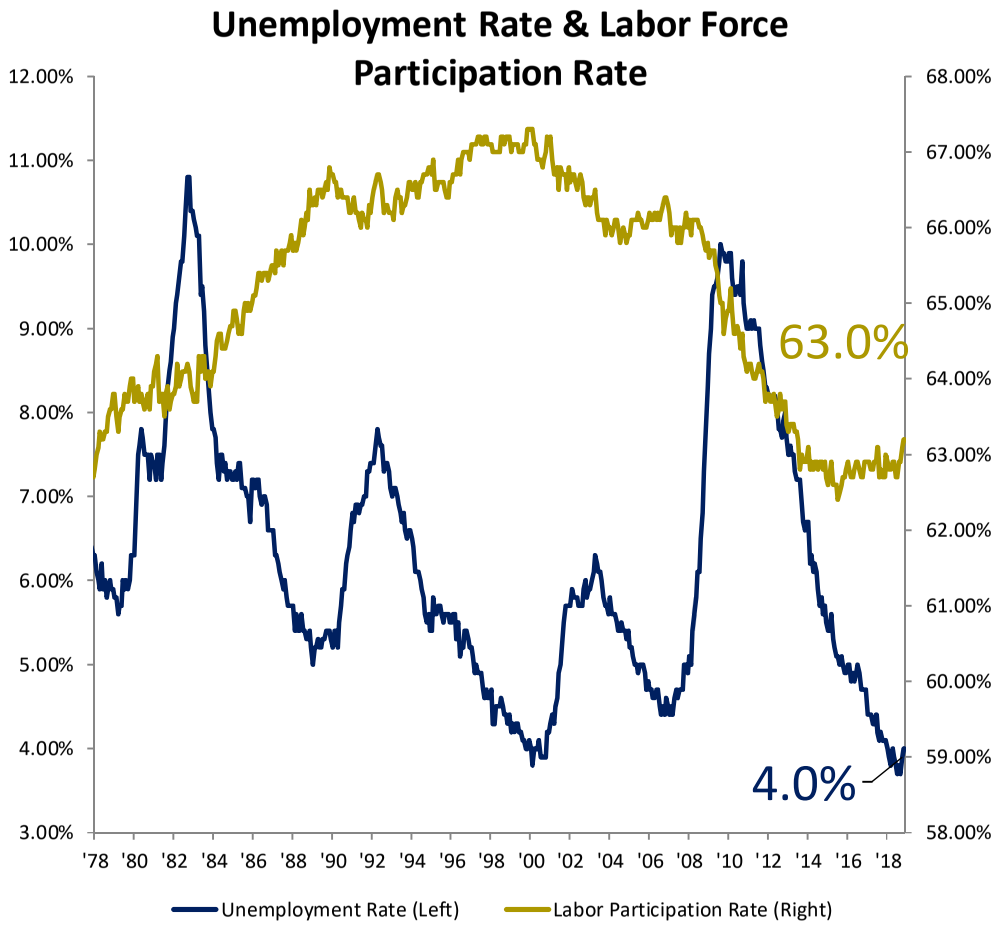
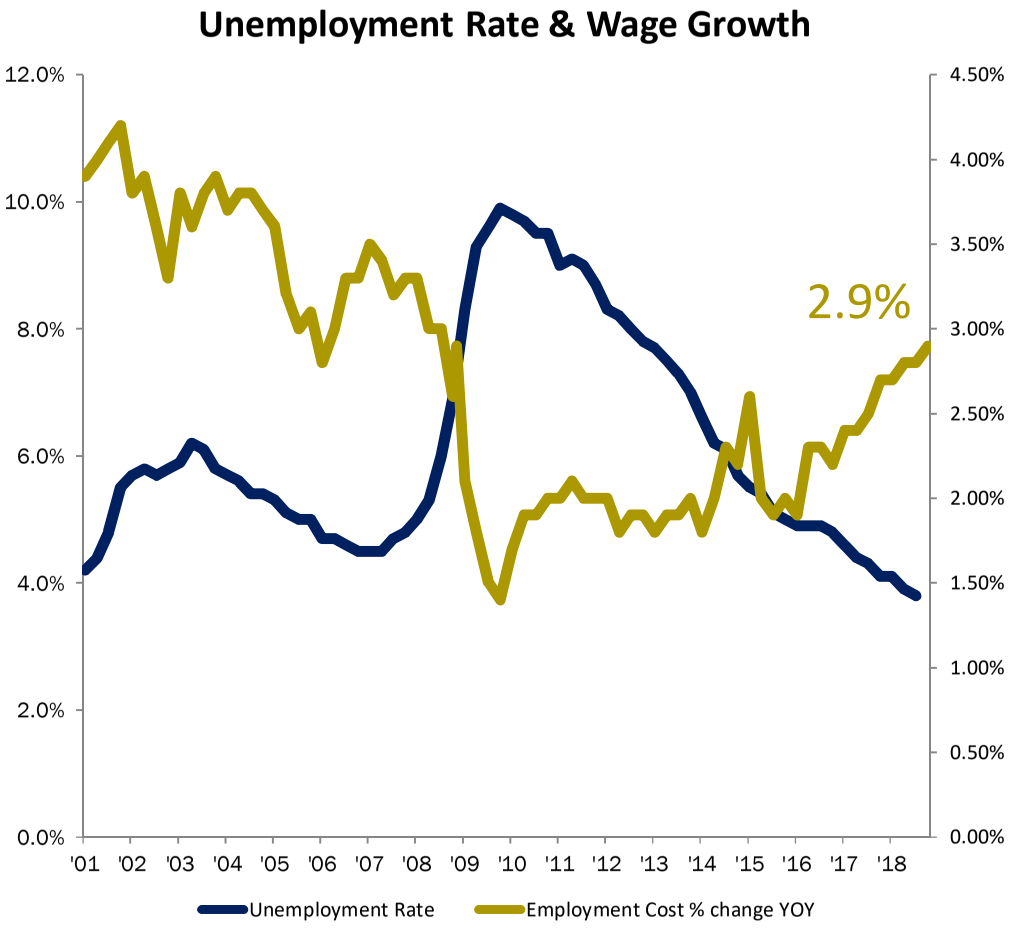
EMPLOYMENT AND INCOME INEQUALITY





Source: Bloomberg, FFA Investment Management

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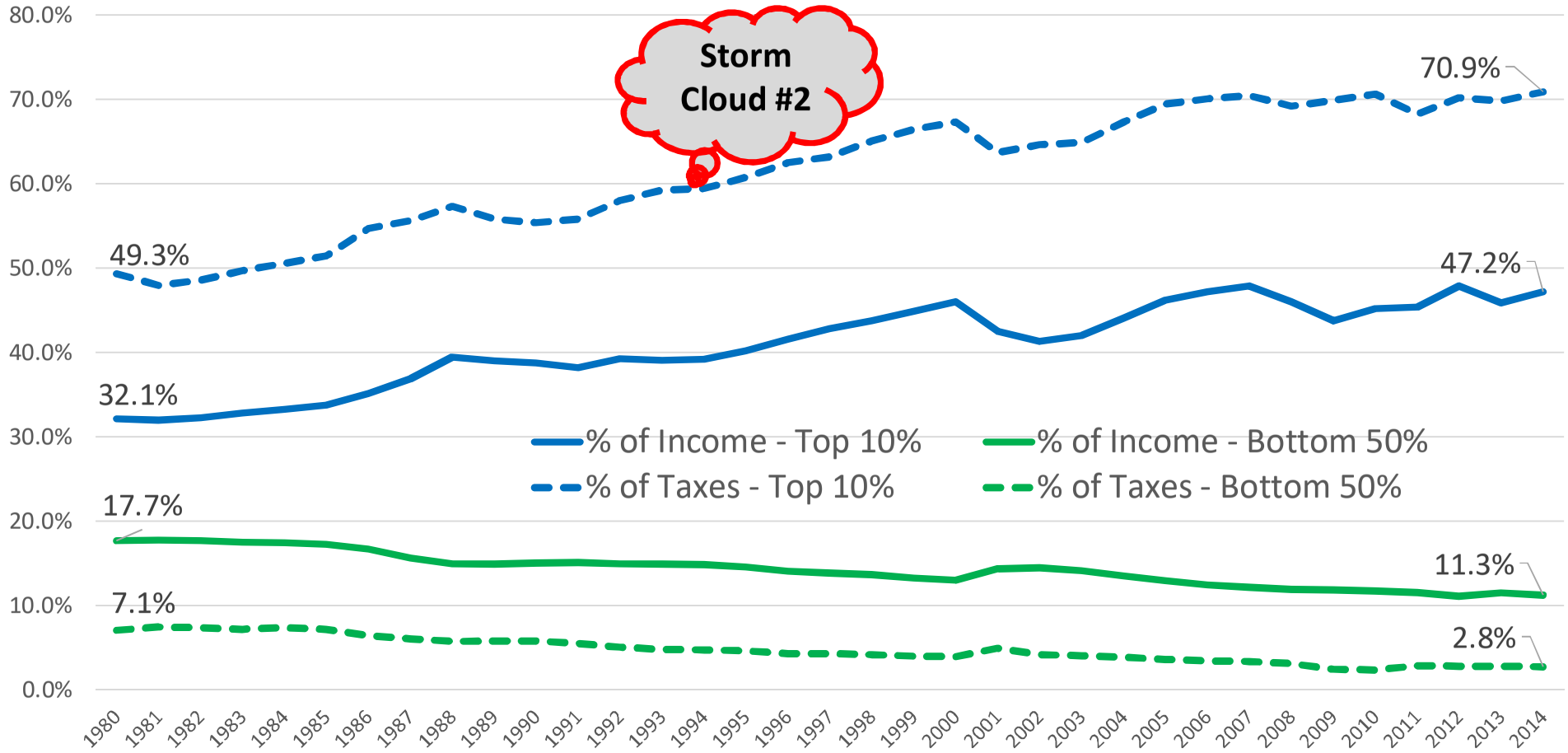
Employment - Income Disparity - Top 10% vs. Bottom 50%



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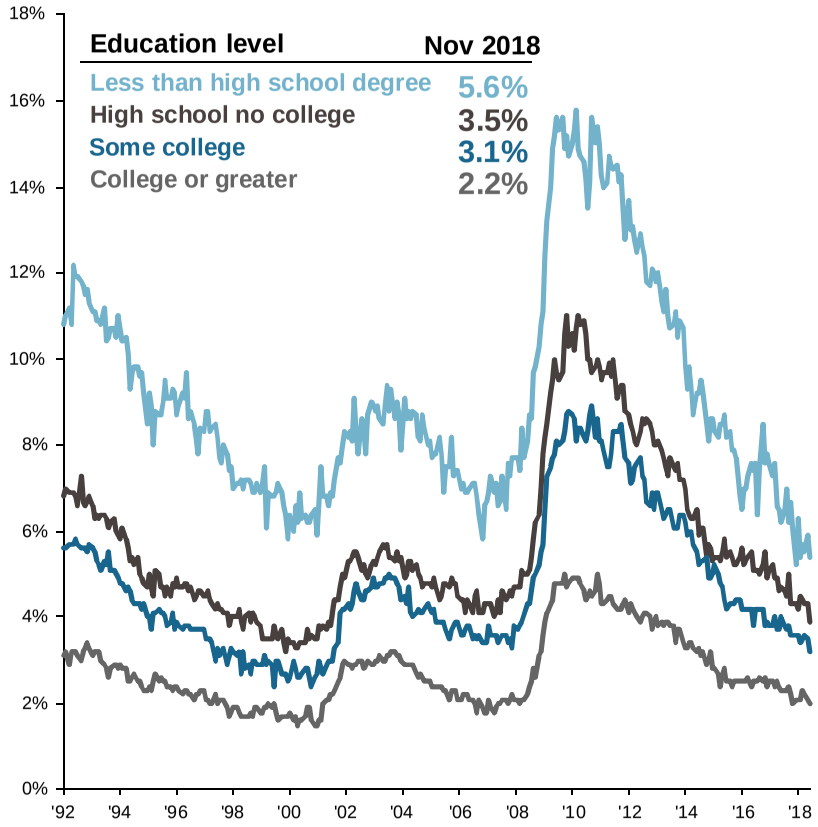
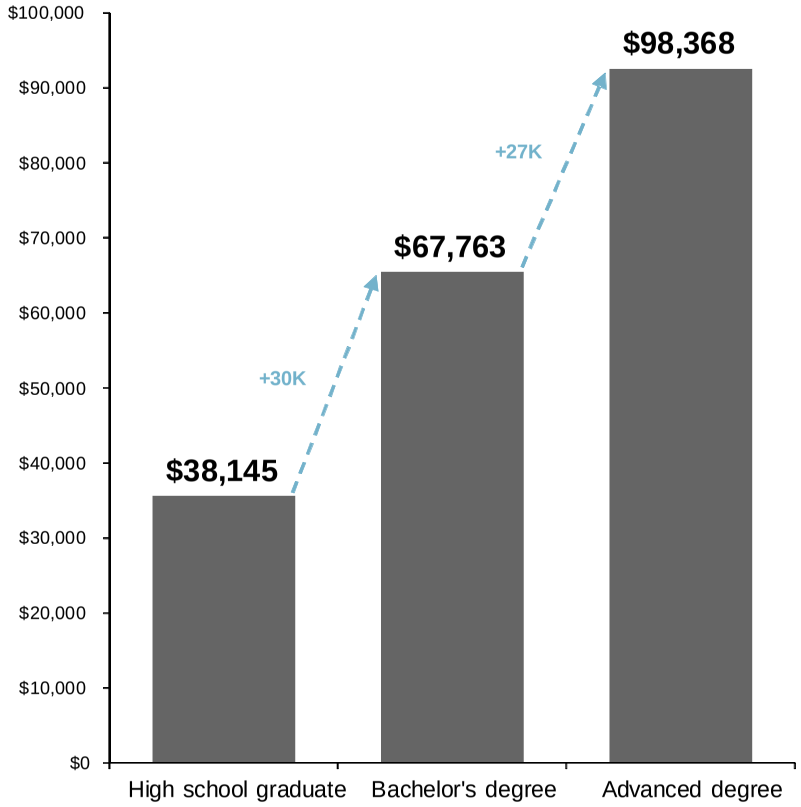
EMPLOYMENT

