WEEKLY ECONOMIC COMMENTARY

This Week's Economic Review and Outlook

May 2016

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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Building Blocks

KEY TAKEAWAYS

Despite the expectations of financial markets regarding job growth, evidence suggests growth as slow as 125,000 jobs per month may be sufficient.

Productivity and labor force growth are the building blocks of countries' potential GDP growth.

Potential GDP has slowed down across the board for developed nations overall, not just in the U.S., in the aftermath of the Great Recession.

Job growth may be slowing, but when put in a broader context, it may be also be at the height of its new potential. In last week's Weekly Economic Commentary, "Yet Another Disconnect," we wrote that according to several Federal Reserve (Fed) officials, monthly job gains as low as 125,000 per month in the U.S. would be enough to tighten the labor market, take up slack in the economy, and push up wages and ultimately inflation. Meanwhile, financial markets would likely view such a slowdown in jobs creation as a signal that economic growth was waning, and that perhaps the next move from the Fed would be a rate cut, not a rate hike. This week, we take a closer look at why job growth as slow as 125,000 per month may be sufficient to take up slack in the labor market, and expand our analysis beyond the U.S. to other developed economies.

SLOWING POTENTIAL

Productivity (as measured by output per hour worked) is slowing, not only here in the U.S., but around the world. The roots of slowing productivity have sparked a lively debate in academic circles that has occasionally crossed over into the mainstream-especially when productivity is mentioned by a member of the Federal Open Market Committee (FOMC). The debate is whether the slowdown in productivity is cyclical (largely due to the nature and severity of the Great Recession), structural, or something else-that something else usually being a "measurement problem."

Productivity matters because it's the building block for how fast the economy can grow. The maximum gross domestic product (GDP) growth rate (formally known as "potential GDP") is equal to productivity growth plus labor force growth. **Figure 1** illustrates the "building blocks" for potential GDP. The figure compares potential GDP, productivity, and labor force growth among nations in the Organization of Economic Cooperation and Development (OECD)* as a group and the seven largest economies within the OECD over two periods: the decade and a half prior to the onset of the Great Recession (1991-2007) and since the onset of the Great Recession (2007 to present).

In the decade and a half prior to the onset of the Great Recession, potential GDP in the OECD ran at 2.5%, ranging from highs of 5.9% in South Korea and 3.4% in Australia, to lows of 1.3% in Japan and 2.0% in the EU. In the U.S., potential GDP growth averaged close to 3.0%. Since 2007, driven by low economic growth, a widening skills mismatch in the global labor force, subpar business capital spending, constrained fiscal spending, and heightened economic and financial market volatility, the potential growth rate among OECD nations has dropped to 1.6%. In the past eight years, potential GDP growth has slowed significantly in every one of the top seven nations in the OECD relative to its pace prior to the Great Recession. Japan saw the biggest deceleration, with the EU and U.S. seeing significant declines as well.

WITH AN AGING POPULATION IN PLACE, PRODUCTIVITY MATTERS

Taking a closer look at why potential GDP growth has slowed since 2007 relative to the 1991-2007 period, we find slowdowns in both building blocks of potential GDP: labor force growth and productivity. Labor force growth is largely determined by birth rates, although in some nations net immigration (or lack thereof) can play a role. The labor force grew at 0.8% per year in the OECD between 1991 and 2007, and then slowed to just 0.5% since then. This slowdown is mostly demographic, although in the U.S. and other nations, some people of working age have dropped out of the labor force after not finding a job for several years, or because they stayed in school (or went back). In Japan, the labor force is shrinking; and in the EU, labor force growth is near zero. Among the seven largest OECD economies, only Australia has seen its labor force growth accelerate versus the pre-Great Recession period.

Productivity growth in the OECD has declined from 1.8% per year from 1991-2007 to just 0.6% in the 2007-2015 period. Each of the largest seven nations have seen a dramatic slowdown in productivity, with notable deceleration in the EU (1.3% to 0.2%), the U.K. (2.1% to 0.4%), and Japan (1.1% to 0.4%). As we noted in last week's commentary, productivity in the U.S. has slowed as well. Although there is agreement among global policymakers that productivity across the developed world has slowed since 2007, there are disagreements among policymakers and academics researching the issues regarding the causes. One point of contention is measuring productivity in a global economy that has rapidly become more service oriented and technology driven, making it more difficult to capture productivity the old fashioned way, i.e., measuring the amount of goods output by the factory based on the number of hours of labor it took to make them.

