

2015 Economic & Stock Market Outlook

Mid-Year Update – Uncertainty Now; Opportunity Later

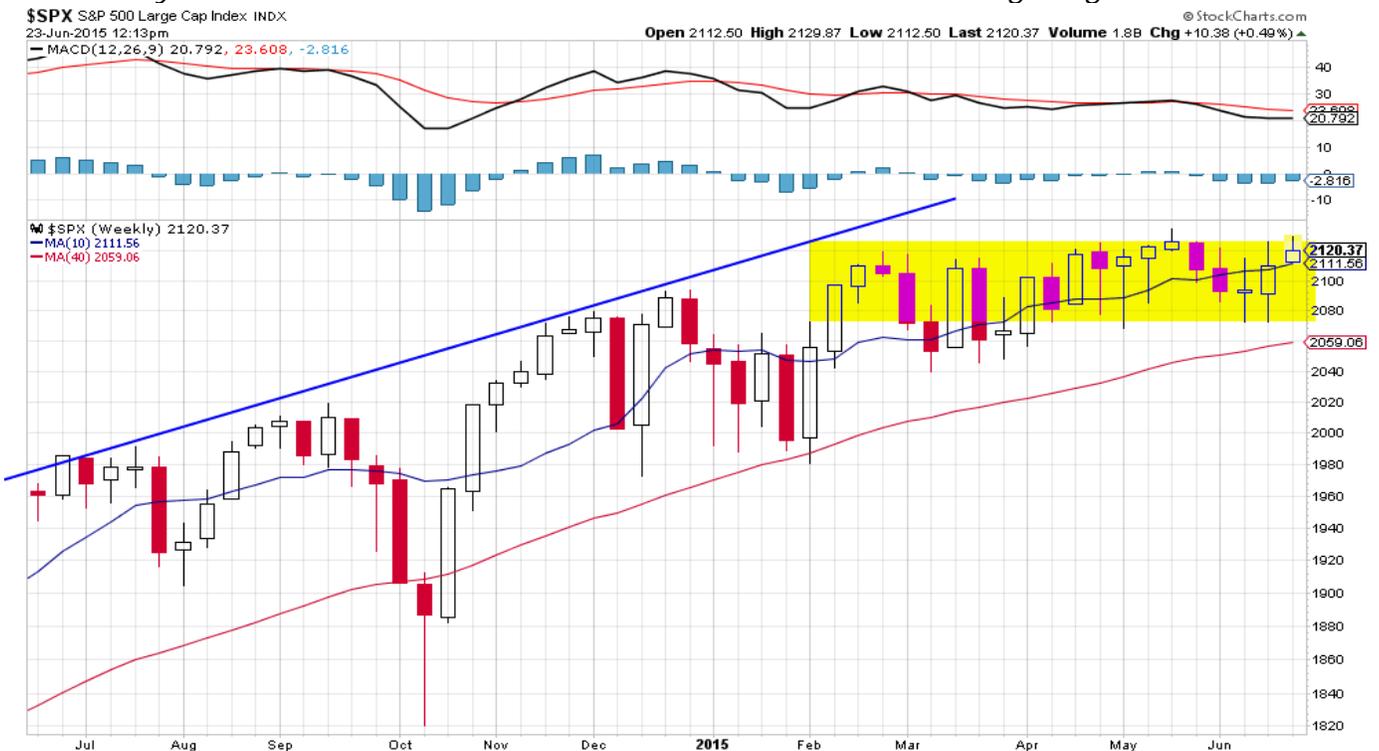
June 24, 2015

Please refer to Appendix – Important Disclosures.

The weight of the evidence has slipped to neutral at mid-year as the bullish influences from Fed Policy and Seasonal Patterns/Trends present at the beginning of 2015 have waned. Sentiment has made a round trip from neutral to bearish and now back to neutral, while breadth rose from neutral to bullish and is now back to neutral. This is not inconsistent with a stock market (using the S&P 500 as a proxy) that has struggled to sustain gains. In such an environment, investors should be selective in looking for opportunities, be cautious of crowded trades, watch relative trends, and wait for confirmation.

The message at mid-year is caution now, but opportunity later. To be sure, we do not know how the second half will unfold, but it is not difficult to envision a more constructive environment as we move through the second half. If and when the Fed finally raises rates, conviction in a gradual tightening process could raise Fed policy back to bullish, and better seasonal patterns (and perhaps improved momentum) could be in store in the fourth quarter. On the other hand, a quick return of investor optimism and/or further breadth deterioration could add downside pressure in the near term.

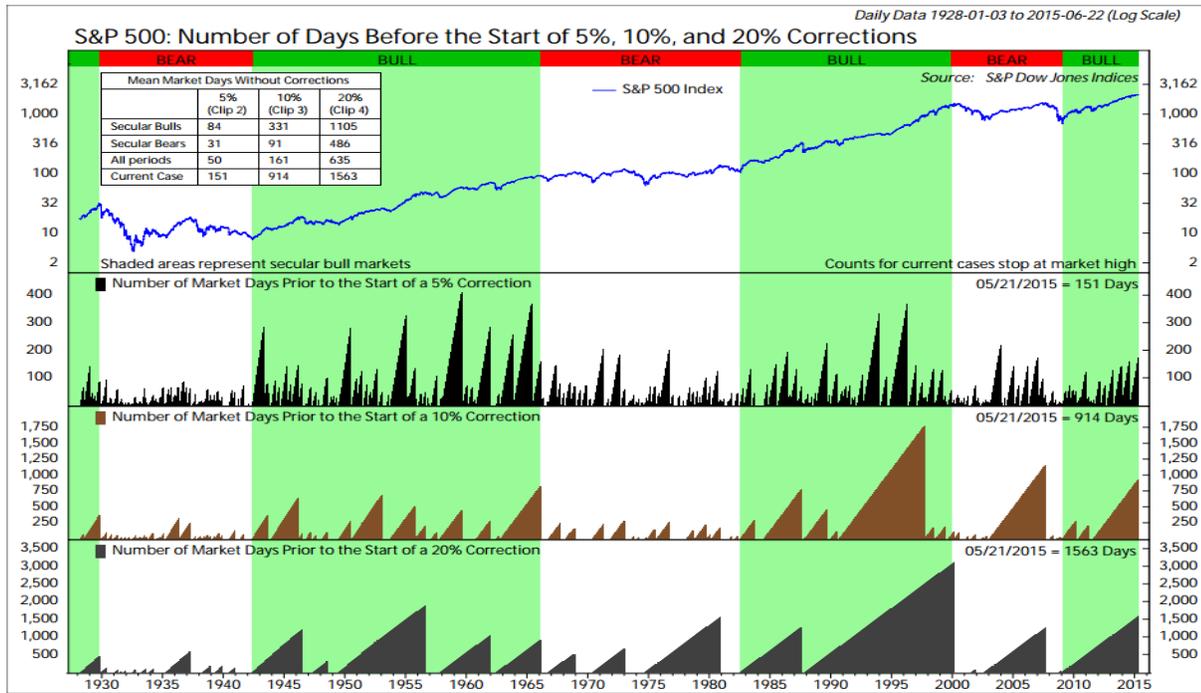
Uncertainty has risen as the S&P 500 has settled into a broad trading range



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A correction is overdue, but that alone does not mean one is imminent



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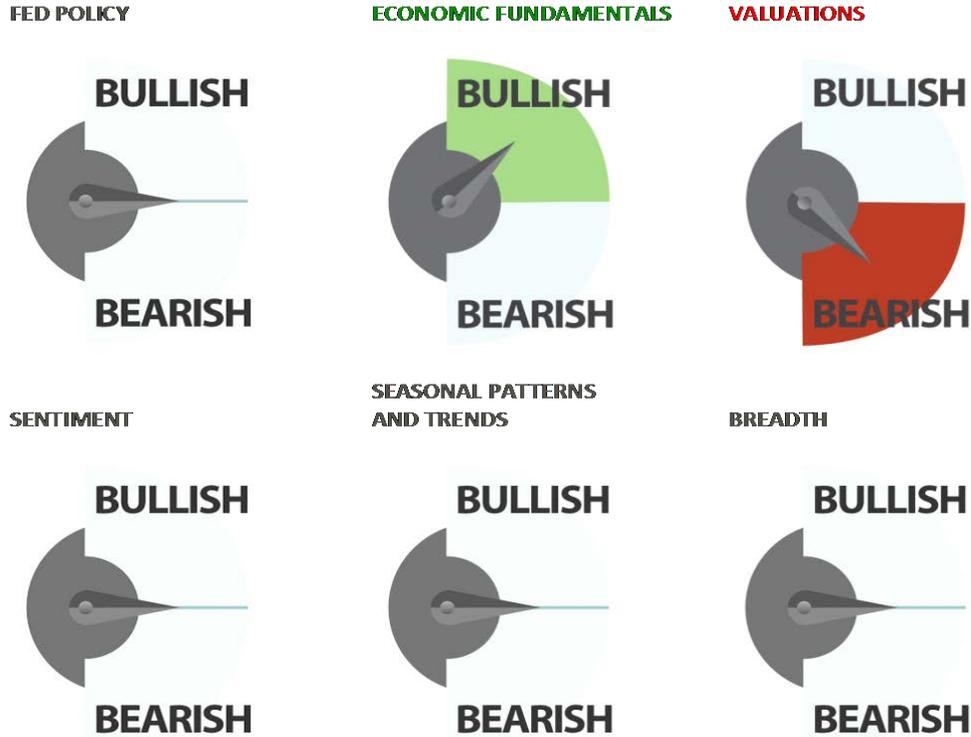
Source: Ned Davis Research

Should the focus really be on something that is down 80% over the past five years?



