IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

A significant challenge facing most major economies has been a prolonged period of slow economic growth. Monetary policy was the primary tool used to help stimulate the economy following the 2008–09 recession, but its effectiveness in boosting growth has clearly diminished. Many other issues such as; weak demand, an uncertain political outlook, terrorism, the impact of Brexit, and the stability of the European Union have created concerns that growth is unlikely to improve anytime soon.

Global Growth

The World Bank recently lowered its global growth outlook, by 0.5% to 2.4%, due to a slowdown in emerging markets as well as diminished confidence in the effectiveness of central bank policies. Additionally, inflation expectations remain at very low levels despite the recent recovery in oil prices rising to the strongest levels since the summer of 2015.

The global economy faces many serious structural challenges, which have contributed to slower growth rates. Aggregate demand has suffered from an aging population, transitioning emerging economies, as well as increased regulations. These issues have created a vicious cycle where concerns about the future rate of growth has hindered corporations' willingness to increase production levels. Many

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LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.

economists believe that slower growth expectations have contributed to a reduction in consumption. The weakness in real incomes for most people has boosted the appeal of the populist political movement in many countries, which professes to represent the masses. A shift in political support would likely add to economic uncertainty and could have a negative impact on corporate profits.

A shift toward a more "populist" sentiment may, however, have some longer-term positive developments, such as a renewed effort to boost fiscal stimulus as a way to interject demand into the global economy. Global monetary policy has become less effective in the past few years and austerity measures by many European governments have hurt economic activity. An increase in government spending could reverse some of these negative trends.

Areas of the economy that could likely benefit from an increase in fiscal spending would be infrastructure, education, job training, and research & development. These initiatives could help boost growth and increase competitiveness.

We expect that the global economy will continue to advance at a slow and moderate pace in the coming years, as scarce demand prevents significant growth. One positive outcome could be that lack of excessive investment will likely limit economic overcapacity, which typically is the precursor to a recession.

Despite this overall trend of lackluster economic growth, markets have experienced less stability, demonstrating corrections in response to events; such as, falling oil prices and the Brexit vote, followed by swift recoveries. The volatility is likely a result of concerns that in a low growth environment, minor events can have bigger impacts for a slow growth world.

Given the relatively stable financial system backdrop, and the lack of economic excesses, the overall risk of recession remains low in our opinion. The current expansion, which is poised to become the longest in U.S. history, elevates this risk compared with recent years. Any slowdown or contraction in economic activity will likely be shallow because things such as regulations and austerity are impeding growth, and also preventing a boom-bust cycle that causes recession.

Another factor negatively impacting economic activity is low productivity levels. Productivity measures have experienced significant declines over the past few years, especially compared to much more robust levels experienced in the past few decades. Most recently, U.S. productivity fell 0.4% in the second quarter of 2016. Profit growth and standard of living increases depend on productivity improvement.

China

China has been a major driver behind economic growth in recent years. Consequently a slowdown in Chinese economic activity has had a negative impact on global growth rates. So far this year, China has experienced a bit more economic strength than most had expected at the beginning of the year. Fears of a hard landing in China have declined. Non-performing loans have created concern but has not led to deeper fiscal problems. Chinese consumers have held back on their spending because of a lack of government-supported healthcare and retirement programs. Also, strained diplomatic relations between the U.S. and China have also contributed to lower activity levels.

Fed Policy

Federal Reserve Bank Chairperson, Janet Yellen, gave a much anticipated speech in late August in Jackson Hole. The speech focused on near-term Fed monetary policy as well as an extended reflection of longer-term issues that have negatively impacted growth.

Yellen mentioned that the “case for an increase in the federal funds rate has strengthened in recent months.” She noted that the U.S. economy is close to meeting the Fed’s goals of “maximum employment and price stability.” Her remarks did not mention specific timing of the next move and she added the usual caveat that Fed policy actions are data dependent.

The second part of the speech was a comprehensive discussion of the longer run policy issues. There is a debate among Fed Governors about the long-run equilibrium interest rate. Members of the FOMC view the long-term federal funds rate as 3%, down 125 basis points from the Fed’s first-published forecasts in 2012. After adjusting for the Fed’s inflation target, the real rate would be 1%. Yellen mentioned that the real rate is close to zero by some calculations. She indicated “it could remain at this low level if we were to continue to see slow productivity and high saving.” This implies the Fed’s path for monetary policy tightening will be gradual.

Conclusion

The current economic environment does not warrant a sharp increase in interest rates. Therefore, we expect that the Fed will monitor activity and inflation levels which will result in an environment of slowly rising interest rates in the foreseeable future.

S&P 500 Index

3 Month	4.10%
Year-to-Date	7.82%
1 Year	12.54%
3 Year	12.27%
5 Year	14.66%

MSCI EAFE Net Index

3 Month	1.61%
Year-to-Date	0.49%
1 Year	-0.12%
3 Year	2.47%
5 Year	5.00%

Barclays Aggregate Bond Index

3 Month	2.32%
Year-to-Date	5.86%
1 Year	5.97%
3 Year	4.37%
5 Year	3.24%

As of 8.31.2016

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