Unemployment rate by education level



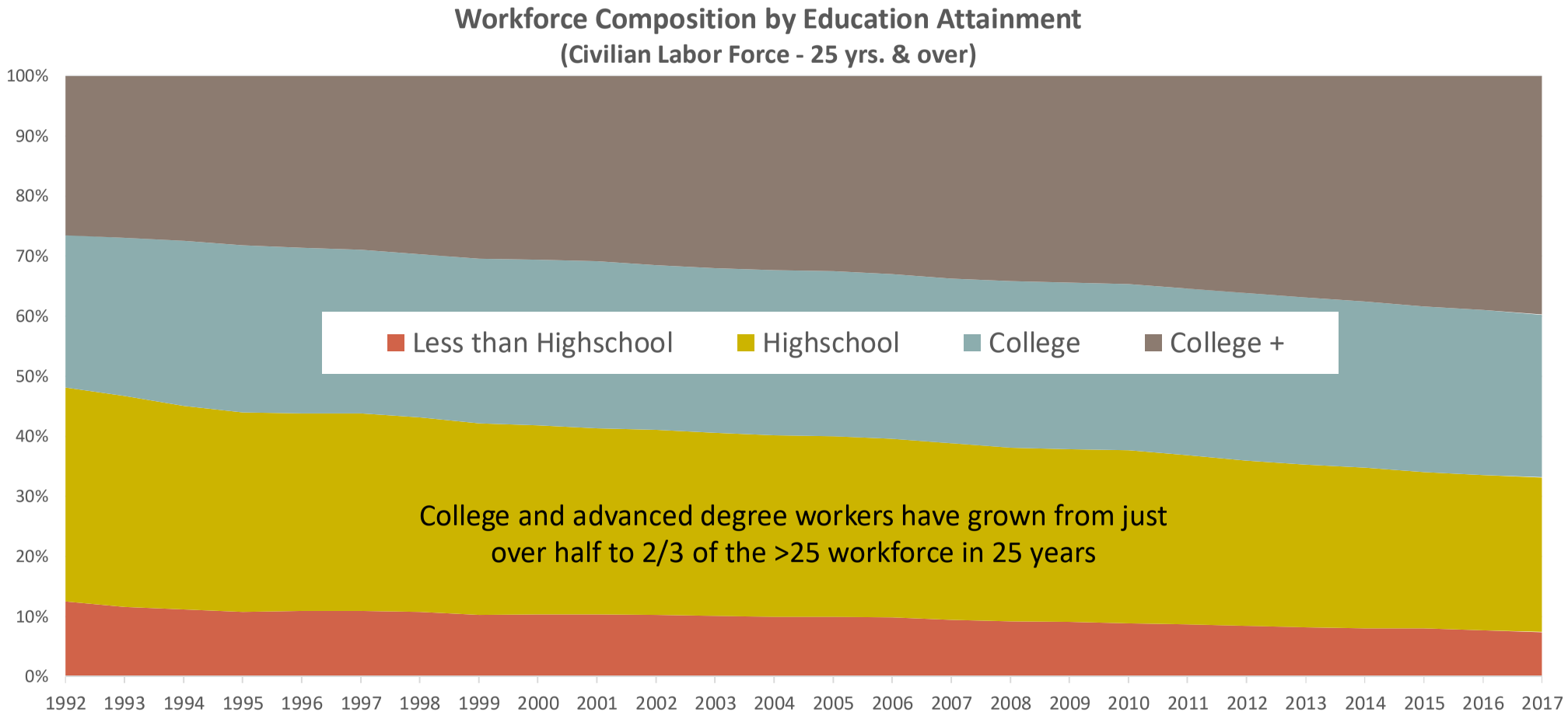
Average annual earnings by highest degree earned

Workers aged 18 and older, 2017



Source: J.P. Morgan Asset Management; (Left) BLS, FactSet; (Right) Census Bureau.
Unemployment rates shown are for civilians aged 25 and older. Earnings by educational attainment comes from the Current Population Survey and is published under historical income tables by person by the Census Bureau.
Guide to the Markets – U.S. Data are as of December 31, 2018.

EMPLOYMENT – IMPACT OF EDUCATION



Source: U.S. Bureau of Labor Statistics

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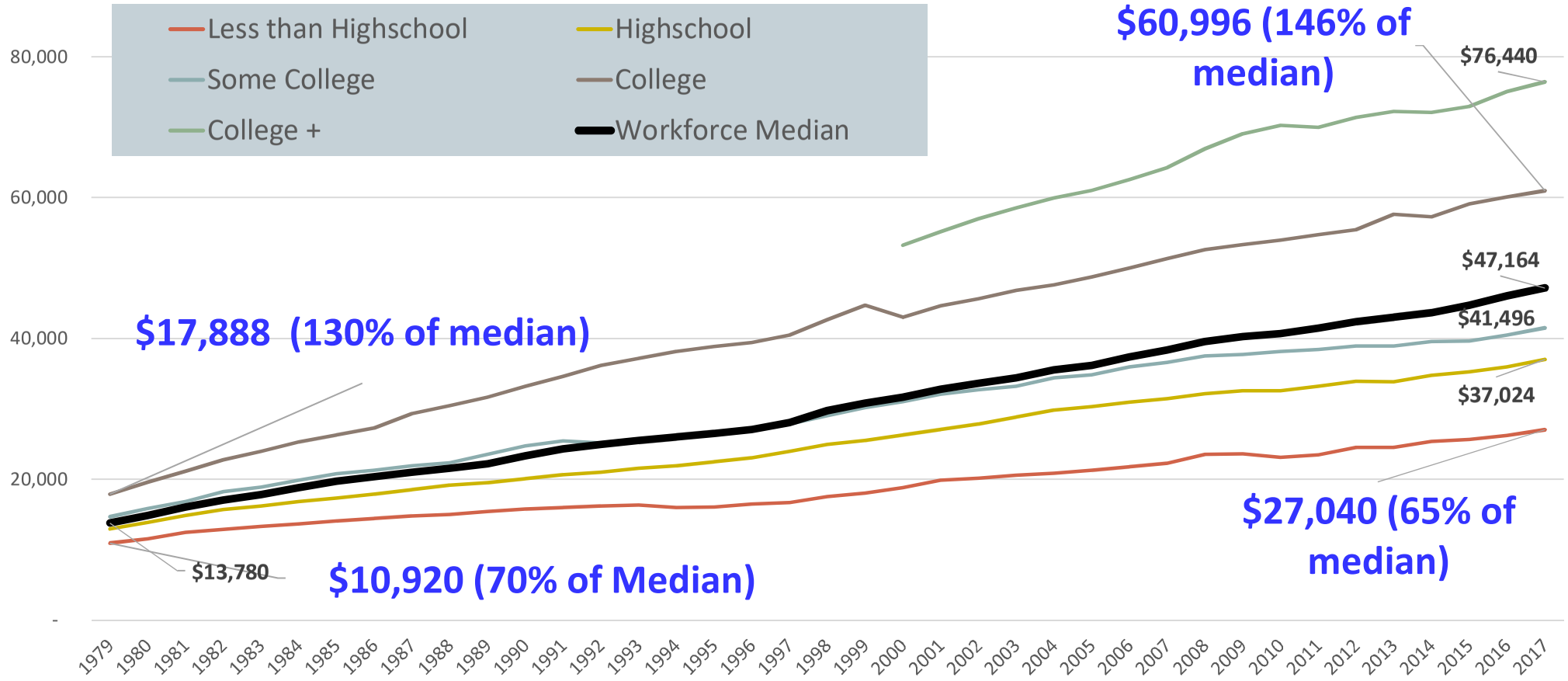
Earnings – Impact of Education (Workforce over 25 yrs. Of age)



Source: U.S. Bureau of Labor Statistics

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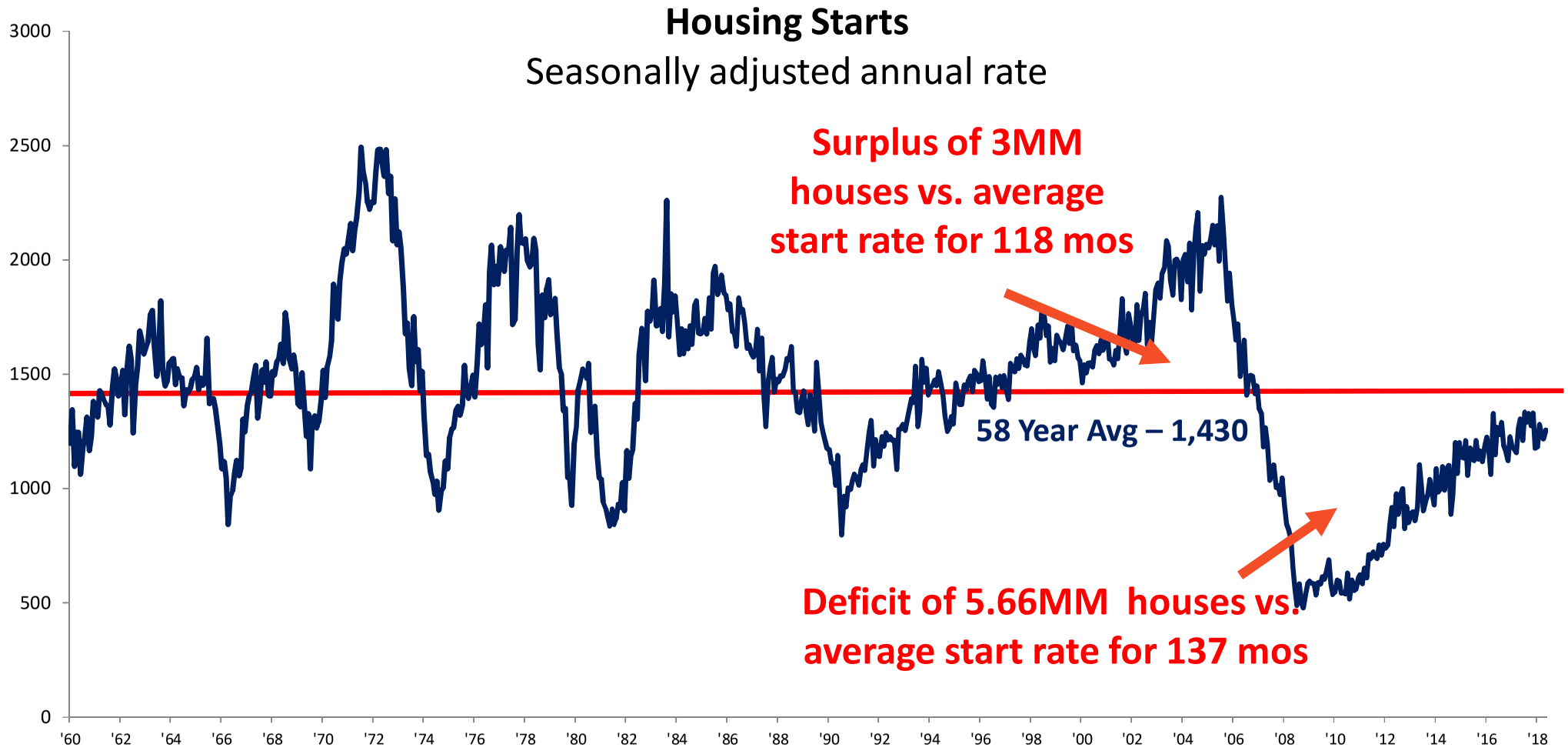
RECESSION WATCH: HOUSING, INFLATION, INTEREST RATES, ENERGY

