

ECONOMIC OUTLOOK

- ◆ Federal Reserve Chair Janet Yellen gave a sanguine view of the economy at the FOMC’s annual Jackson Hole Economic Policy Symposium on August 26. In the anticipated speech, Yellen stated the US economy is “now nearing the Federal Reserve’s statutory goals of maximum employment and price stability.” The Fed believes its dual mandate of stable growth and full employment may be within reach. As the economy gains momentum, the Fed is expected to gradually raise the Federal Funds rate in an effort to maintain economic stability.
- ◆ Jobs were added at a faster rate than anticipated in July. Payroll gains of 275,000 outpaced the six-month average and beat expectations. More individuals who had previously quit looking for employment entered the workforce causing the unemployment rate to remain unchanged at 4.9%, while increasing the labor participation rate. In August, the jobless rate and labor participation rate held steady though just 151,000 jobs were added. Strength in employment supports the thesis that the U.S. economy continues to gain momentum. The Atlanta Fed’s GDPNow forecast for third quarter GDP growth of 3.2% reflects acceleration from 1.2% in the second quarter.
- ◆ The consensus year-over-year increase in the Consumer Price Index (CPI) for the first quarter of next year is 2.2%; the headline Personal Consumption Expenditures (PCE) deflator is estimated to advance nearly 1.9%. This jump in headline inflation is recognized by the Fed and could be one reason why they have signaled the need to raise the inflation target - or allow the “economy to run hot” with inflation above its target. Rising inflation expectations would likely push the 10-year Treasury yield higher.
- ◆ Productivity gains have not materialized, leading some to question the sustainability of GDP growth. Nonfarm business productivity – the goods and services produced each hour by workers, recently declined at a 0.5% annual seasonally adjusted rate. The decrease occurred in the second quarter and reflects a slowing from the tepid rate of 1.3% from 2007 through 2015 – itself just half the pace seen in 2000 through 2007. The decline may reflect difficulty in gauging productivity in the service sector which has been growing as a percent of GDP. Also, during an expansion, productivity initially declines as businesses add employees.
- ◆ The U.K. economy has shown remarkable resilience since the British vote on June 23 to exit the Eurozone. A weaker British pound has buoyed tourism while the UK manufacturing orders survey for August reached the highest level in two years. Elsewhere, the Eurozone composite PMI ticked up in August.

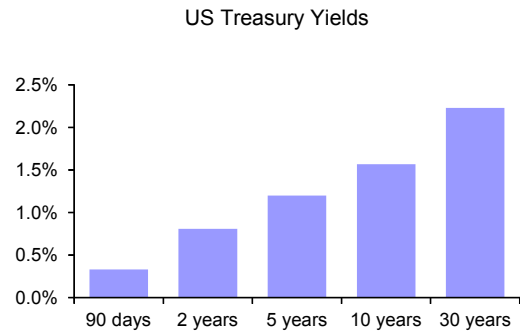
INVESTMENT REVIEW

- ◆ The major U.S. equity indices ended were essentially unchanged in August despite reaching all-time highs mid-month. Over the past 30 days, the Dow Jones Industrial Average and S&P 500 were flat while the Nasdaq Composite increased just +0.6%. The markets may be temporarily range-bound awaiting more evidence of economic strength.
- ◆ Expectations for higher U.S. interest rates have resulted in the dollar strengthening. A stronger dollar may pose a headwind to forecasts for higher revenues and earnings next year. Analysts estimate S&P 500 revenue will grow about 6% in 2017 after increasing less than 2% this year. Earnings for 2017 are, likewise, expected to increase nearly 14% year-over-year.
- ◆ The Bank of England (BOE) cut its benchmark interest rate to 0.25% from 0.50%, an historic low. The BOE stated the economic growth outlook for 2017 had “weakened materially” even while recent economic data has positively surprised. Central banks around the globe have employed unprecedented monetary easing measures to counter slowing growth.

KEY INVESTMENT STATISTICS

	8/31/2016	12 Month High	12 Month Low	YTD Price Change
Dow Jones Industrial Average	18401	18636	15660	5.6%
Nasdaq Composite	5220	5262	4267	4.1%
S & P 500 Stock Index	2171	2190	1829	6.2%
2016 Operating EPS Estimate	118			
P/E on 2016 EPS	18x			
2017 Operating EPS Estimate	128			
P/E on 2017 EPS	17x			
Dividend Yield	2.0%			

Yields on US Treasury Obligations	
90 days	0.33%
2 years	0.81%
5 years	1.20%
10 years	1.57%
30 years	2.23%



CPI: Trailing 12 Months	0.8%		
Crude Oil: Price Per Barrel [WTI]	\$45	\$51	\$26
Gold: Price Per Ounce	\$1,307	\$1,365	\$1,051
Natural Gas: Price per MM BTU [spot]	\$2.89	\$2.99	\$1.64

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

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