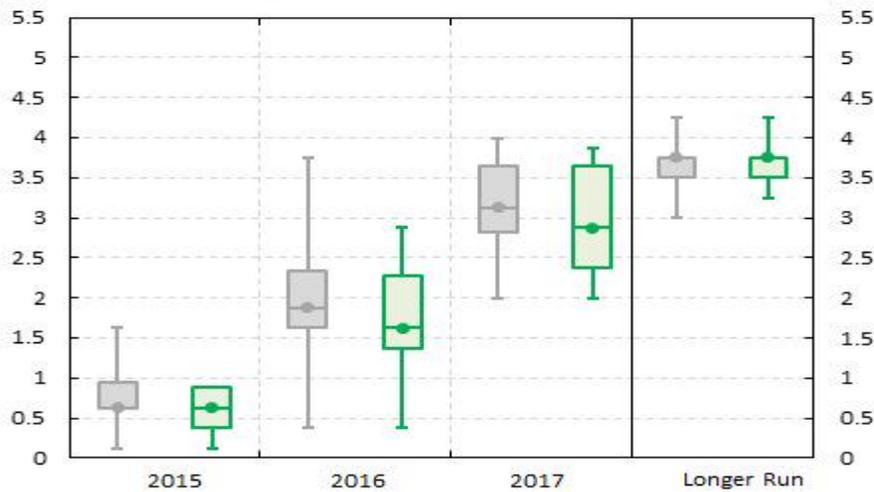
Source: FactSet

Weight of the evidence has cooled to neutral on downgrades of Fed Policy & Seasonals



The Fed continues to expect to raise rates this year, but the path is lower for longer

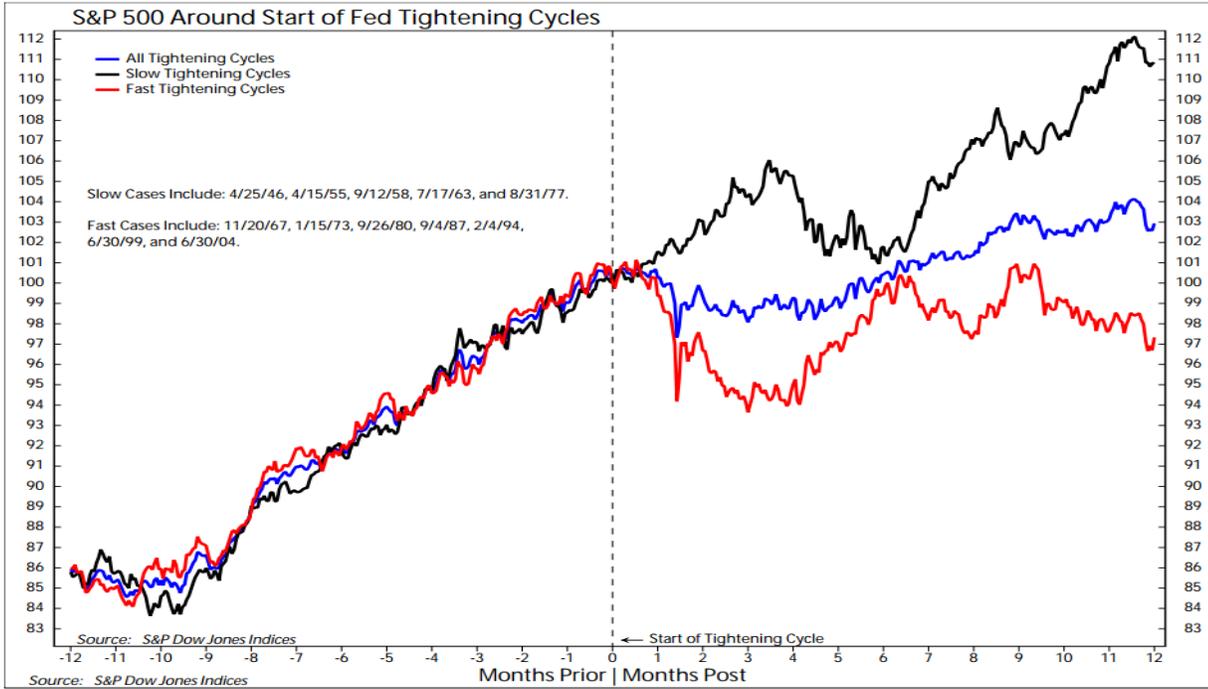
Changes in the distribution of the FOMC projections for the Federal Funds Rates



Note: The boxes represent the range, the interquartile range and the median of the FOMC dots' distributions from the March 2015 meeting (in grey) and the June 2015 meeting (in green).

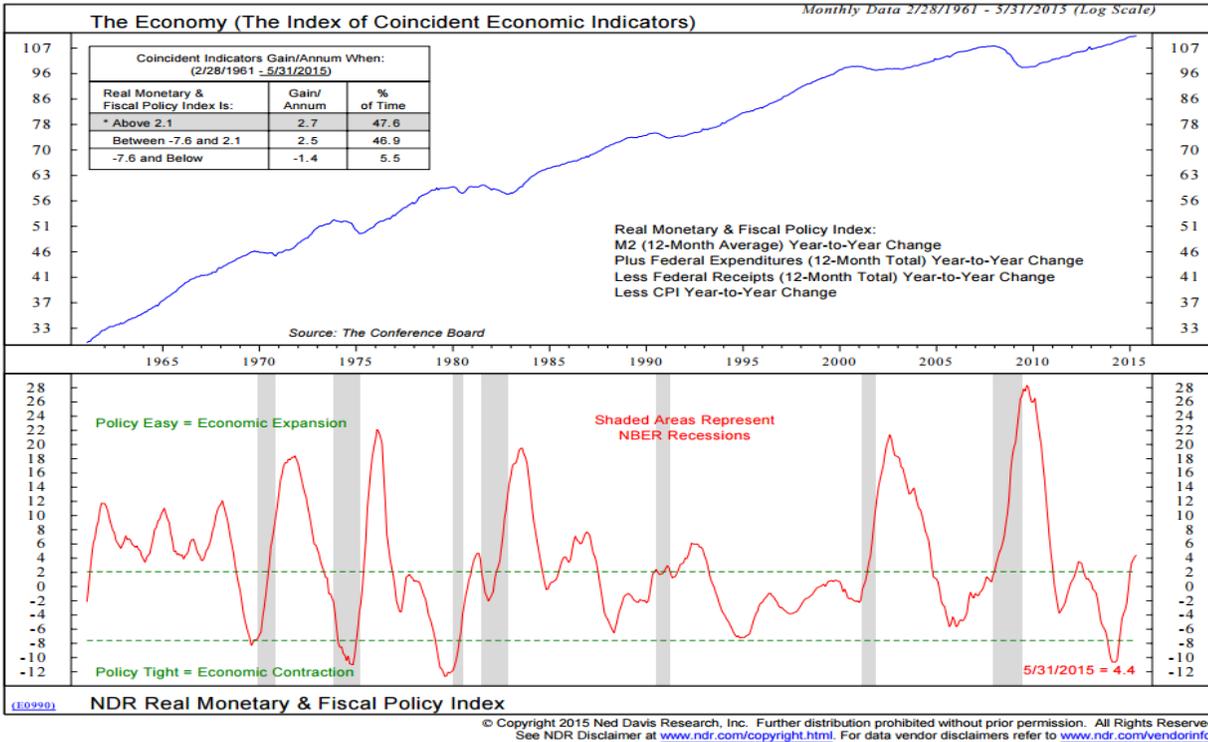
Sources: Federal Reserve, Fulcrum Asset Management

Too much can be made of the actual lift-off date, as stocks tend to weather it well



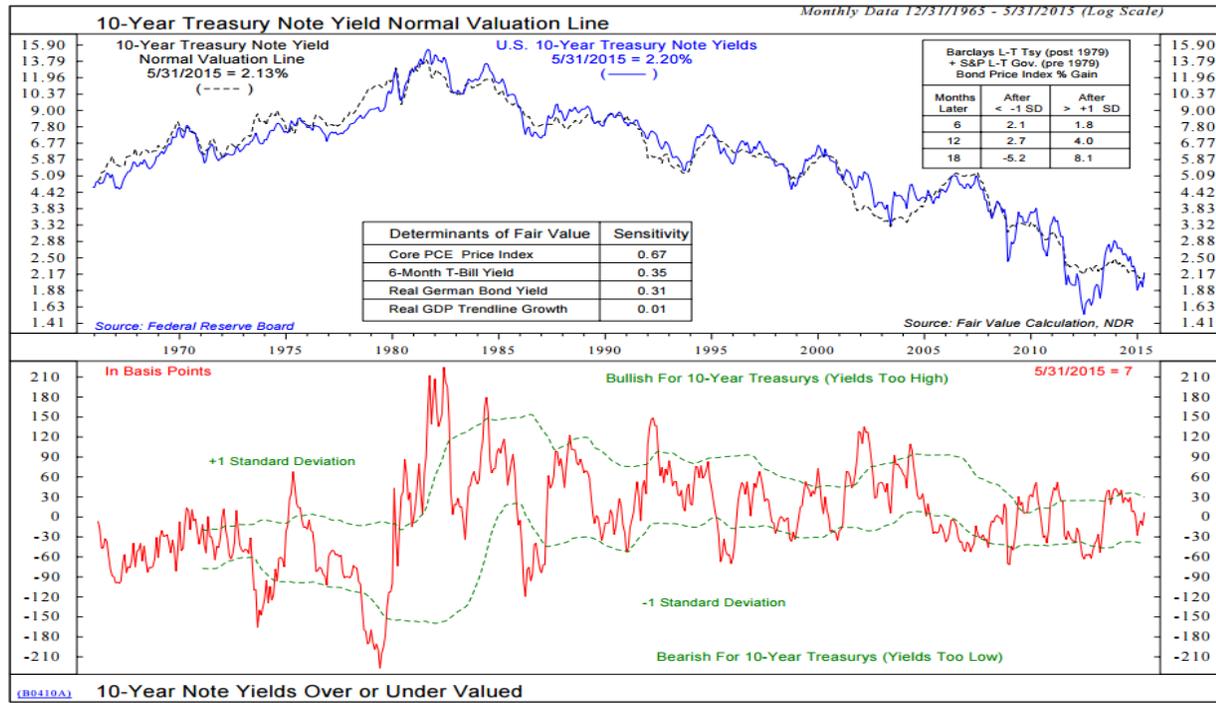
Source: Ned Davis Research

The overall policy backdrop has become more supportive of economic growth



Source: Ned Davis Research

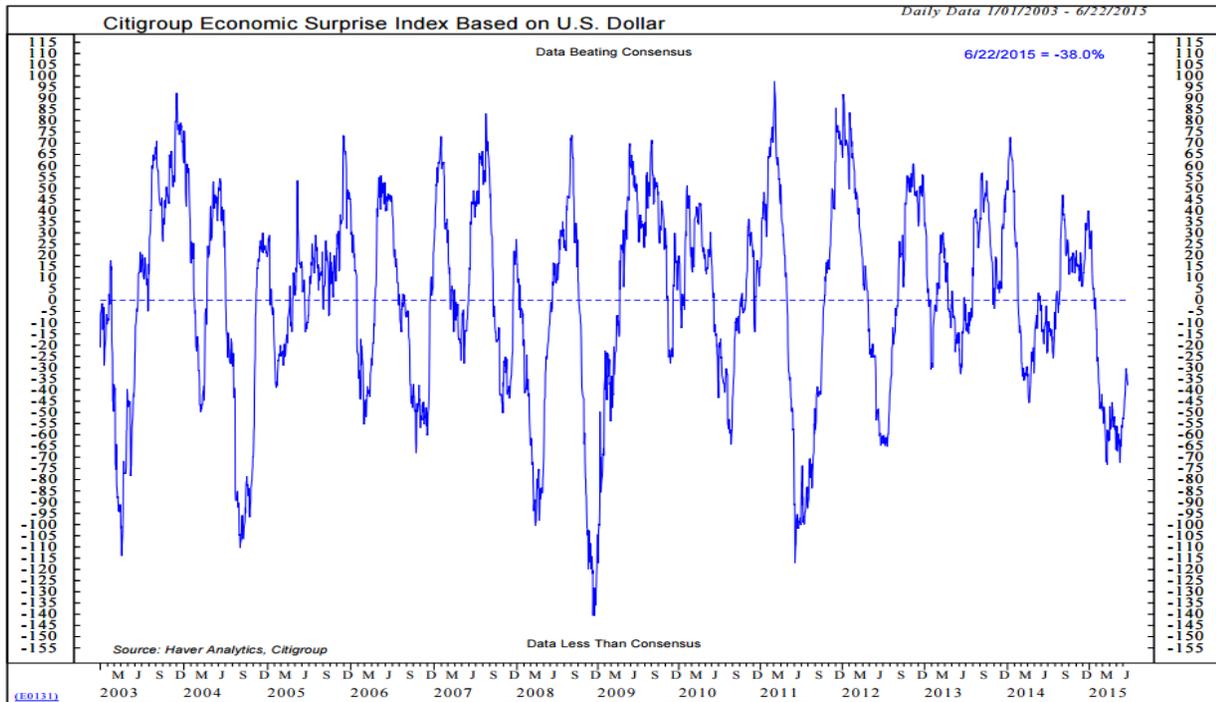
Based on key drivers, bond yields are about where they should be



