

AUGUST 2016

ECONOMIC OUTLOOK

- ◆ U.S. economic growth was weaker than expected in the second quarter (Q2) as reduced business investment, downsizing of inventories and declining government spending tempered growth and offset the strength in consumer spending. The Commerce Department reported that Q2 GDP grew at a seasonally and inflation adjusted annual rate of 1.2%. The second quarter combined with the revised 0.8% growth rate in the first quarter suggests the economy grew at a 1% pace in the first six months, the weakest start to a year since 2011. We expect improvement in the second half on the strength of housing, consumption, and the service sector and anticipate GDP growth of 2% for the full year.
- ◆ Consumer spending provided most of the growth in Q2 and the report showed that spending rose at a 4.2% annual rate, the quickest pace in almost two years. Personal consumption, which accounts for more than two-thirds of U.S. economic activity, increased 0.4% in June after a similar advance in May and 1% growth in April. Wages increased 0.3% in June, slightly less than spending, and subsequently the savings rate declined to 5.3% as Americans tapped some of their reserves for the purchases. Expenditures are broadening out beyond durable goods, such as houses and automobiles, as new job creation, wage gains, and higher home values are bolstering consumer confidence.
- ◆ The housing market remains an improving bright spot in the U.S. economy. The Commerce Department recently reported strong housing numbers for the month of June. Sales of new single-family homes rose by 3.5% to a seasonally adjusted annual rate of 592,000, the fastest pace in over seven years and 25% higher than last year. Housing starts in June rose 4.8% versus May and home prices continue to increase as the S&P/Case-Shiller Home Price Index rose 5% in the 12 months ended in May. The median sale price of a home sold in June was \$306,700, up 6.1% compared to last year.
- ◆ The Federal Open Market Committee met on July 26-27 and members left the benchmark rate unchanged, but retained the option of raising rates later this year. The statement specifically noted, "Near-term risks to the economic outlook have diminished." The Fed's inflation target rate of 2% has not been met for over four years as slumping energy prices and a strong dollar, which lowers import prices, have provided downward pressure. We anticipate an increase in the federal funds rate will most likely not occur before their December meeting.

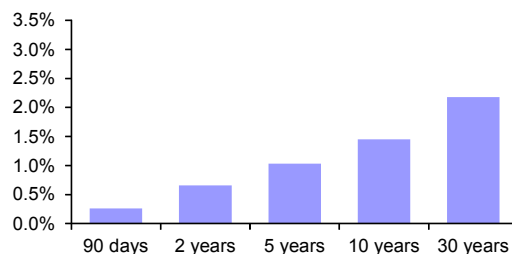
INVESTMENT REVIEW

- ◆ The major U.S. equity indices posted strong gains in July. The Dow Jones Industrial Average rose 2.8%, the S&P 500 added 3.6% and the Nasdaq Composite increased 6.6% for the month. The U.S. being viewed as a safe haven in a chaotic world and a relief bounce from the initial Brexit shock were the main drivers for the upward move.
- ◆ U.S. crude prices declined 15.9% in the month of July to \$41 a barrel, hitting a three month low. An increase in U.S. production and the oil supply is the primary cause for the drop in value. Refiners also have a glut of gasoline which has driven down the price at the pump. This is bad for energy companies' earnings, but a windfall for consumers.
- ◆ Fueled by low interest rates, M&A activity remains strong, especially in the technology sector. Analog Devices has agreed to buy Linear Technology for \$14.8 billion and Oracle is buying cloud-services provider NetSuite for \$9.3 billion. Also, Citrix is merging its GoToMeeting unit with LogMeIn. We expect mergers to continue as long as companies have access to cheap financing to fund growth.

KEY INVESTMENT STATISTICS

	7/31/2016	12 Month High	12 Month Low	YTD Price Change
Dow Jones Industrial Average	18432	18595	15660	5.8%
Nasdaq Composite	5162	5162	4267	3.1%
S & P 500 Stock Index	2173	2175	1829	6.3%
2016 Operating EPS Estimate	\$117			
P/E on 2016 EPS	18x			
2017 Operating EPS Estimate	\$129			
P/E on 2017 EPS	17x			
Dividend Yield	2.1%			
Yields on US Treasury Obligations				
90 days	0.26%			
2 years	0.66%			
5 years	1.03%			
10 years	1.45%			
30 years	2.18%			
CPI: Trailing 12 Months	1.0%			
Crude Oil: Price Per Barrel [WTI]	\$41	\$51	\$26	
Gold: Price Per Ounce	\$1,342	\$1,366	\$1,049	
Natural Gas: Price per MM BTU [spot]	\$2.76	\$2.93	\$1.49	

US Treasury Yields



Source: Bloomberg LLC, Thompson Financial, US Commerce Dept. HIS iSuppli

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