RECESSION WATCH - HOUSING



Source: Bloomberg, FFA Investment Management

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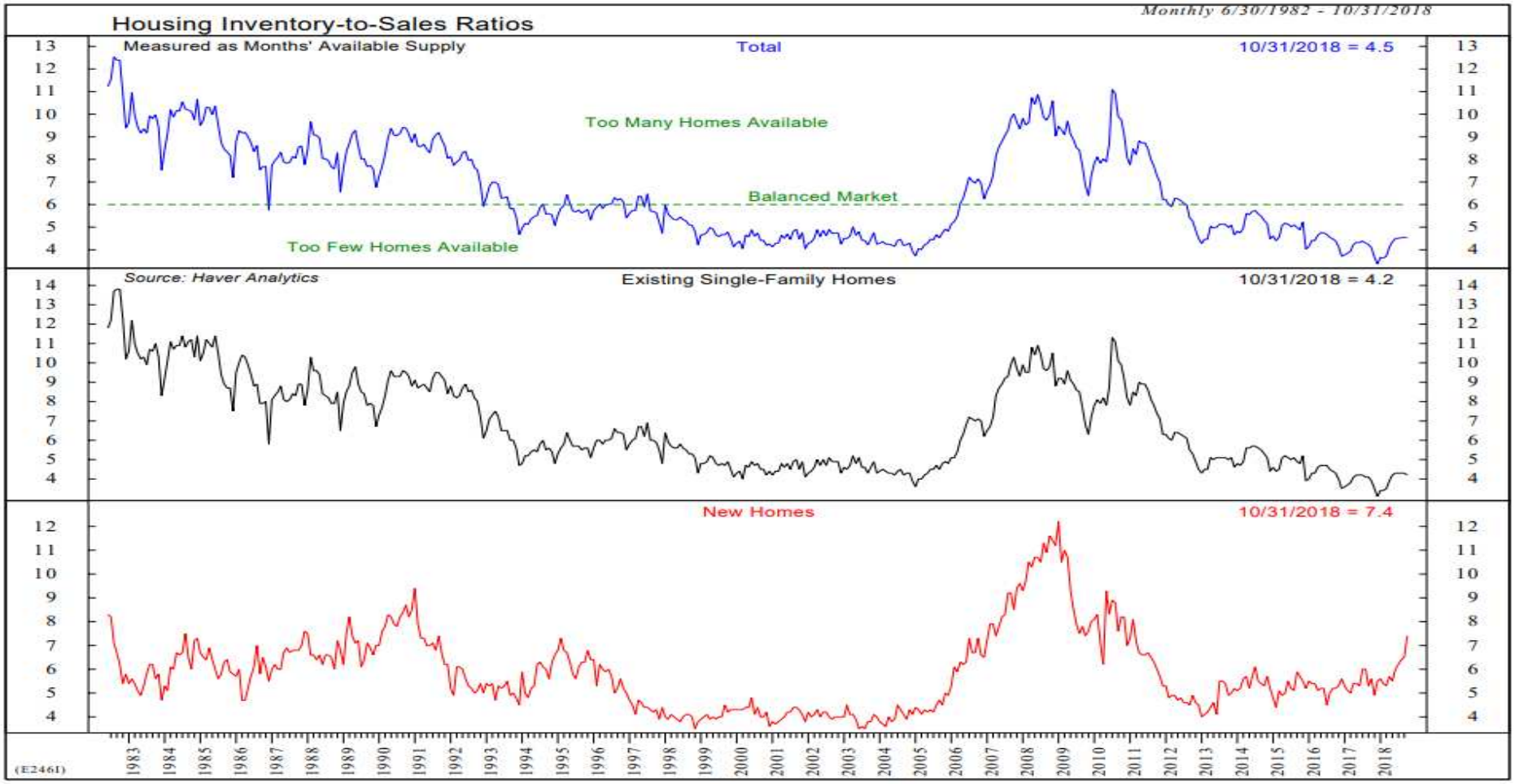
HOUSING IS VERY TIGHT



Source: Ned Davis Research, FFA Investment Management

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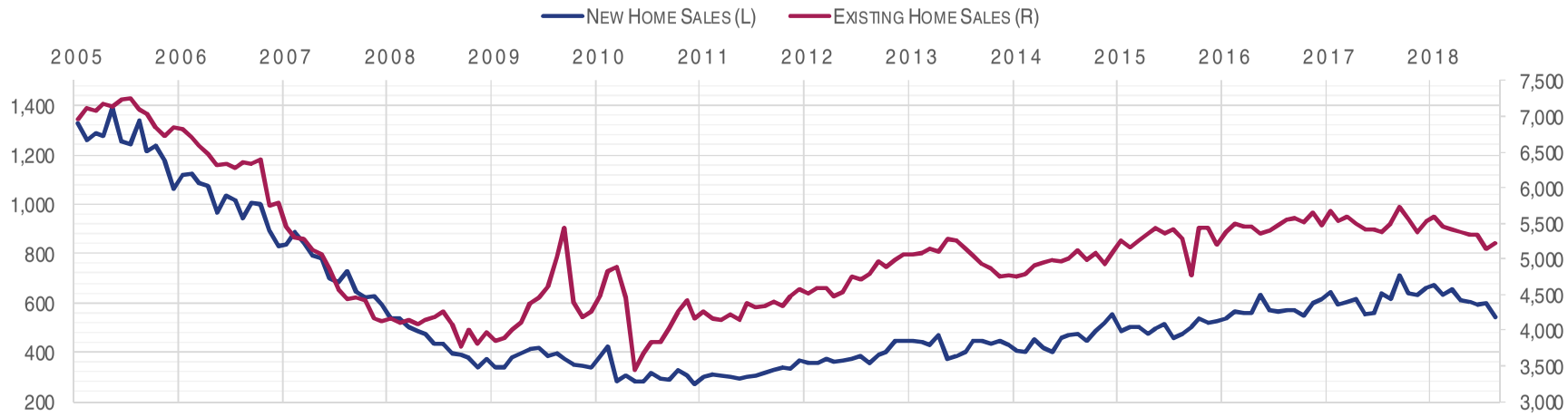
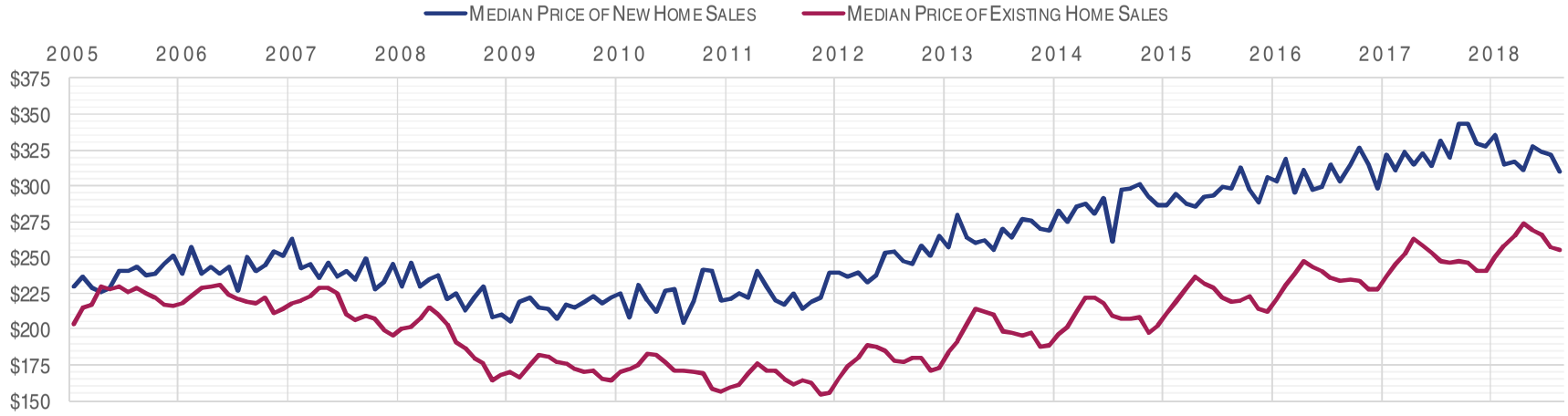
BUT PRICES HAVE DRIFTED DOWN IN RECENT MONTHS





Source: Ned Davis Research, FFA Investment Management

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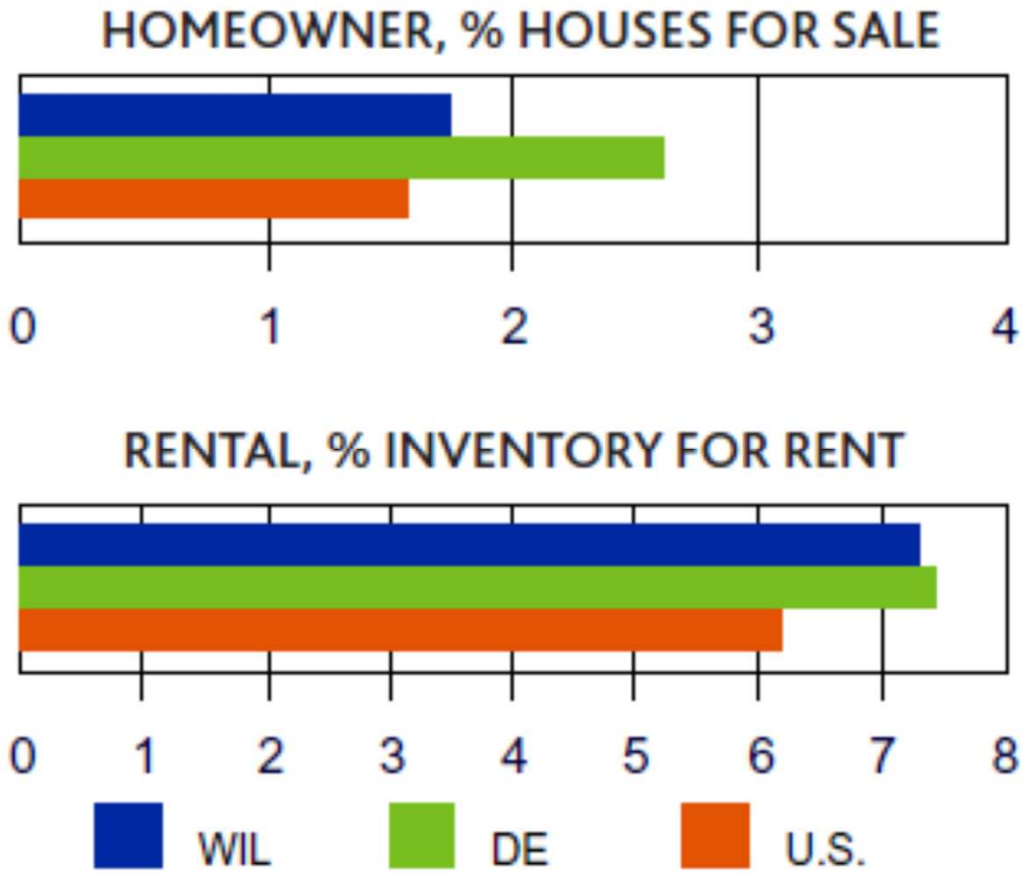
WILMINGTON AND DE ARE A LITTLE LESS TIGHT THAN THE U.S.



Source: Census Bureau, ACS, Moody's Analytics, 2017

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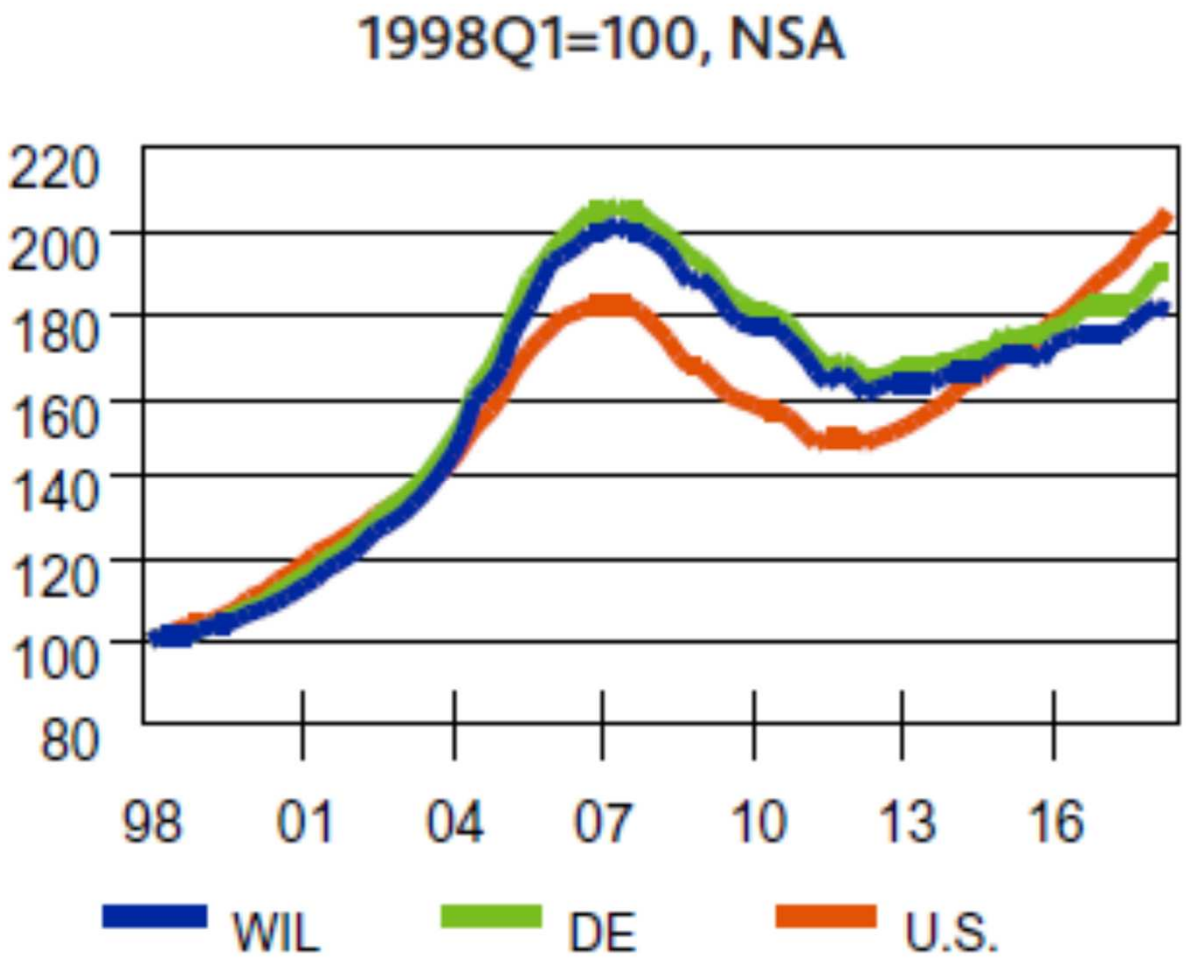
AND HAVE SEEN A LITTLE LESS PRICE APPRECIATION