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Source: Ned Davis Research

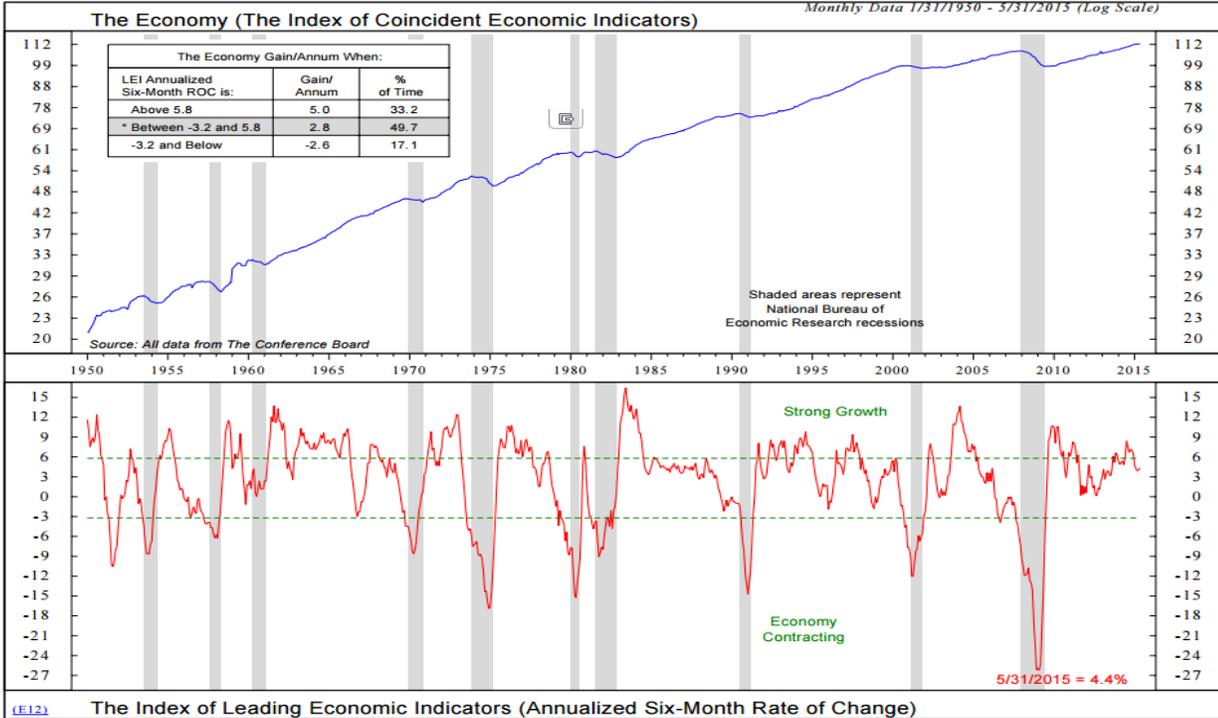
Economic performance has not matched expectations, but then it rarely does



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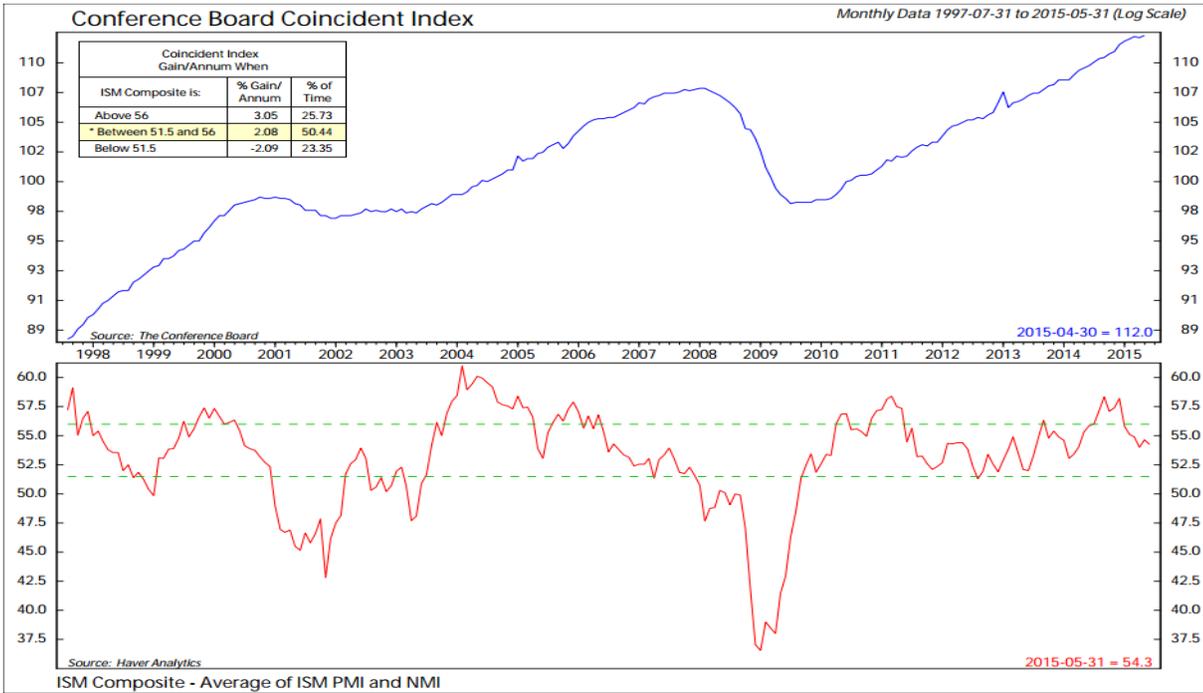
Leading indicators suggest the economy remains on solid footing



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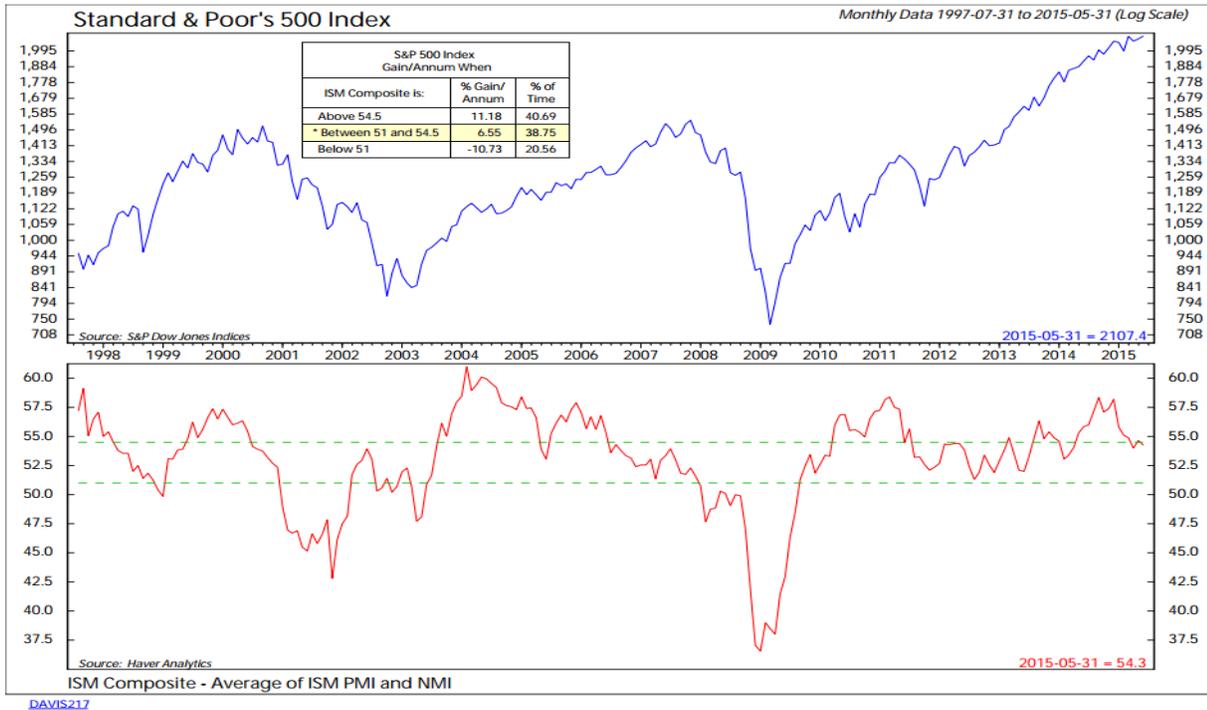
Business activity has moderated but not warning of weakness for the economy . . .



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Source: Ned Davis Research

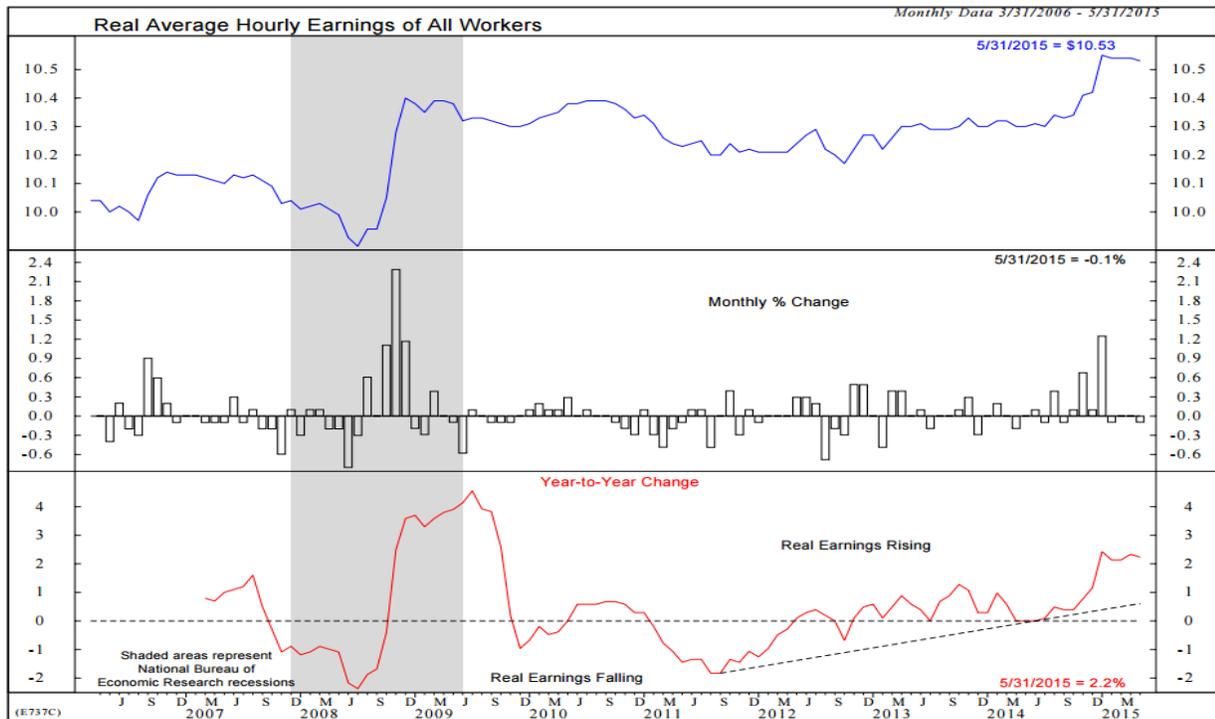
... or for stocks



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Source: Ned Davis Research

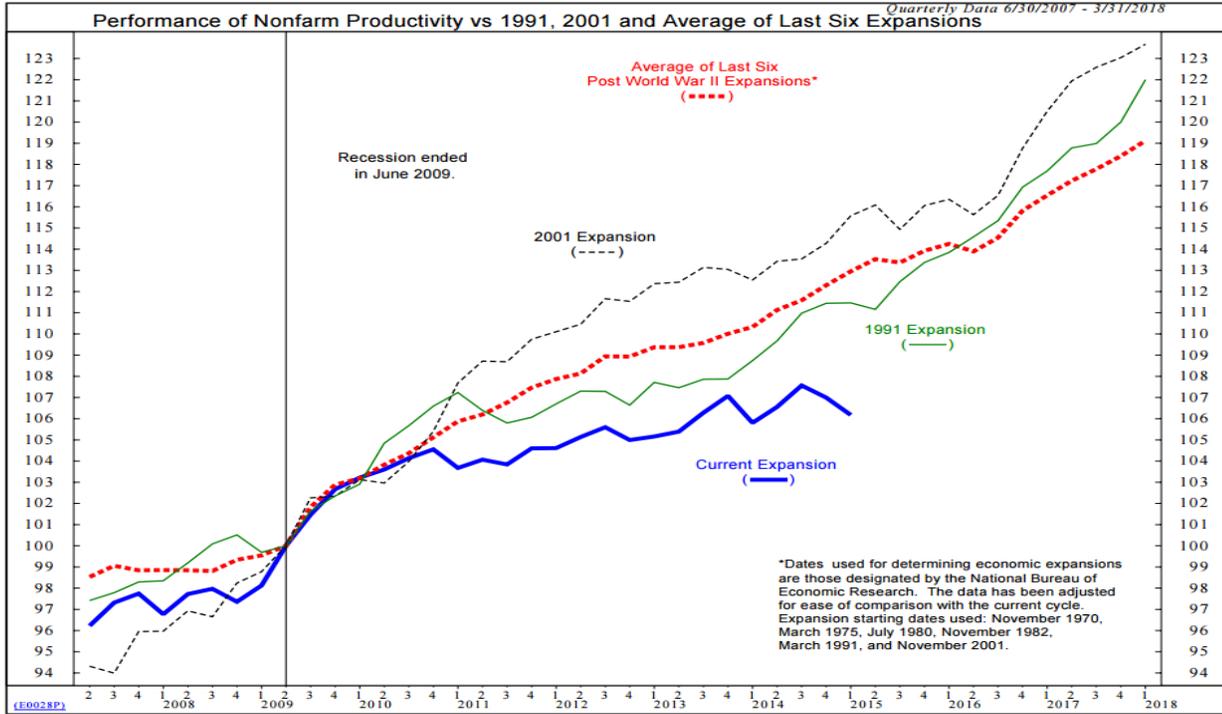
Improvement in wage growth speaks to a broadening economic recovery



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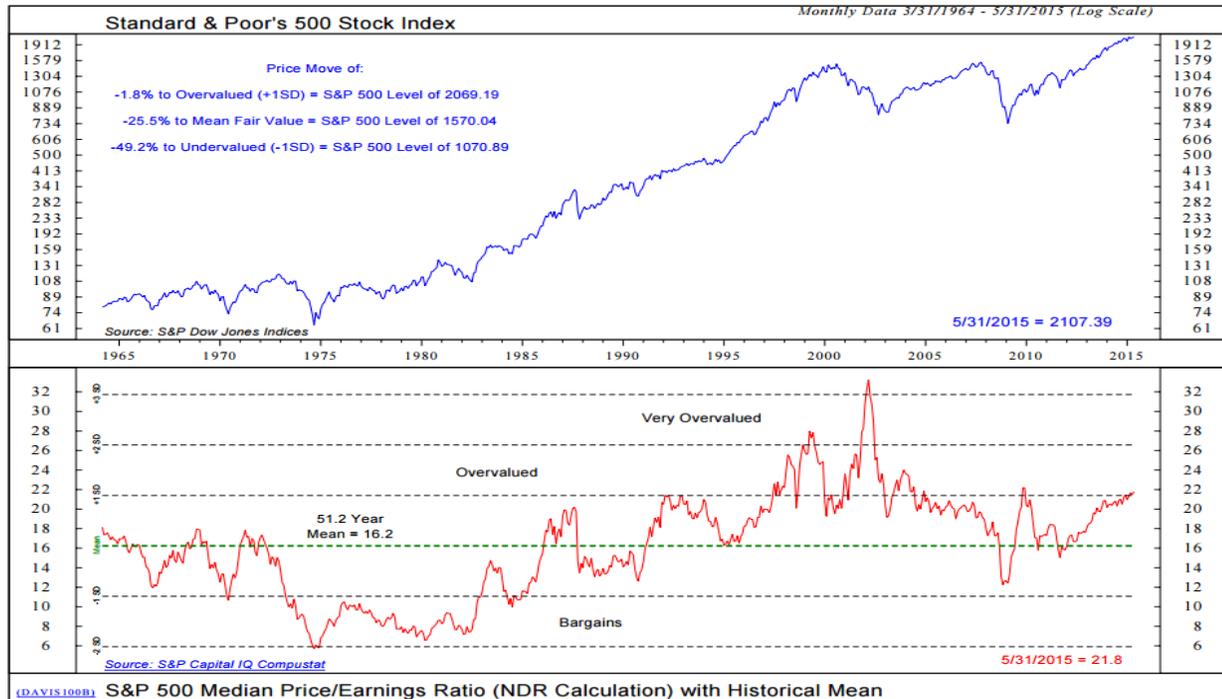
Source: Ned Davis Research