Source: FHFA, Moody's Ana;ytics

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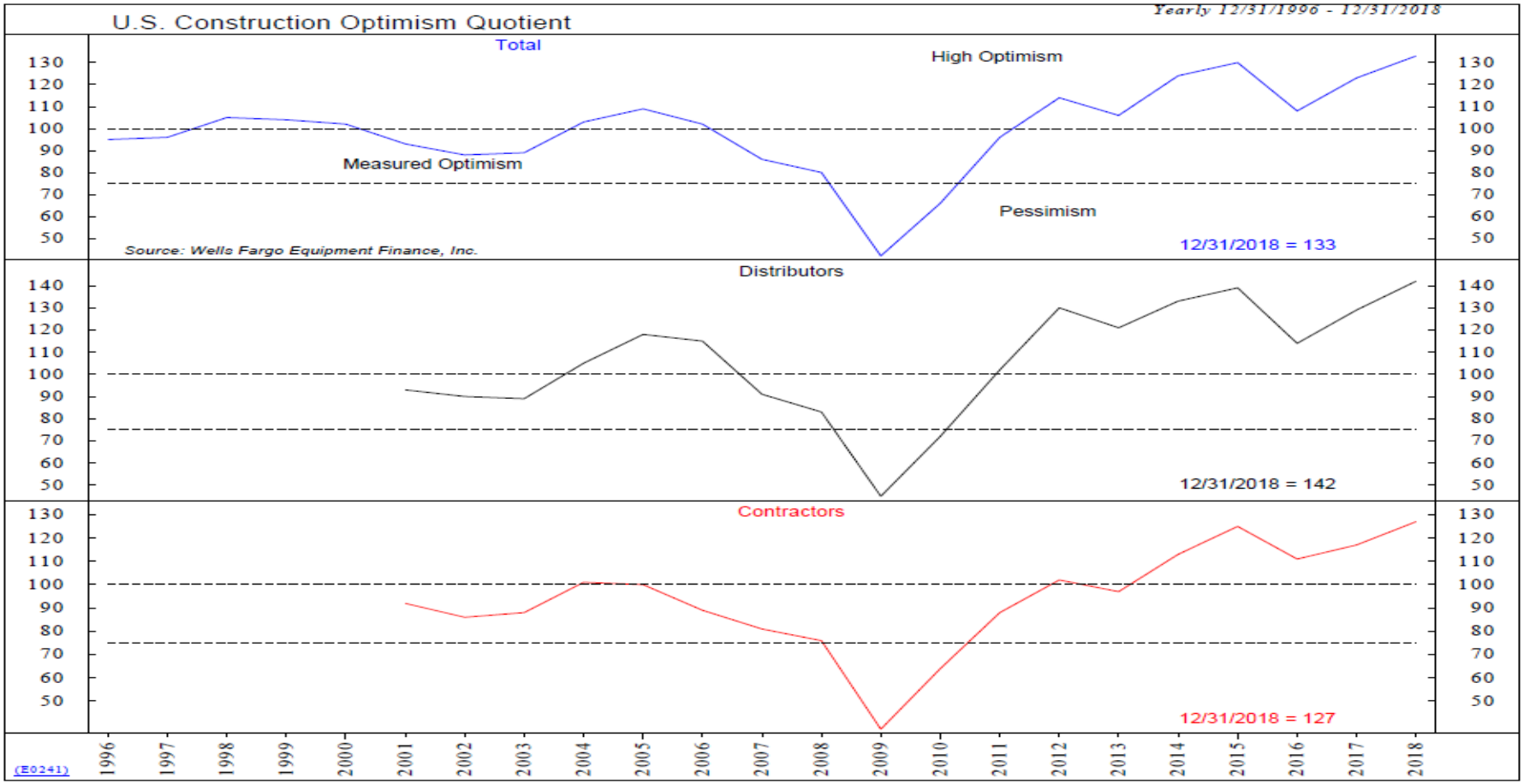
Construction Industry Remains Optimistic



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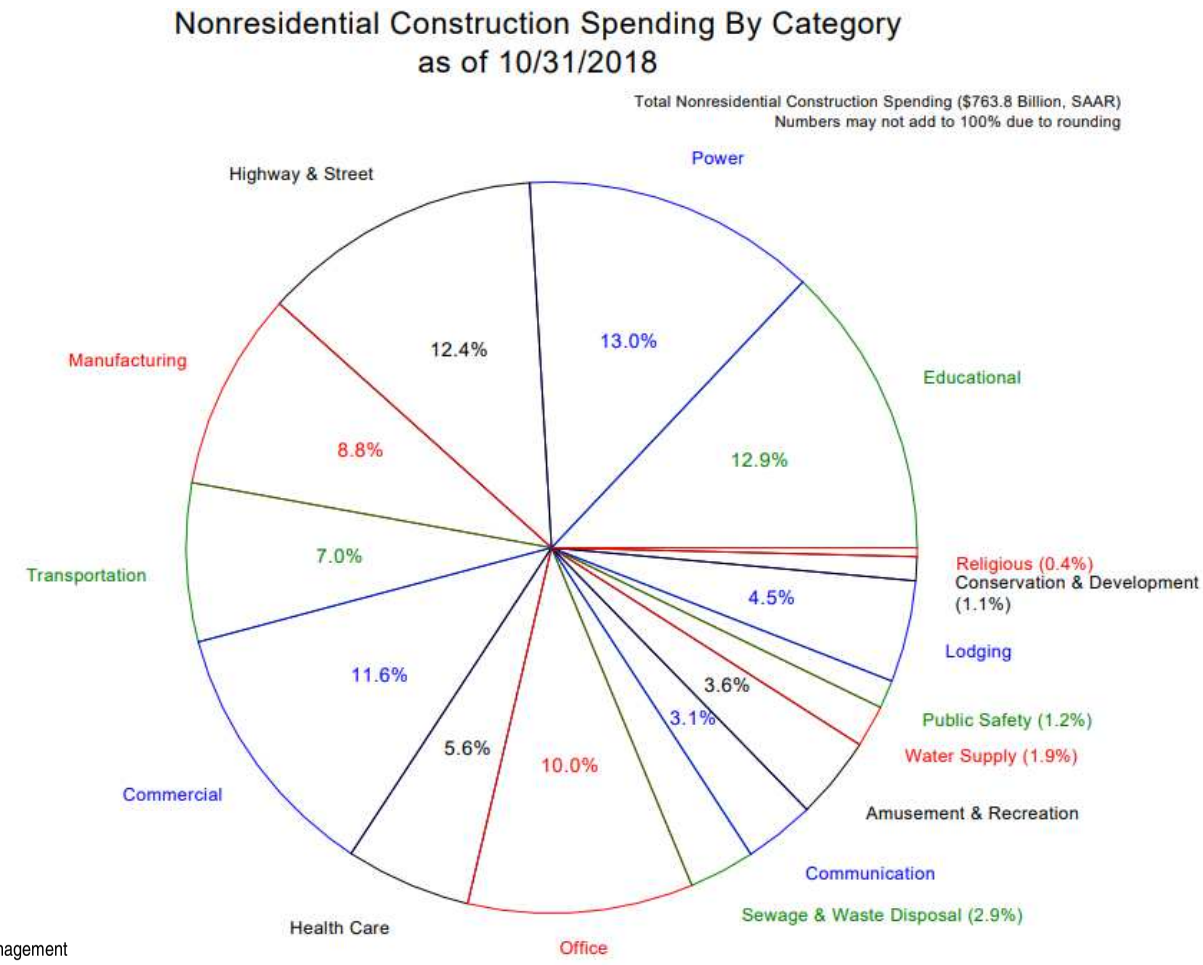
Source: Ned Davis Research, FFA Investment Management

CONSTRUCTION SPENDING MIX



Source: Ned Davis Research, FFA Investment Management

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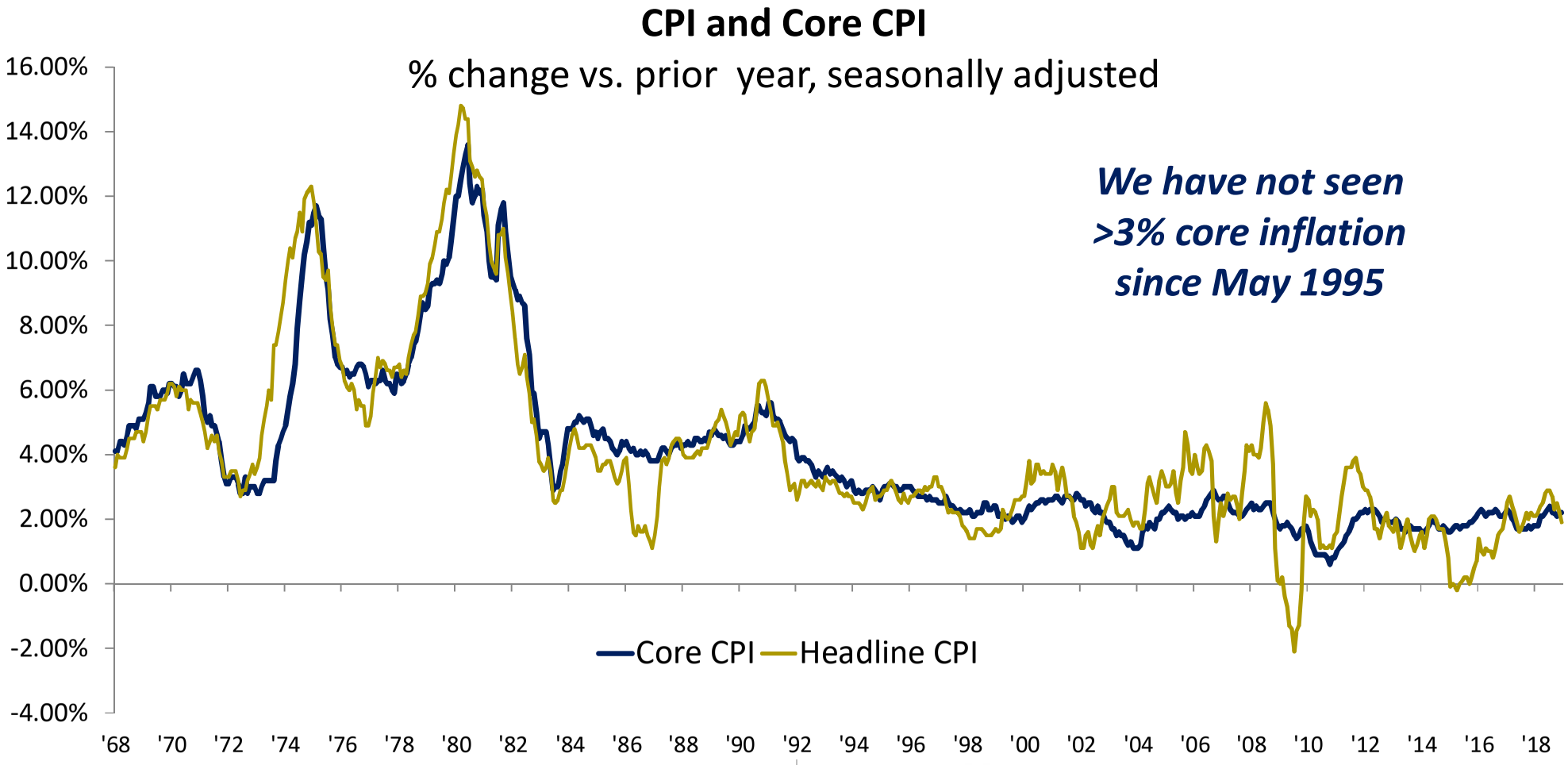
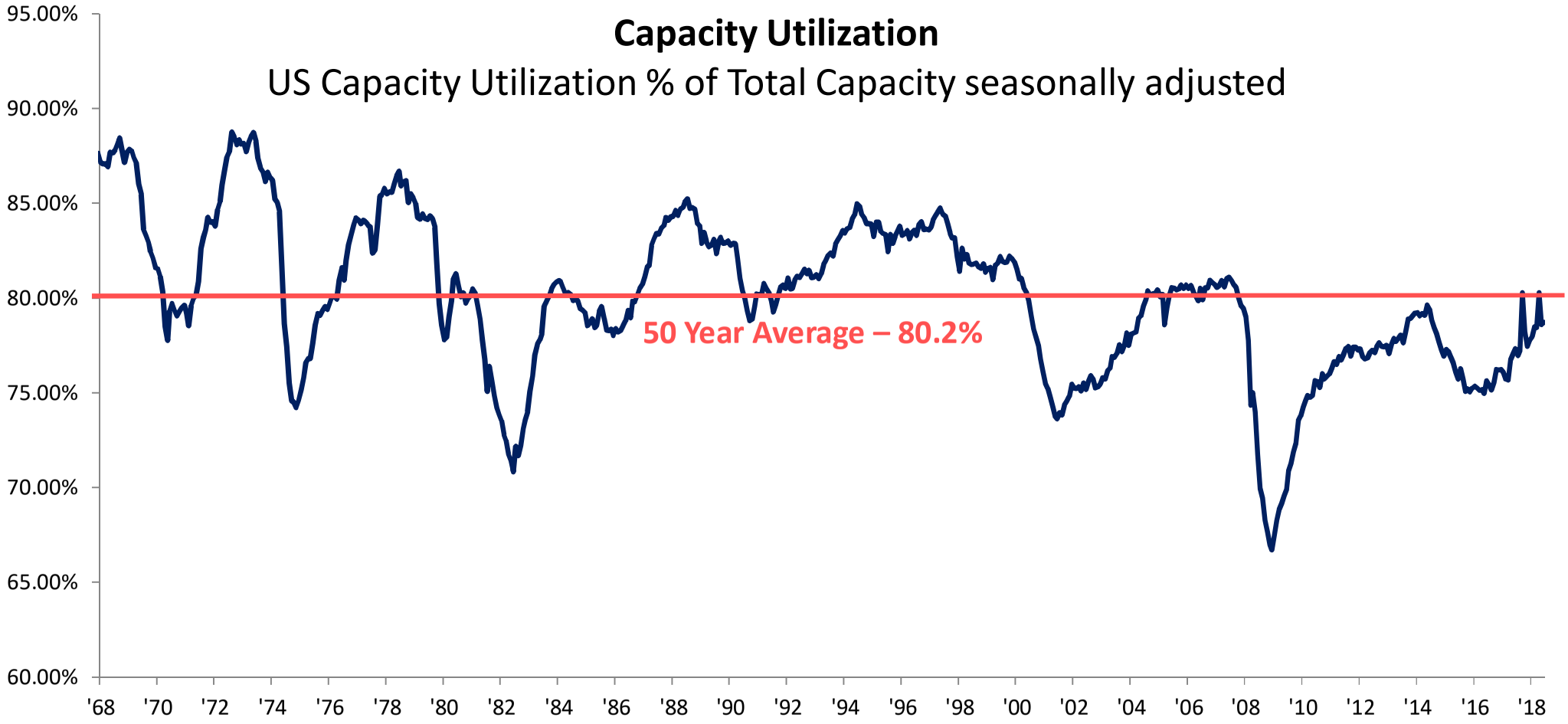
CONSTRUCTION BACKLOG