Rising wages could turn focus back to improving productivity



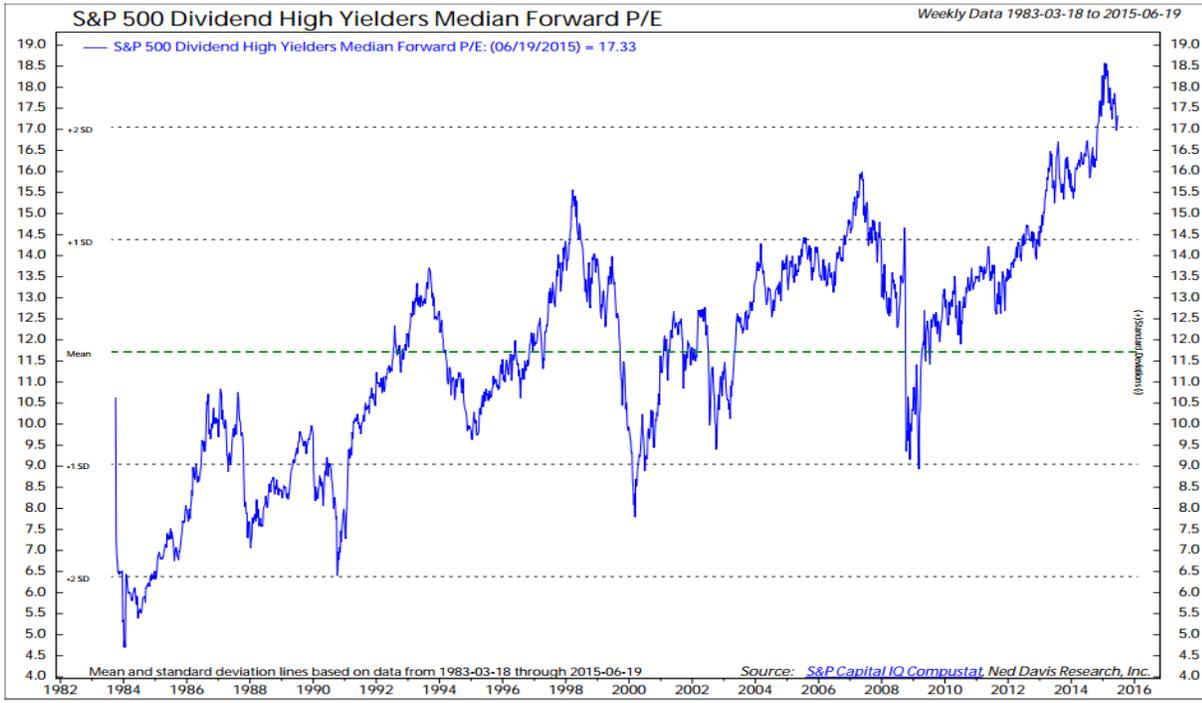
Source: Ned Davis Research

Stock market valuations are stretched



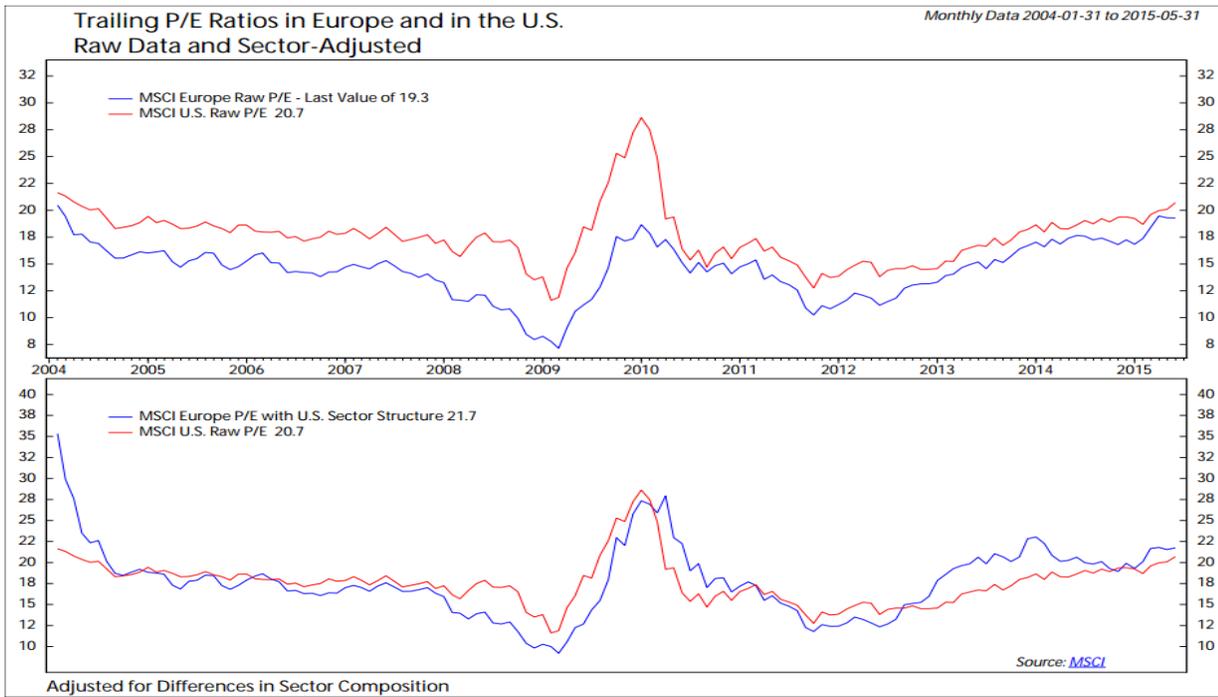
Source: Ned Davis Research

The reach for yield has left that market segment significantly over-valued



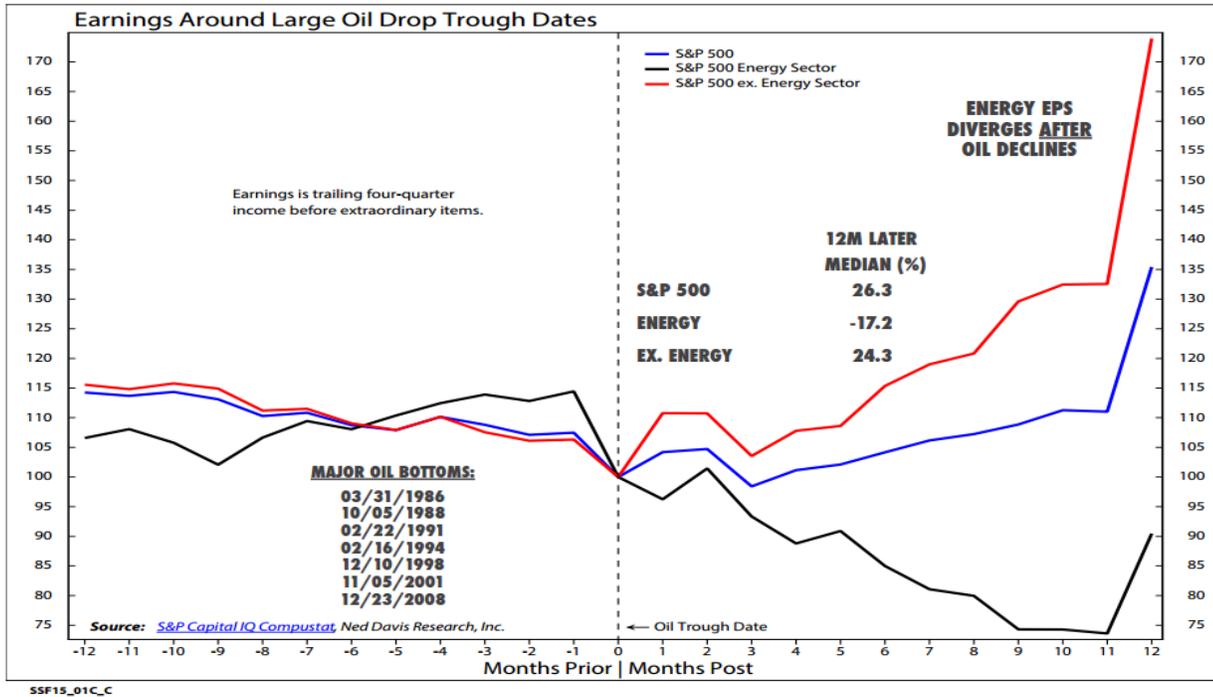
Source: Ned Davis Research

When sector adjustments are made, Europe's valuation advantage disappears



Source: Ned Davis Research

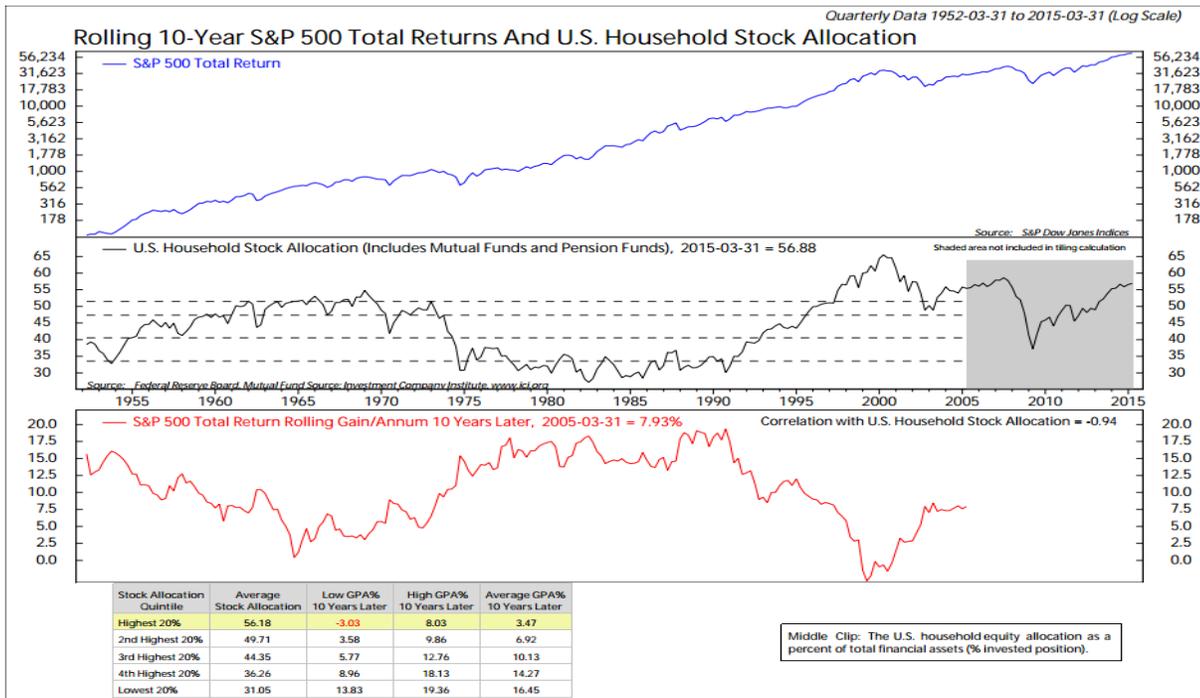
Better earnings growth could relieve some valuation pressures



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Source: Ned Davis Research

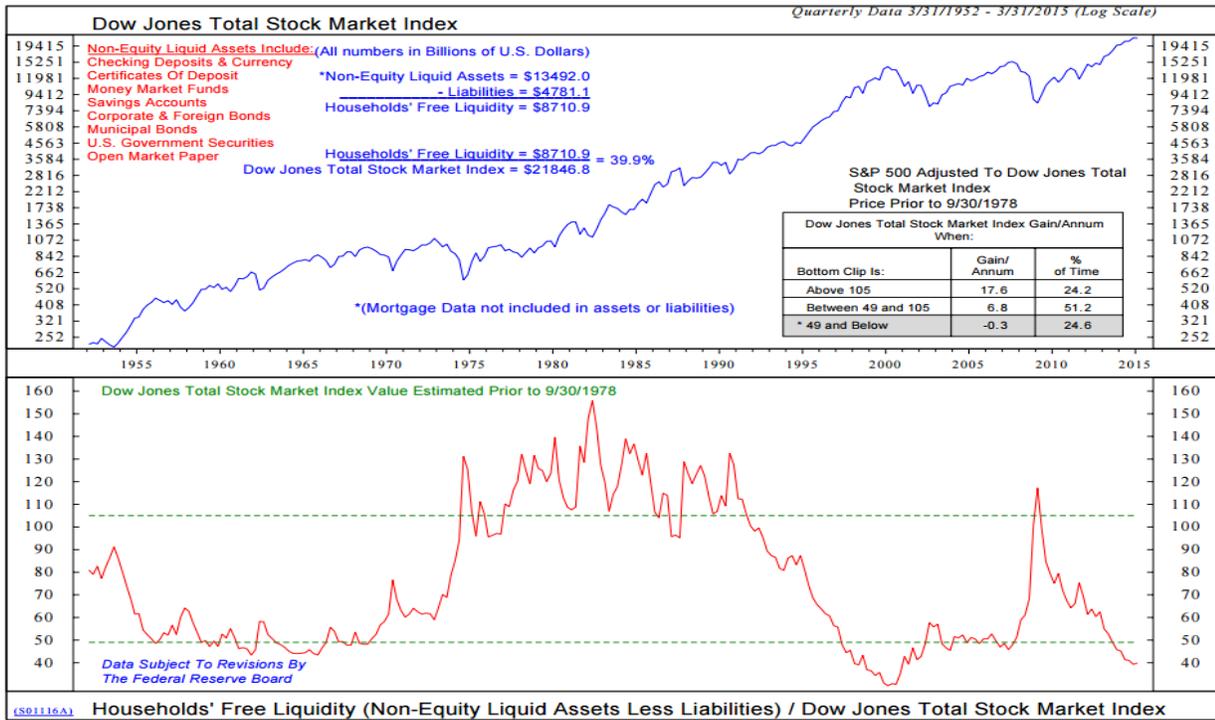
Heavy household exposure to stocks tends to depress returns going forward



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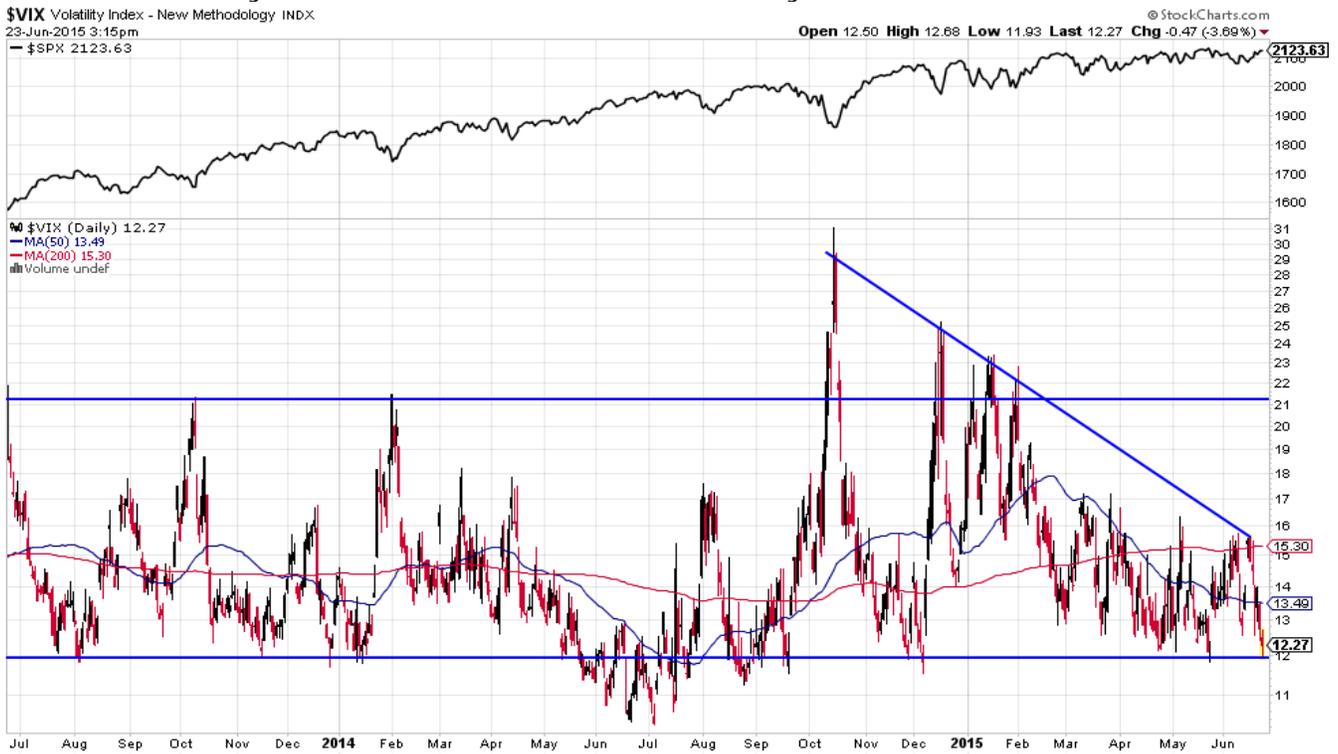
Source: Ned Davis Research

News of less optimism is welcome, but still little evidence of increased liquidity



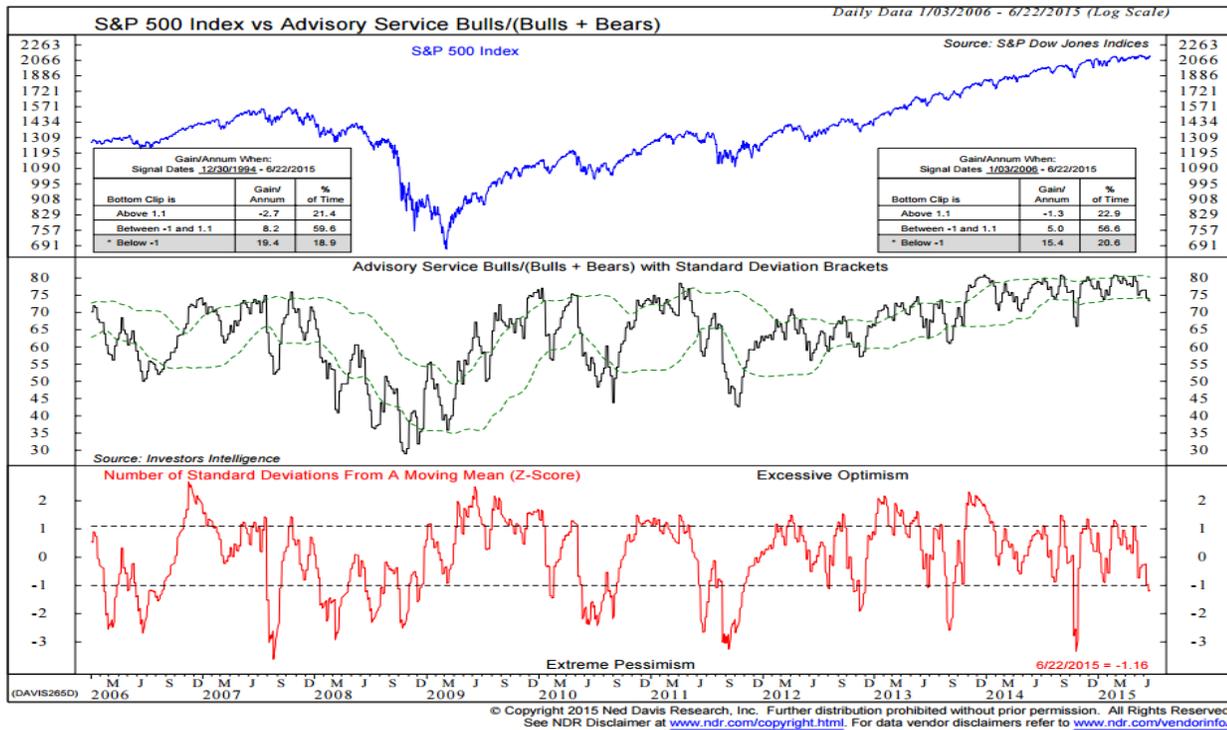
Source: Ned Davis Research

No fear or volatility in stocks as VIX has moved steadily lower in 2015



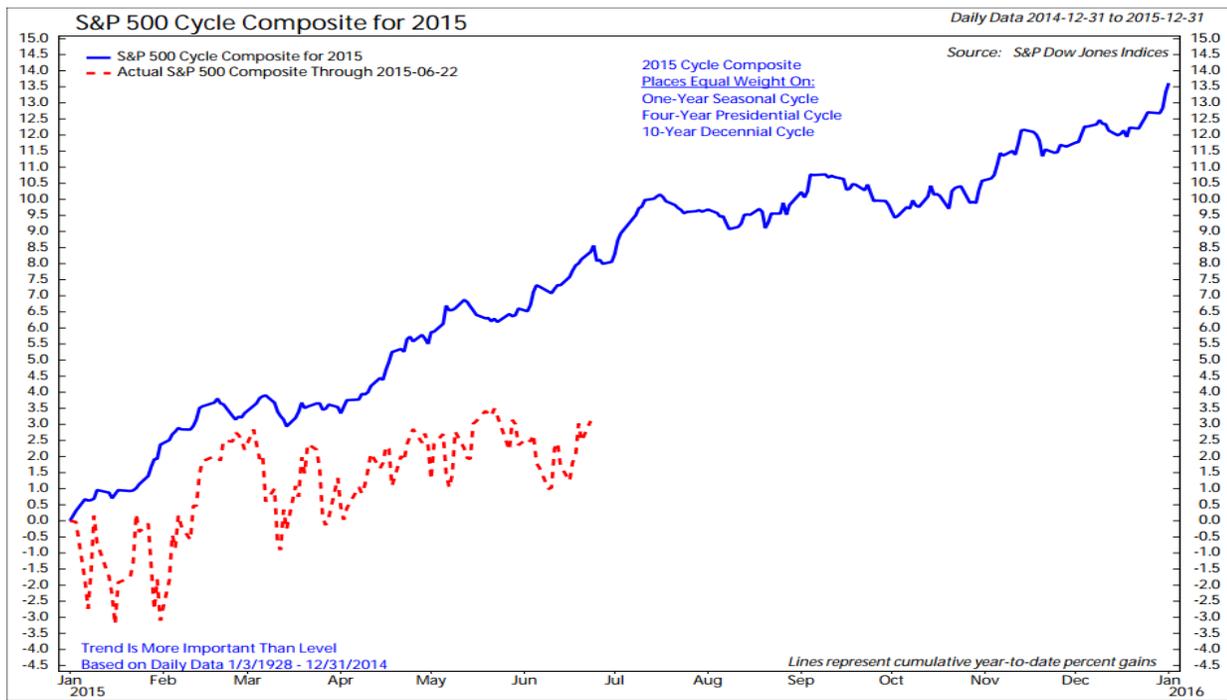
Source: StockCharts

Investor optimism has retreated from recent highs, but is hardly historically low