CONSTRUCTION BACKLOG INDICATOR				
Region	Months of Backlog	% Change from Q2 2018		Change from Q3 2017
Northeast	9.21	-11.4%	▬	-1.00 months
South	10.01	-10.5%	▬	-1.31 months
Middle States	7.76	7.3%	✚	0.15 months
West	9.35	-12.6%	▬	2.74 months
Industry				
Commercial/Institutional	9.20	-11.4%	▬	-0.15 months
Heavy Industrial	7.70	-1.0%	▬	2.27 months
Infrastructure	9.50	-5.9%	▬	-3.07 months
Company Size				
<$30 Million	8.29	-2.5%	▬	0.55 months
$30-$50 Million	9.06	-39.9%	▬	-2.31 months
$50-$100 Million	10.28	-11.3%	▬	-1.27 months
>$100 Million	13.02	-3.4%	▬	-0.79 months
© Associated Builders and Contractors, Construction Backlog Indicator				

Source: Associated Builders & Contractors, FFA Investment Management


CPI and Core CPI
% change vs. prior year, seasonally adjusted
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
'68 '70 '72 '74 '76 '78 '80 '82 '84 '86 '88 '90 '92 '94 '96 '98 '00 '02 '04 '06 '08 '10 '12 '14 '16 '18
Core CPI
Headline CPI
We have not seen >3% core inflation since May 1995

Recession Watch - Capacity Utilization



Source: Bloomberg, FFA Investment Management

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Recession Watch - Energy

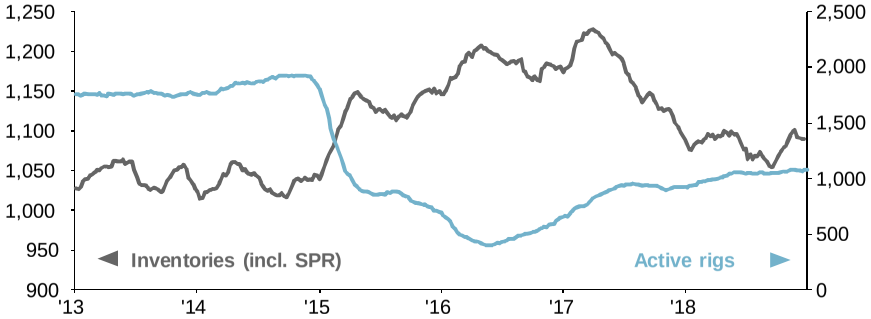
Change in production and consumption of liquid fuels

Production, consumption and inventories, millions of barrels per day

Production	2015	2016	2017	2018*	2019*	Growth since '15
U.S.	15.1	14.8	15.7	17.8	19.6	29.5%
OPEC	38.4	39.4	39.3	39.2	38.3	-0.2%
Russia	11.0	11.3	11.2	11.4	11.5	4.4%
Global	**97.0**	**97.4**	**98.1**	**100.4**	**101.8**	**5.0%**
Consumption						
U.S.	19.5	19.7	20.0	20.5	20.8	6.6%
China	12.4	12.8	13.4	13.9	14.3	15.8%
Global	**95.9**	**96.9**	**98.6**	**100.1**	**101.6**	**6.0%**
Inventory Change	1.1	0.4	-0.5	0.3	0.2	

U.S. crude oil inventories and rig count**

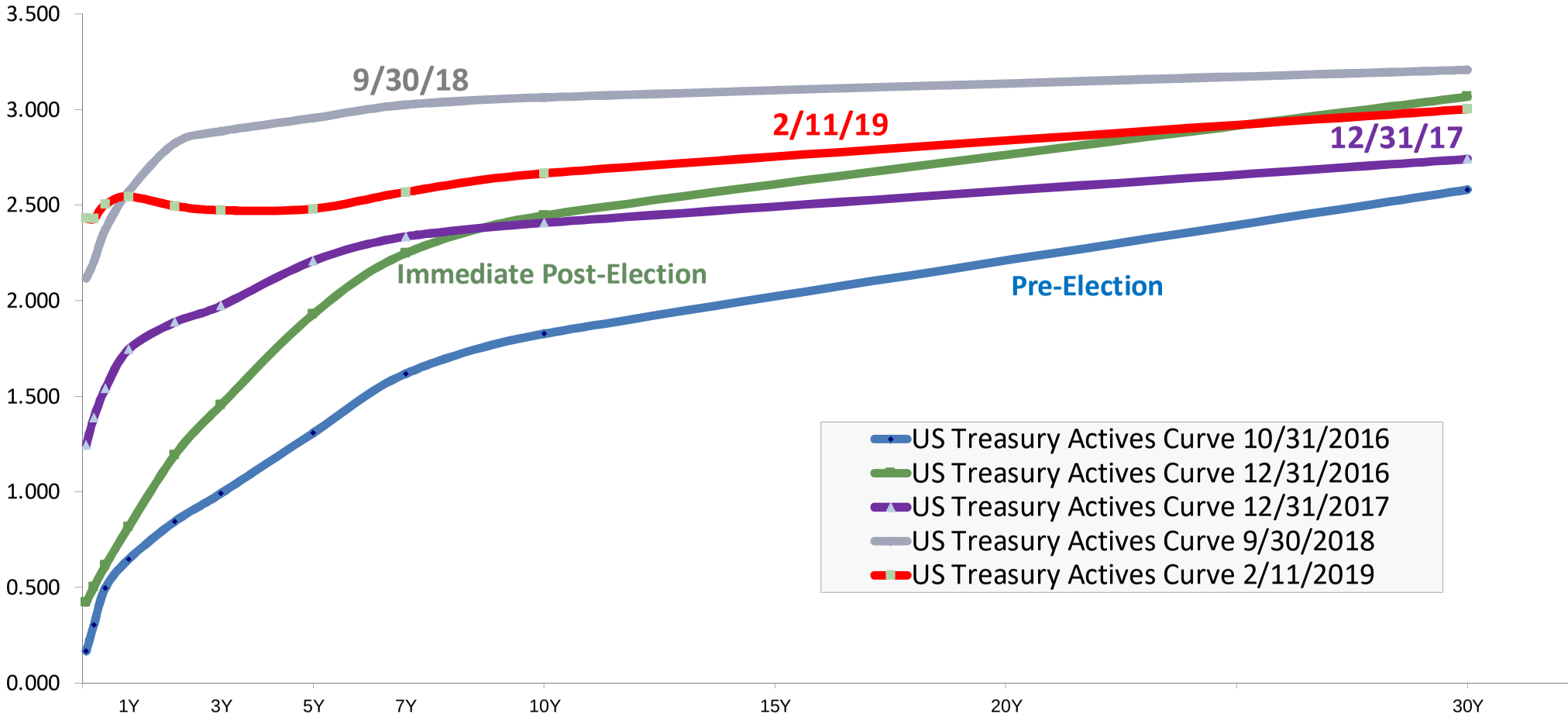
Million barrels, number of active rigs



Price of oil

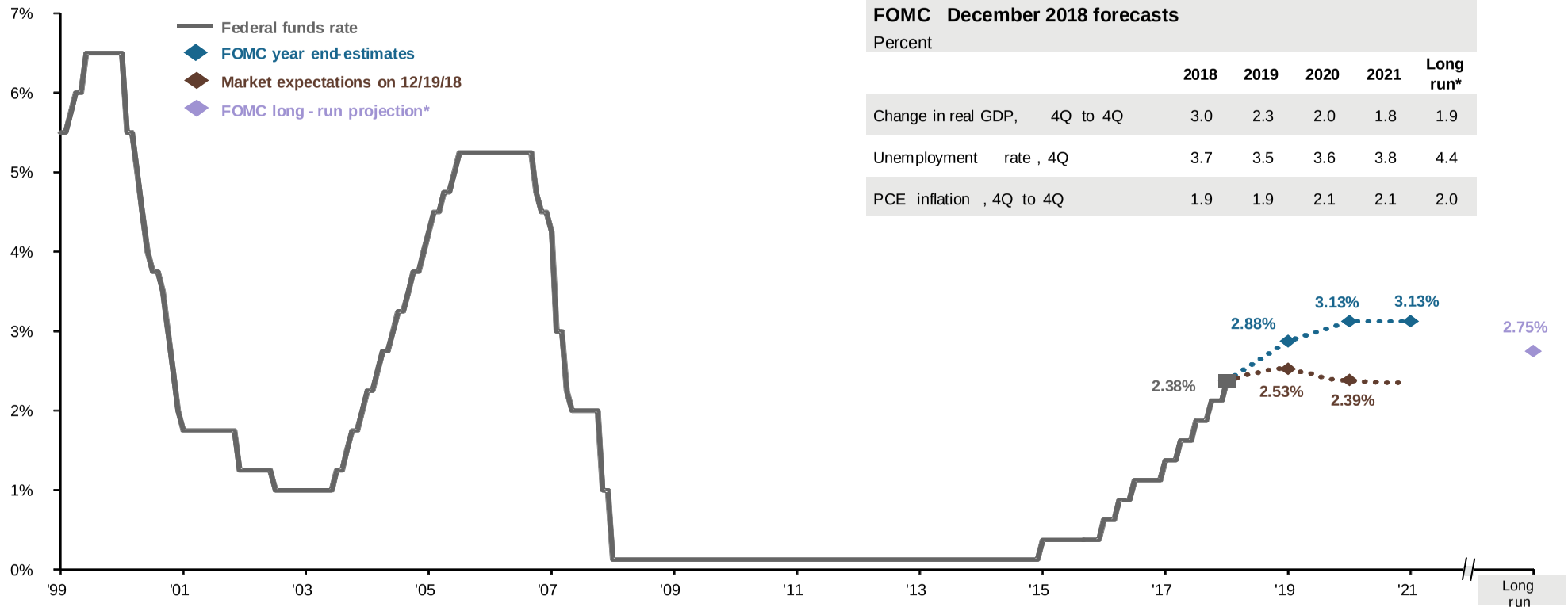
WTI crude, nominal prices, USD/barrel

Recession Watch - Interest Rates



RECESSION WATCH - INTEREST RATES

Federal funds rate expectations
FOMC and market expectations for the federal funds rate

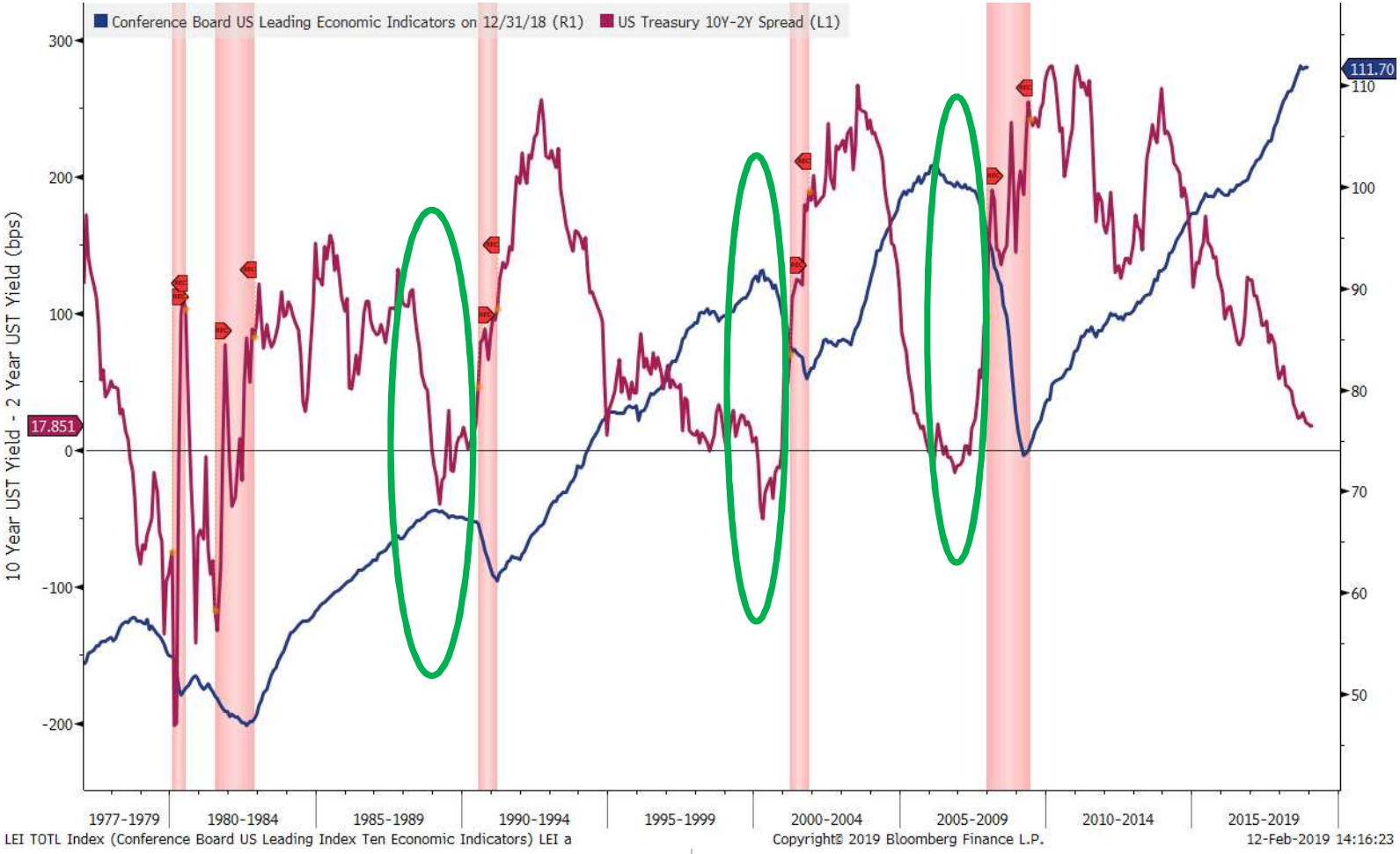


FOMC December 2018 forecasts
Percent

	2018	2019	2020	2021	Long run*
Change in real GDP, 4Q to 4Q	3.0	2.3	2.0	1.8	1.9
Unemployment rate, 4Q	3.7	3.5	3.6	3.8	4.4
PCE inflation, 4Q to 4Q	1.9	1.9	2.1	2.1	2.0

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Market expectations are the federal funds rates priced into the fed futures market as of the date of the December 2018 FOMC meeting and are through November 2021. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy.
Guide to the Markets – U.S. Data are as of December 31, 2018.

YIELD CURVE RECESSION SIGNALS?



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PRIVATE SECTOR AND THE EQUITY MARKETS

S&P 500 Index Q4 Thrill Ride

Source: Bloomberg, J.P. Morgan, FFA Investment Management

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S&P 500 Returns after bad quarters

	Quarter Ending	Quarterly Performance	Forward Performance One Year	Three Years	Five Years
1	June-32	-37.7%	162.9%	170.5%	344.8%
2	September-31	-33.6%	-9.6%	13.1%	118.2%
3	December-29	-27.8%	-24.9%	-60.9%	-40.7%
4	September-74	-25.2%	38.1%	72.7%	117.5%
5	December-87	-22.6%	16.8%	48.8%	109.0%
6	December-08	-21.9%	26.5%	48.6%	128.2%
7	December-37	-21.4%	31.1%	17.6%	25.4%
8	June-62	-20.6%	31.2%	69.2%	94.8%
9	March-38	-18.6%	35.2%	38.2%	84.5%
10	September-46	-18.0%	6.4%	24.5%	115.4%
11	June-70	-18.0%	41.9%	57.4%	56.3%
12	June-30	-17.7%	-23.4%	-34.7%	-32.8%
13	September-02	-17.3%	0.3%	27.0%	66.3%
			25.6%	**37.8%**	**91.3%**
14	**December-18**	**-17.1%**		**?????**	

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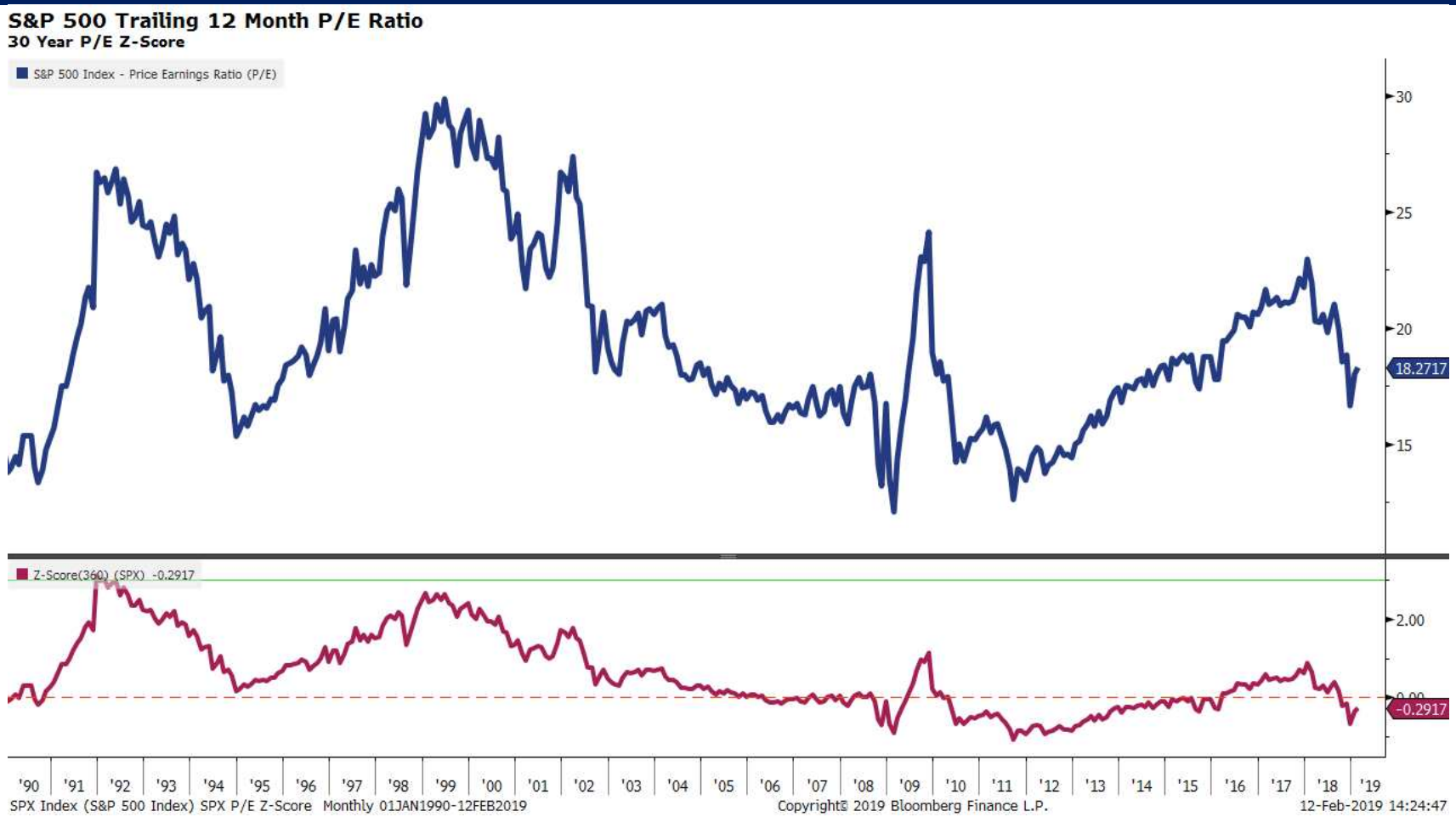
S&P 500 Index – Reasonably Valued?



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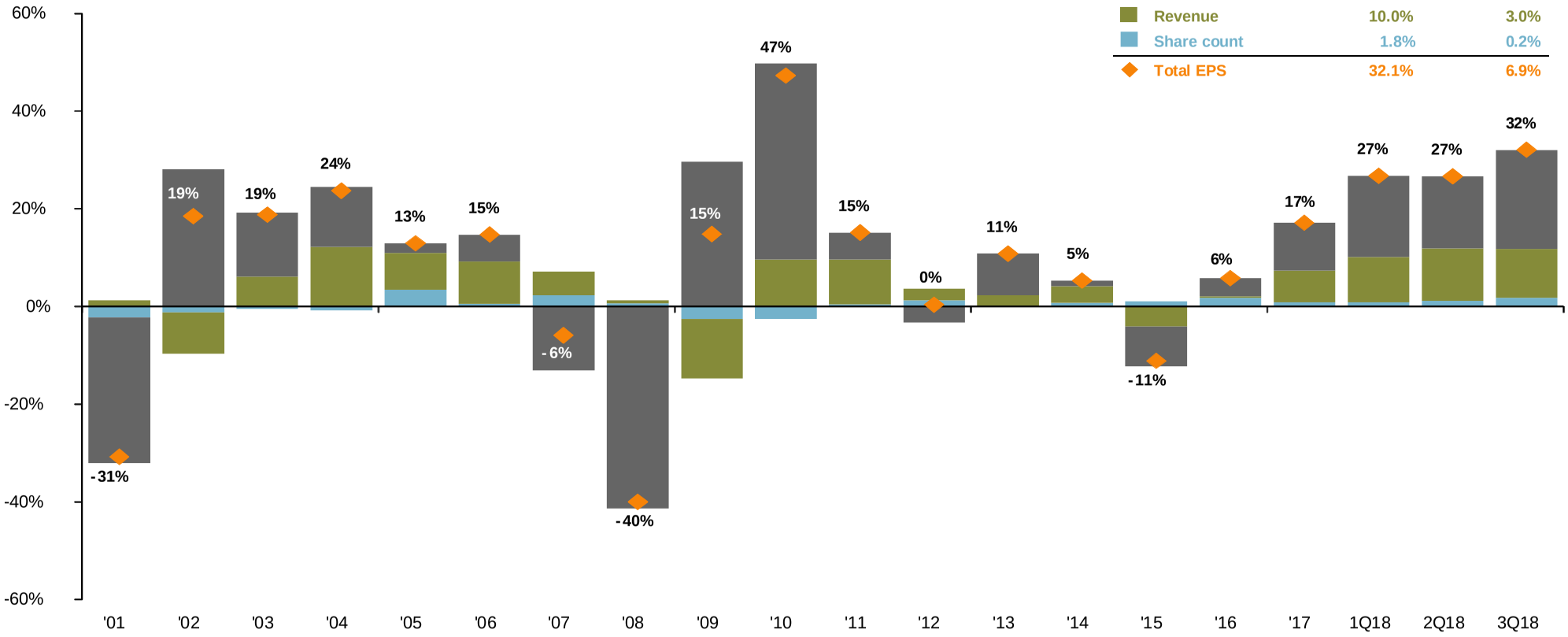
S&P 500 Index - Source of Earnings

S&P 500 year-over-year operating EPS growth

Annual growth broken into revenue, changes in profit margin & changes in share count

Share of EPS growth	3Q18	Avg. '01 -'17
Margin	20.3%	3.8%
Revenue	10.0%	3.0%
Share count	1.8%	0.2%
Total EPS	32.1%	6.9%



Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.
EPS levels are based on annual operating earnings per share except for 2018, which is quarterly. Percentages may not sum due to rounding. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of December 31, 2018.