Source: Ned Davis Research

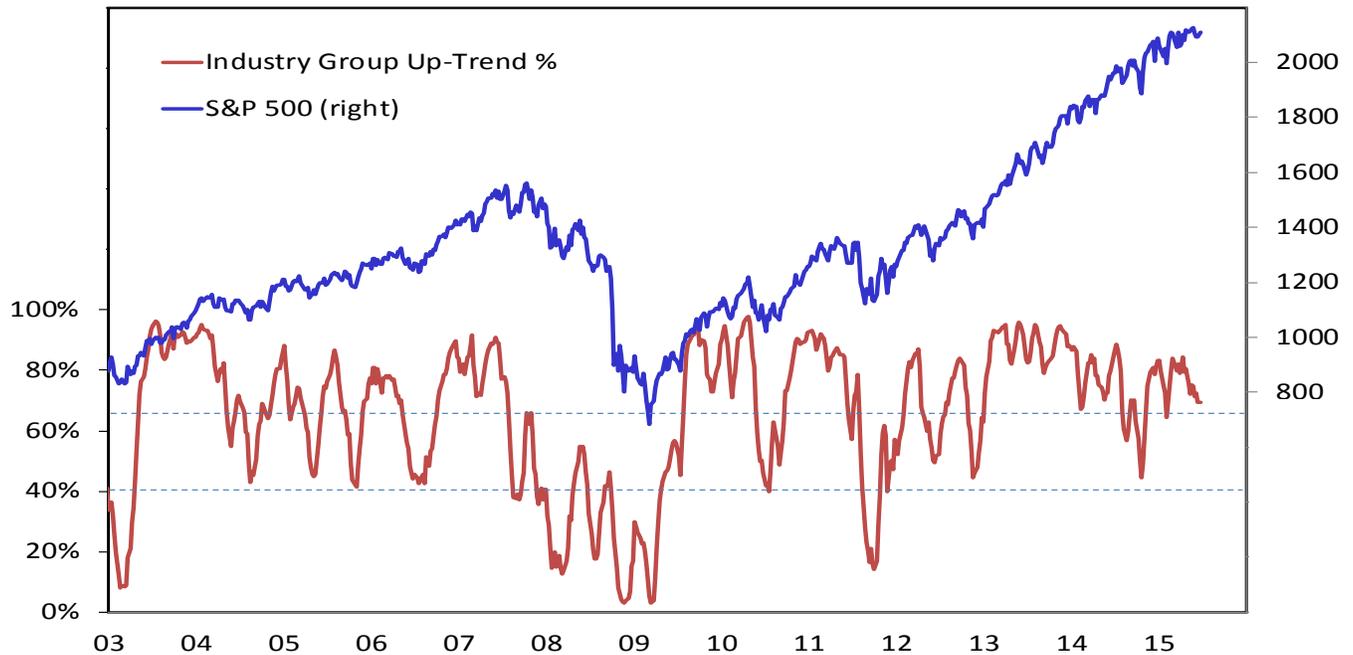
Expected seasonal tailwind for 2015 has not materialized



Source: Ned Davis Research

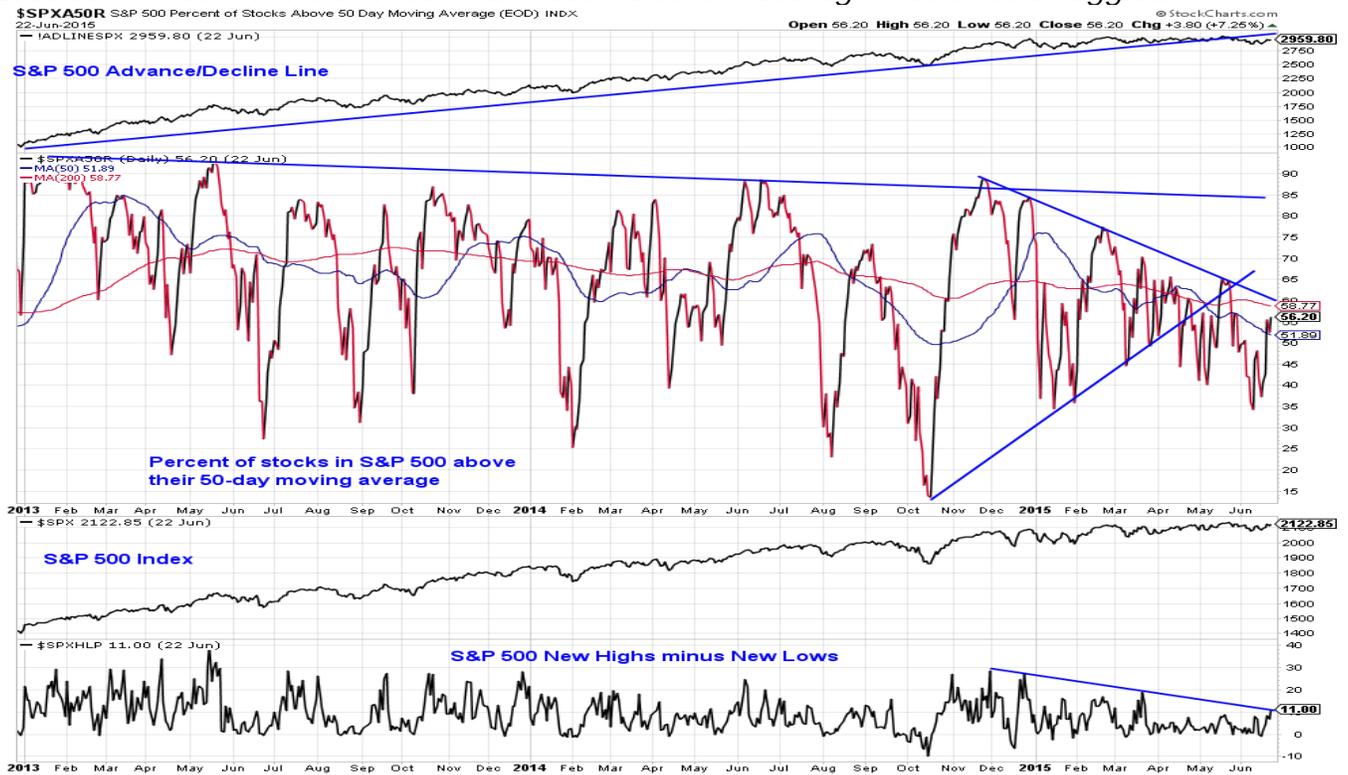
Industry group trend has faltered after early-year improvement