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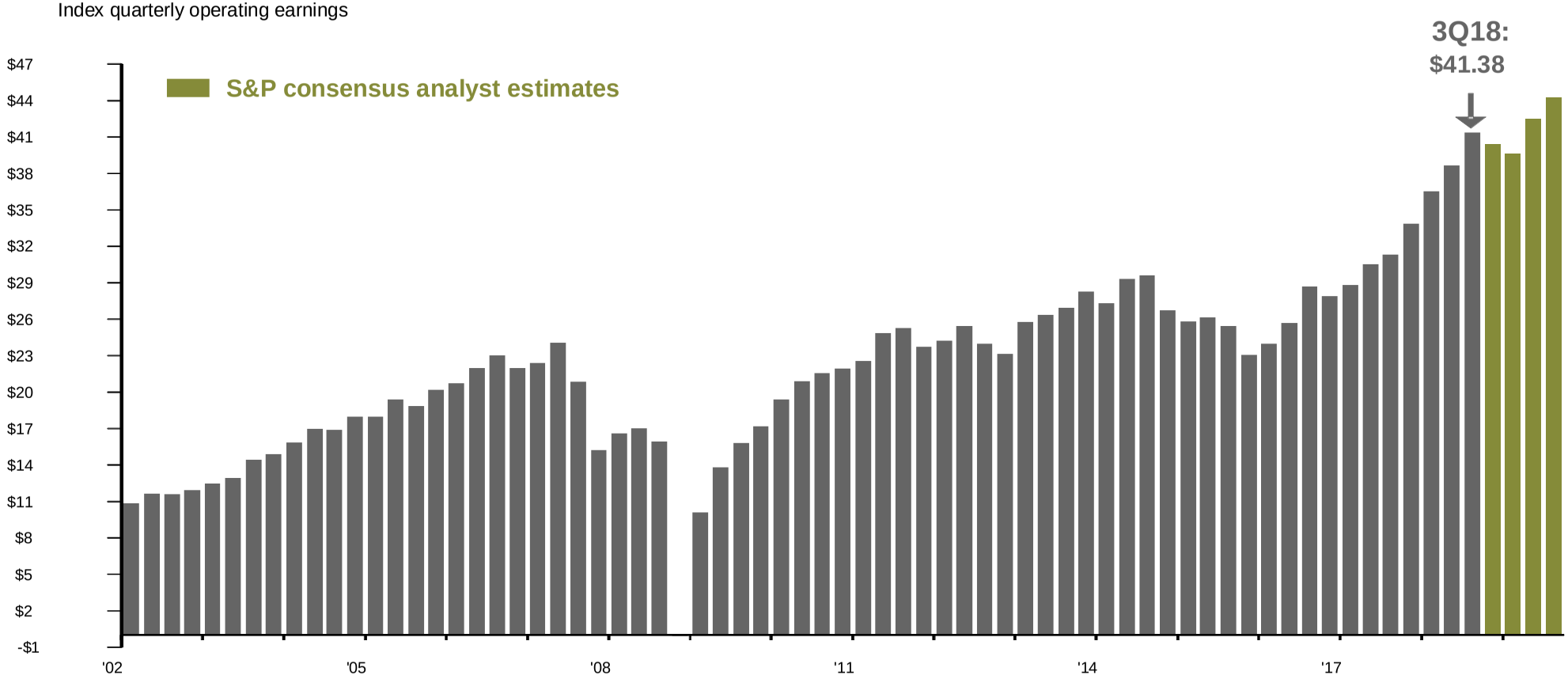
S&P 500 operating earnings per share

Index quarterly operating earnings



Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Top right) Federal Reserve, S&P 500 individual company 10k filings, S&P Index Alert

EPS levels are based on operating earnings per share. Earnings estimates are Standard & Poor's consensus analyst expectations.

THE FEDERAL GOVERNMENT

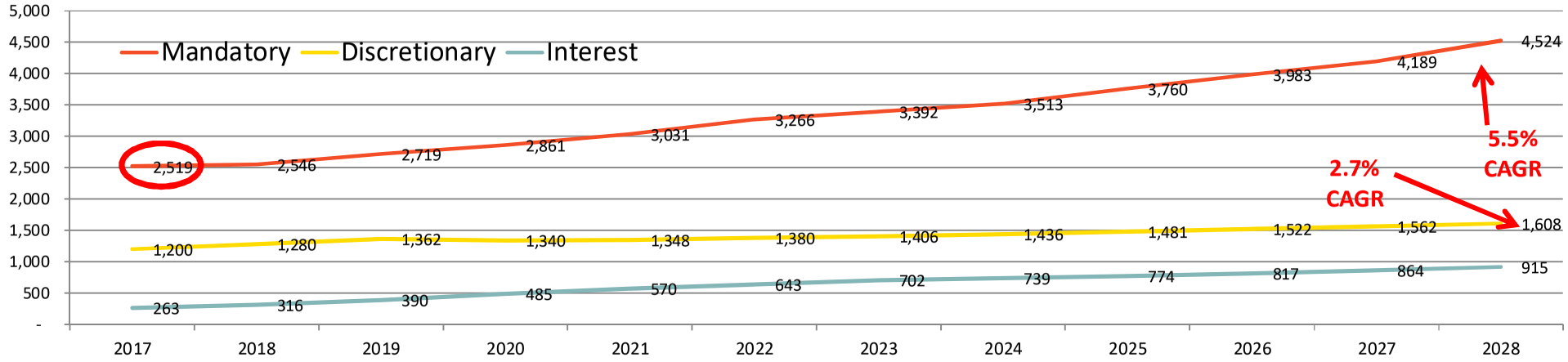
Federal Budget (billions)

	2017
Revenue	$3,316
Expense	$3,982
Deficit	$ 665
% of GDP	3.5%
Debt % of GDP	76.5%

Storm Cloud #3

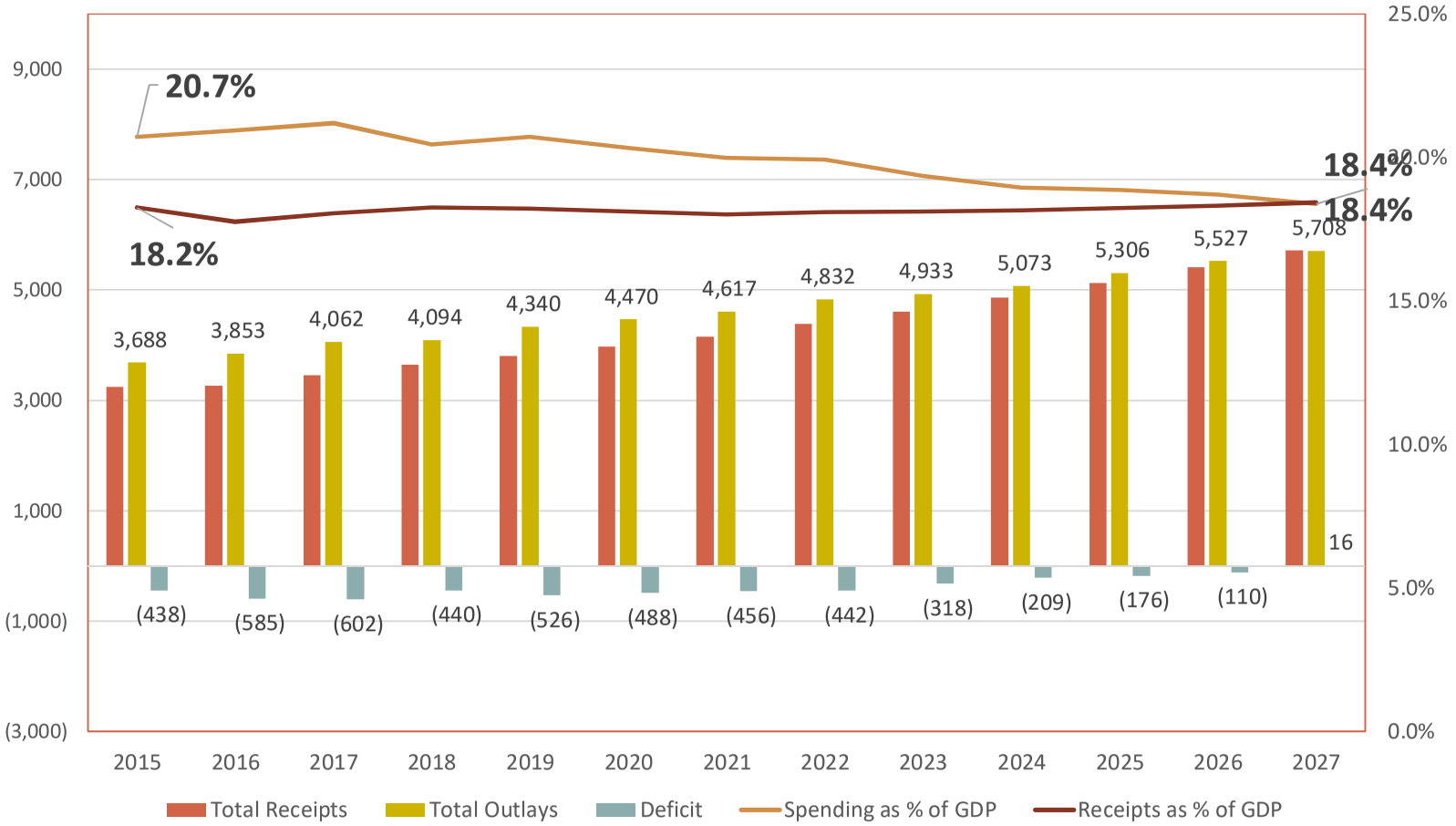
2017 U.S. Federal Revenue (billions):

Personal Income	$1,587
Corporate Income	$ 297
SS, Medicare, FUT	$1,162
Excise, Duties, T&E, etc.	$ 270
Total	**$3,316**



Source: www.whitehouse.gov – Budget of the United States Government, Fiscal Year 2017, Summary Tables S-1 and S-4

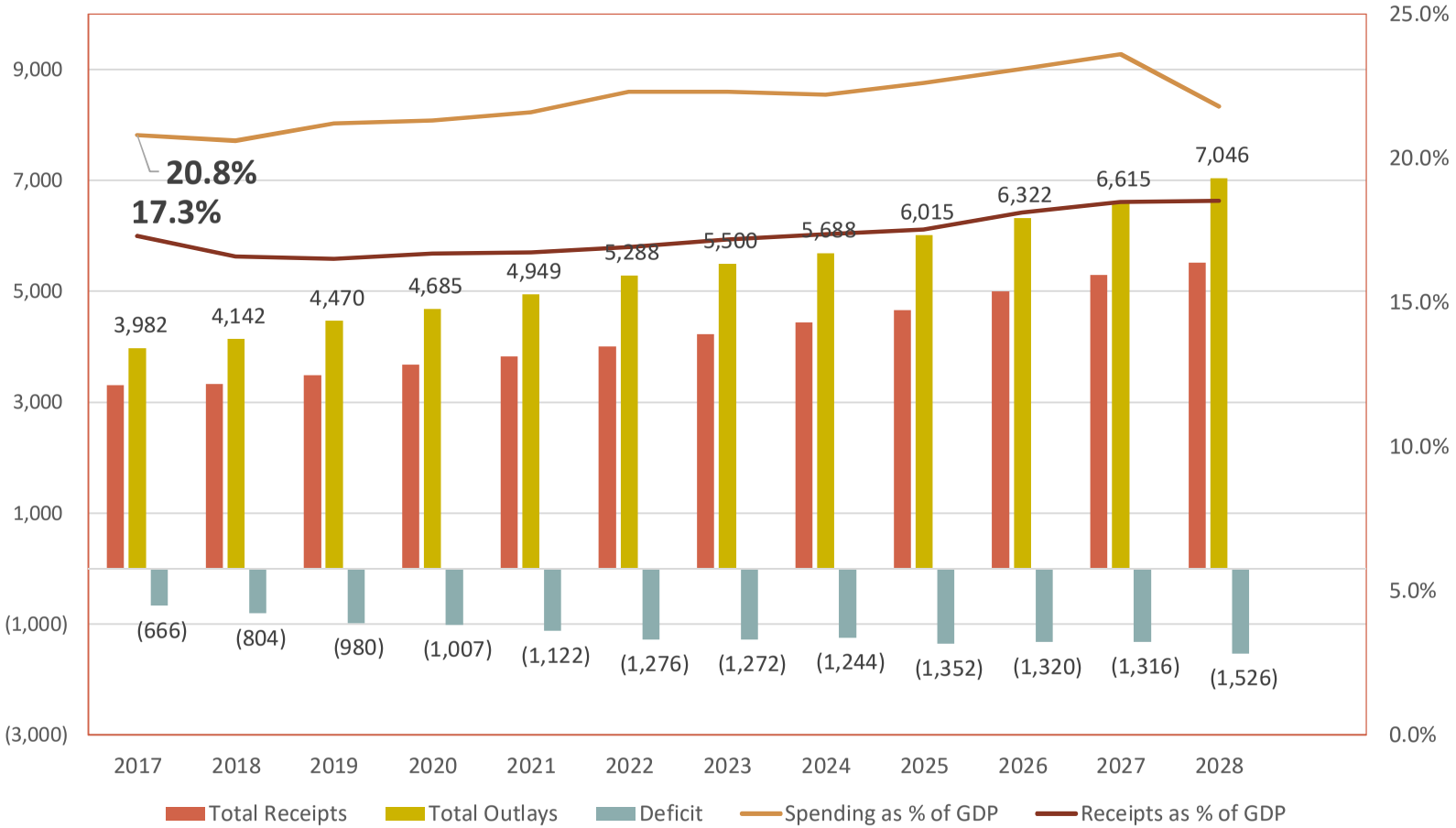
Trump Budget Proposal From Beginning of 2017



Source: www.whitehouse.gov – Budget of the United States Government, Fiscal Year 2018, Summary Tables S-1 and S-4

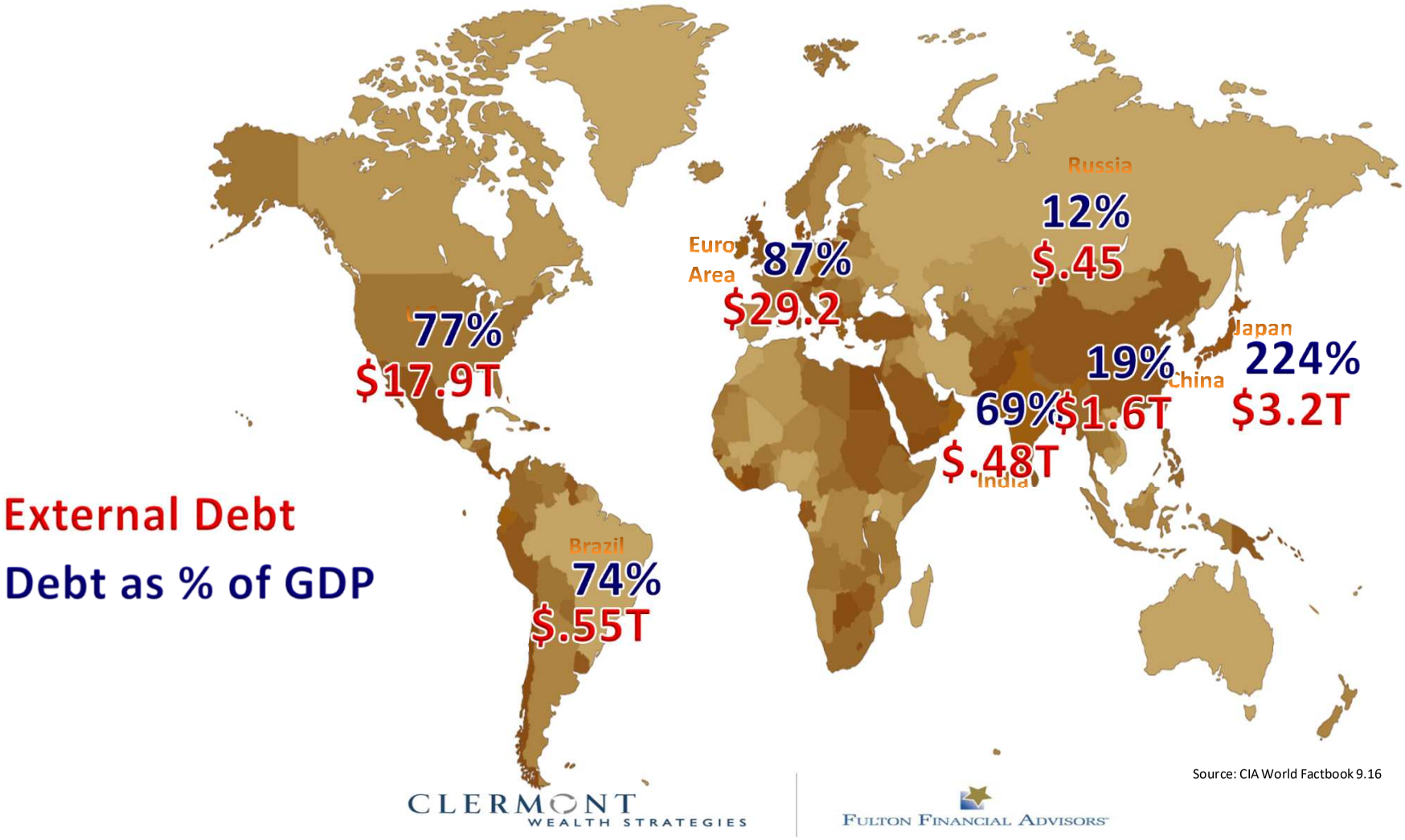
- Debt to GDP **shrinking** from 77.0% to 59.8%
- Personal taxes growing at a CAGR of 6.4%
- Corporate taxes growing at a CAGR of 5.2%
- **Nominal GDP growing at a CAGR of 5.2%**

CBO Budget Projections – April 2018



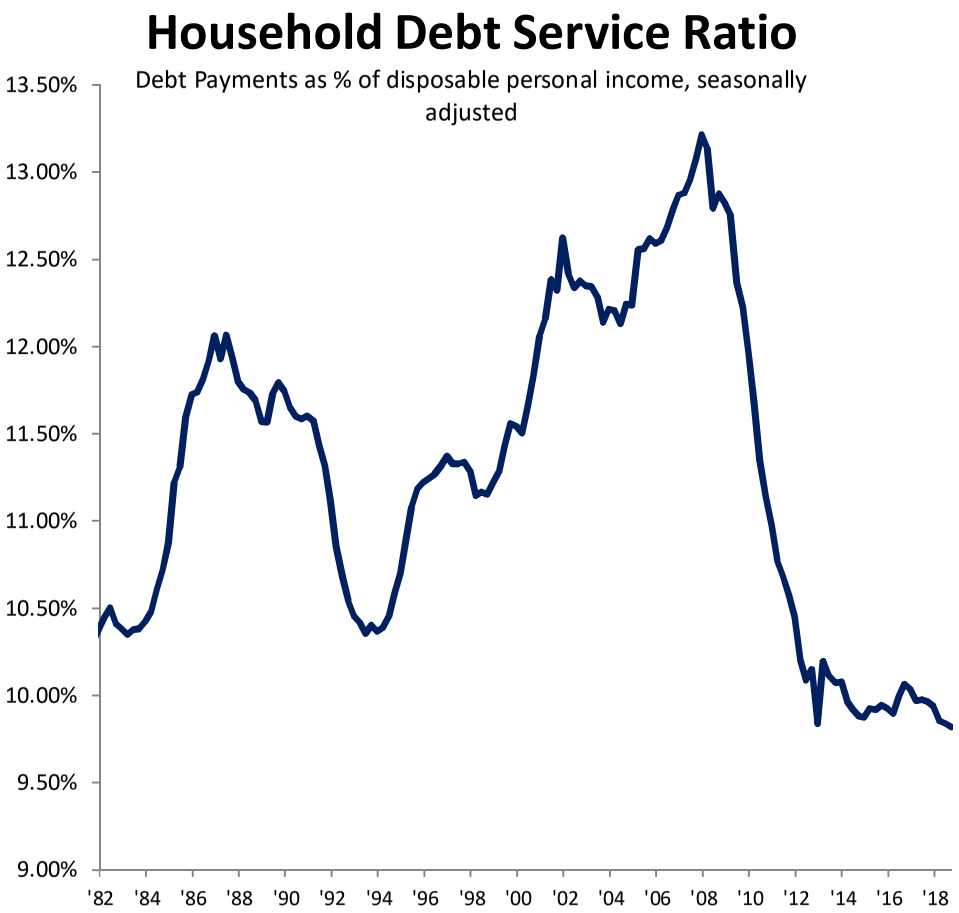
Source: Congressional Budget Office – The Budget and Economic Outlook: 2018 to 20028

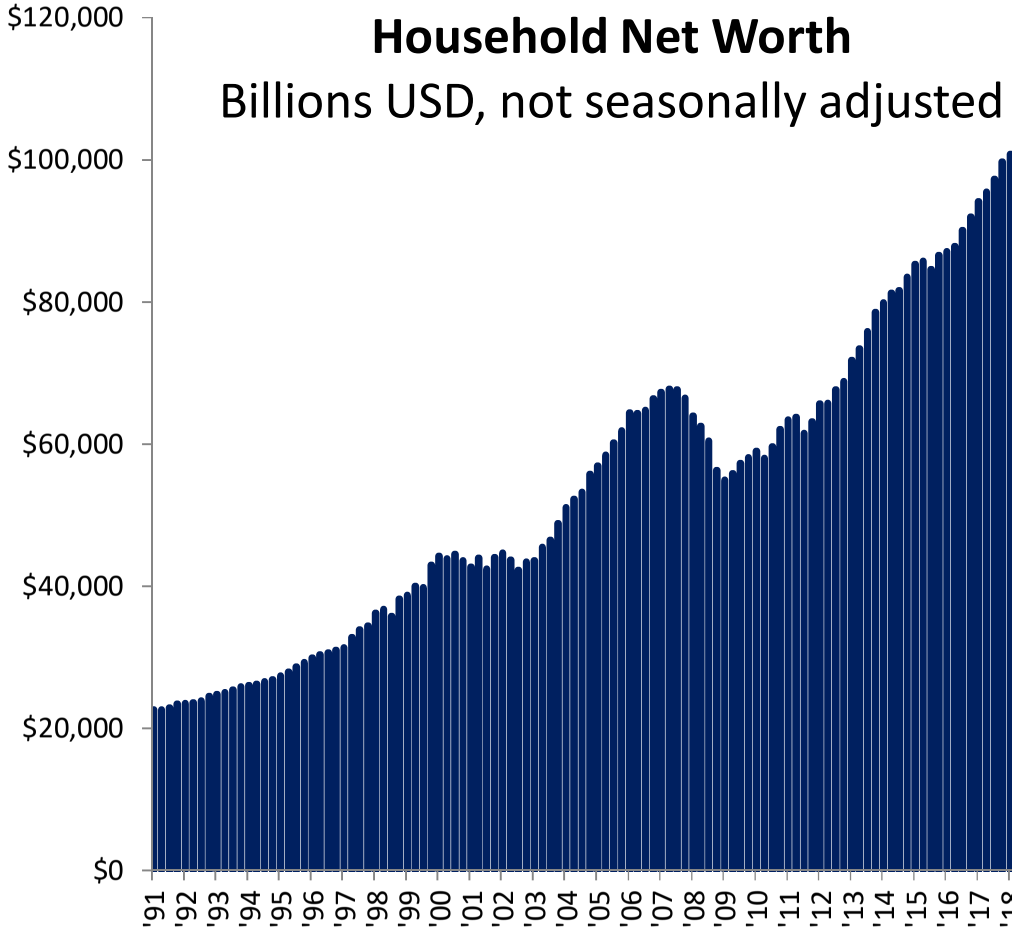
- Debt to GDP **GROWING** from 76.5% to 96.2%
- Personal taxes growing at a CAGR of 5.7%
- Corporate taxes growing at a CAGR of 3.8%
- **Nominal GDP growing at a CAGR of 4.1%**



Source: CIA World Factbook 9.16

WHAT COULD CAUSE AN UPSIDE SURPRISE?





Source: Bloomberg, FFA Investment Management

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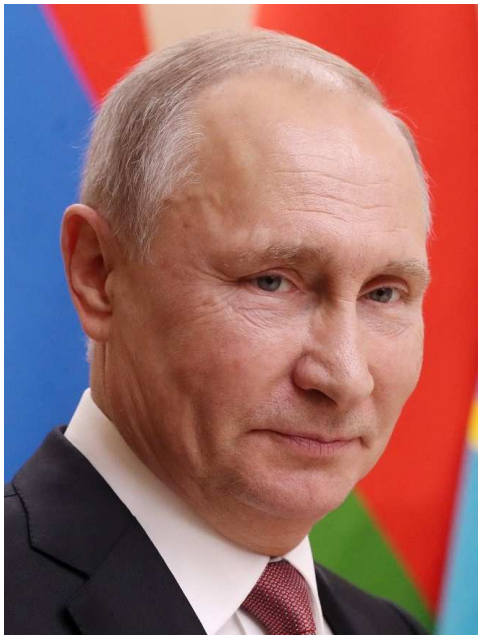
WHAT COULD CAUSE A DOWNSIDE SURPRISE?



IN SUMMATION…

- Growth has firmed up across the globe; U.S. recession is unlikely
- U.S. has been steadily "going 40" (~2% growth)
- Wage growth is trailing unemployment but finally showing up
- Inflation concerns are muted
- Further rate hikes now appear unlikely
- U.S. Equity Markets have been very volatile but are reasonably priced
- Trump budget assumed 3% GDP growth – hard to model but emotion could get us there
- New CBO budget assumes ~2% growth – possibly too pessimistic
- Syria / Korea / China / Russia / Brexit – Geopolitical risk is ever-present