S&P 500 and Industry Group Breadth



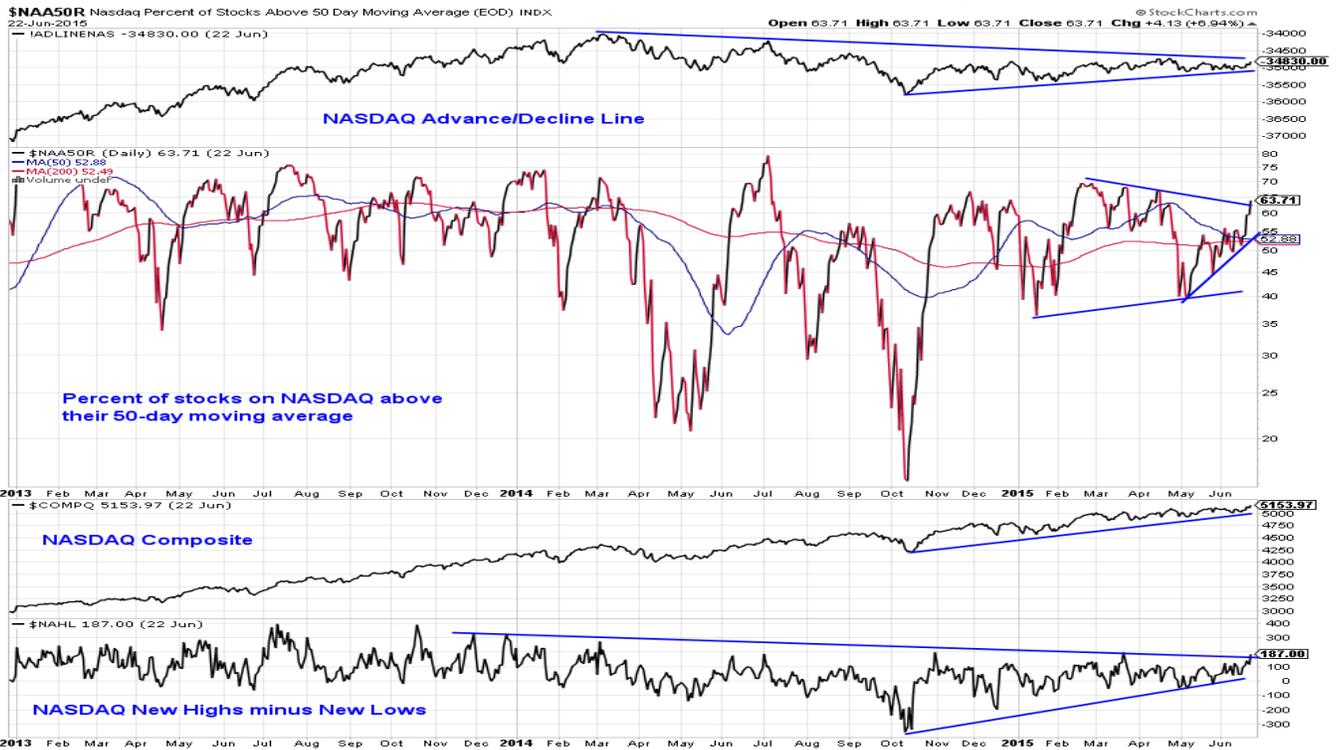
Source: FactSet, RWB Calculations

Breadth trends for the S&P 500 have cooled as the average stock has struggled



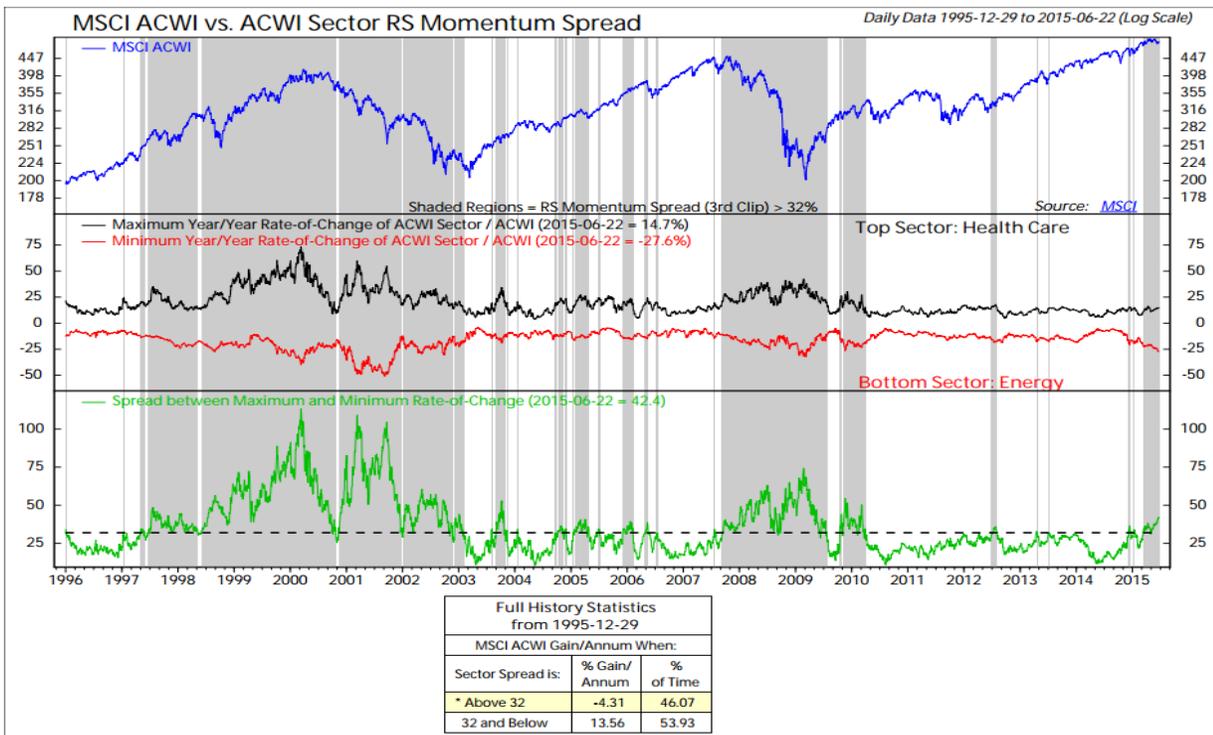
Source: StockCharts

NASDAQ breadth trends are improving and on the cusp of breaking out



Source: StockCharts

The dispersion of sector-level returns suggests stocks are out of gear



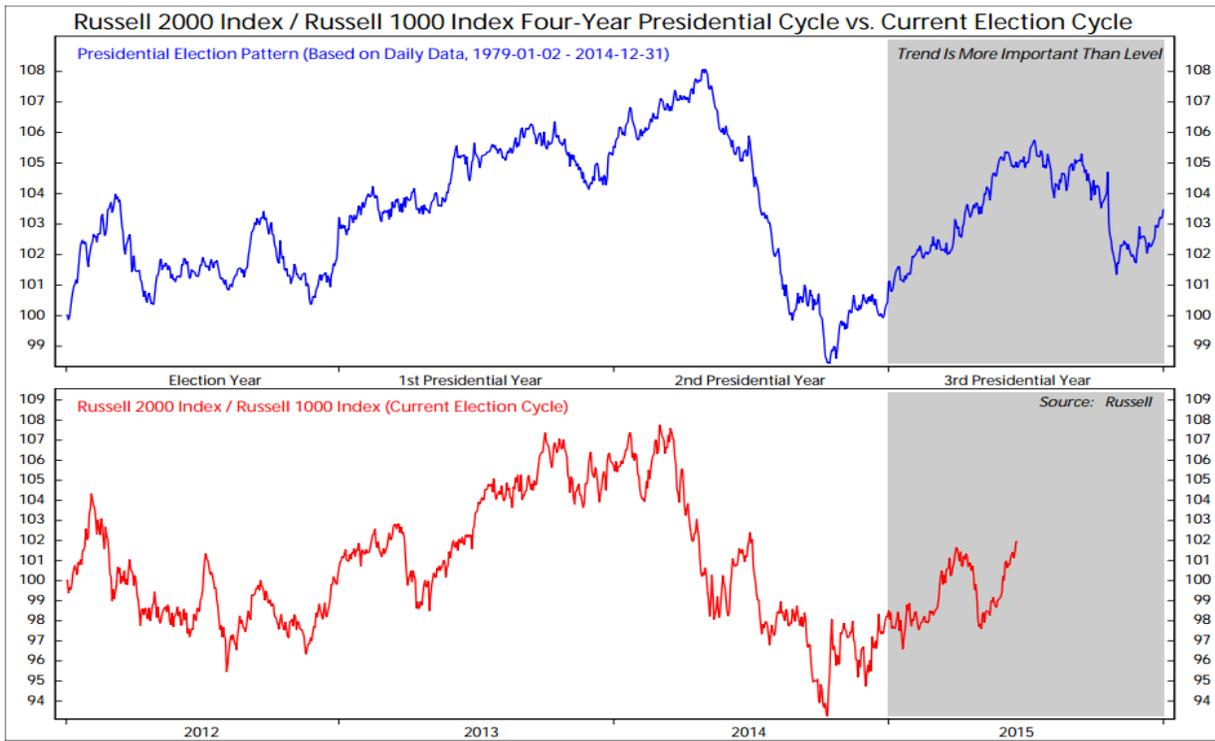
Source: Ned Davis Research

Small-cap leadership emerged in late-2014 and has persisted in 2015



Source: StockCharts

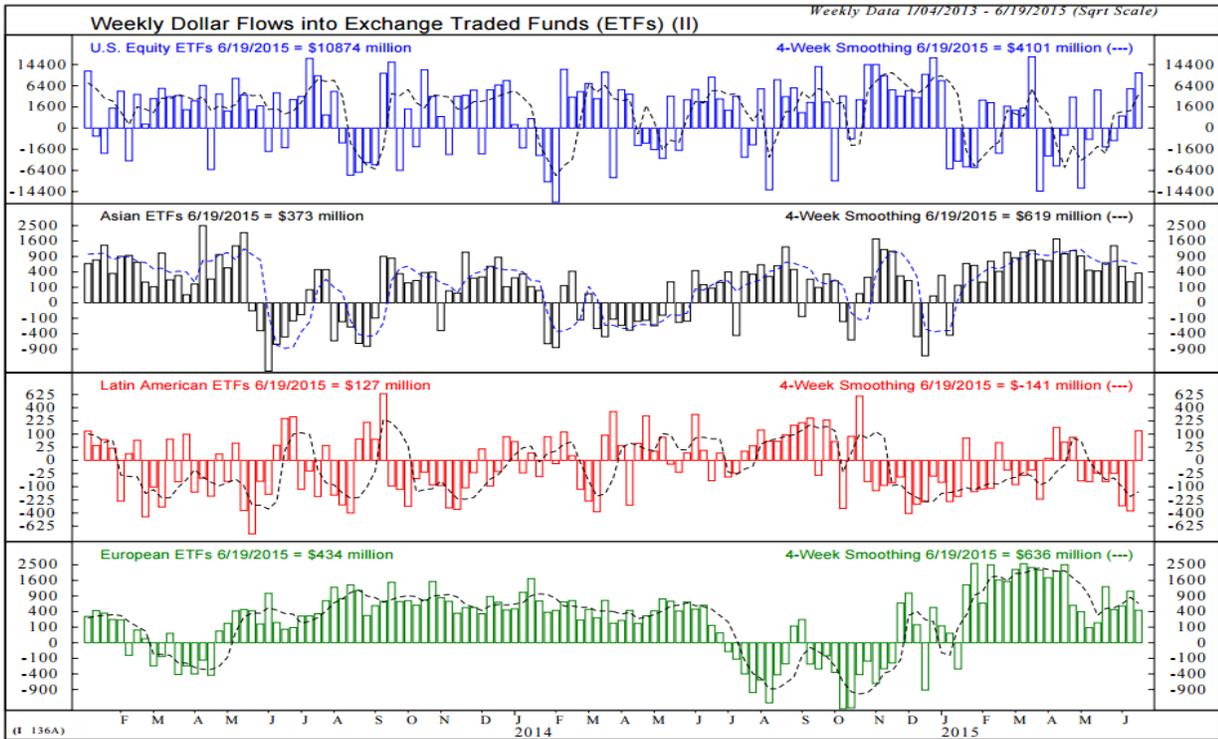
Seasonal patterns could be a significant headwind for small-caps in the second half



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Source: Ned Davis Research

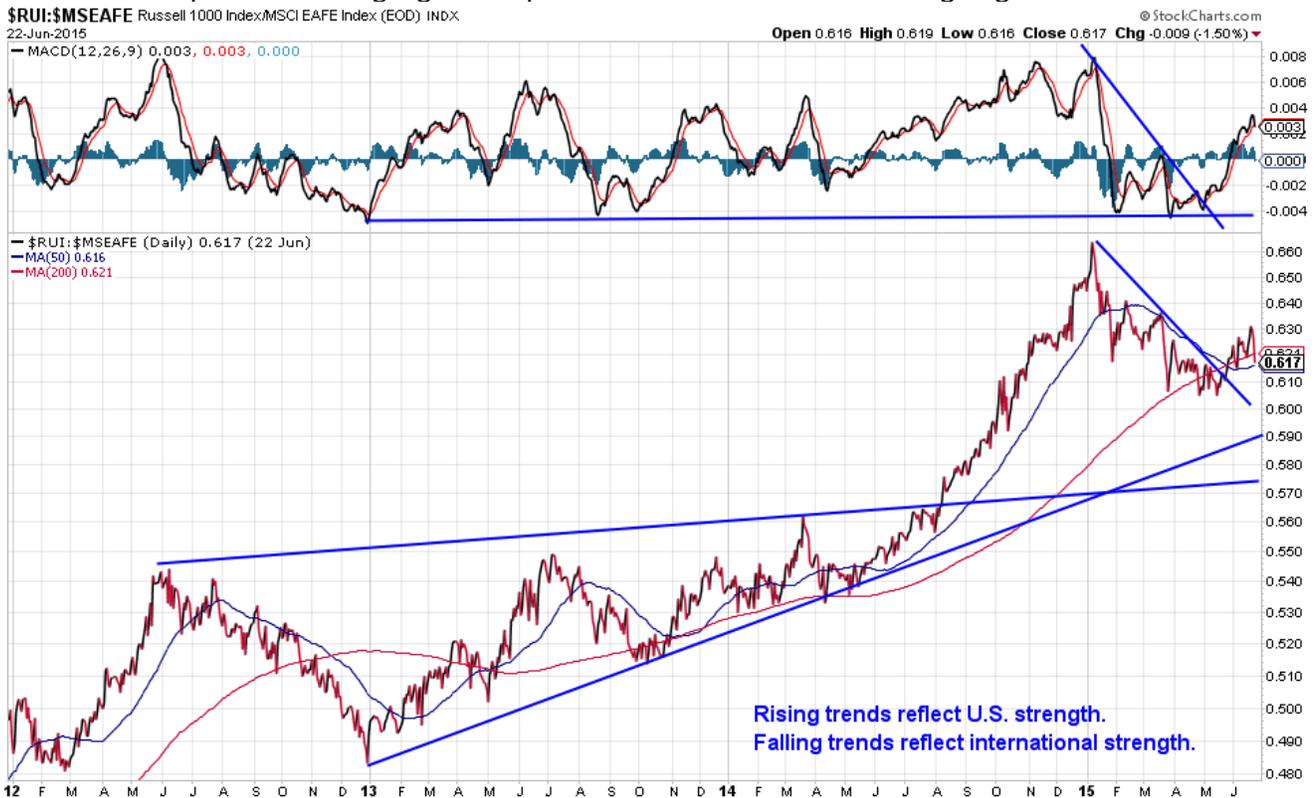
After an early-year hiatus, funds are flowing back to the U.S.



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Source: Ned Davis Research

U.S. leadership is re-emerging, with price and momentum turning higher



Source: StockCharts

Appendix – Important Disclosures

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