THE PATH FORWARD

Since the end of the Great Recession, the causes of-and potential remedies for-the anemic pace of economic growth have been hotly debated by investors, businesses, and policymakers alike. Of the two building blocks of potential GDP, labor force growth is the least flexible, with demographics and long-term secular labor trends difficult to reverse in the short term. There is some reason for optimism on the productivity side of the equation, however.

Still, improvement from the recent tepid pace of productivity will likely require, at minimum, more coordination between businesses, labor, and governments at all levels, and almost certainly more monetary and fiscal policy coordination among policymakers worldwide. For example, businesses need to invest more in refreshing and updating aging plants and equipment and in new technologies at a much faster pace than what we've seen since 2007. Governments around the globe should be encouraging more spending on infrastructure (both public and private), training more workers and potential workers to be more productive in the 21st century economy, and keeping regulatory burdens low to allow businesses to thrive.

The Great Recession still looms large for many, but ultimately, businesses, governments, and individuals will need to look forward and think about how to invest wisely in the future to drive renewed productivity growth. We have vast reserves of know-how. Future productivity gains will depend on how well we put them to work.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

**OECD nations include: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, South Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, U.K., U.S.*

The Organization of Economic Cooperation and Development (OECD) brings together the governments of countries committed to democracy and the market economy from around the world to support sustainable economic growth, boost employment, raise living standards, maintain financial stability, assist other countries' economic development, and contribute to growth in world trade.

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Weekly Market Commentary | Week of May 16, 2016

KEY TAKEAWAYS

- Our analysis of earnings conference call transcripts for the first quarter earnings period provides a mixed picture.
- Management comments do not suggest sentiment is improving much, or deteriorating, and are consistent with a continued slow growth environment.
- There's potential for a second half earnings rebound, but it may need help from the economy, market forces, and corporate efficiency.

CORPORATE BEIGE BOOK: SENTIMENT MIXED

Our analysis of earnings conference call transcripts for the first quarter earnings period provides a mixed picture. The good news is that economic fears and drags from oil and the dollar are abating and earnings are almost certainly putting in a growth trough. However, conference call transcripts do not suggest sentiment is improving much, and management commentary is consistent with a continued slow growth environment. All of this casts some doubt regarding the strength of a potential second half earnings rebound.

CORPORATE BEIGE BOOK

We use earnings conference call transcripts to gauge overall sentiment of corporate management teams, much like we have done with the Federal Reserve's (Fed) Beige Book (a qualitative assessment of the U.S. economy and each of the 12 Fed districts) to create our Beige Book Barometer. To create our Corporate Beige Book, we count the number of strong words (or variations of "strong") and the number of weak words (or variations of "weak") and calculate the difference between the two. (Examples of strong words include "robust," "solid," and "optimistic"; examples of weak words include "soft" and "fragile.") We can then relate that differential to prior quarters to make comparisons over time.

SLOW BUT STEADY GROWTH

Corporate executives generally try to stay away from the "R" word (recession) when talking to investors. That is clear by the small number of mentions the word receives on earnings calls. In fact, the word came up just three times during first quarter 2016 earnings reporting season, the fewest in at least six quarters and consistent with the market's view (and ours) that recession odds have fallen in recent months. We believe the odds of recession over the next 12 months are no higher than 20% currently, factoring in economic and market data and the risk of a potential policy mistake.

Companies do continue to make cautious comments about the U.S. growth outlook. For example:

- "The consumer is on solid footing and despite the noise in the data and some of the volatility in the markets, global growth will continue, albeit at a moderate pace." (Major bank)
- "On the economic front, we see moderate growth in the global economy." (Transportation provider)
- "If taken to the highest level from where we see the economy, I think we still see the overall economy progressing in that 2-2.5% range." (Railroad)
- "Global economic growth remained weak during the first quarter. In the U.S., estimates indicate growth has slowed further since late 2015." (Energy company)

Based on management commentary, over the past three months companies have transitioned from a more difficult macroeconomic environment to slow, but steady. LPL Research's economic forecast suggests more of the same--approximately 2.5% real gross domestic product (GDP) growth for the balance of 2016.*

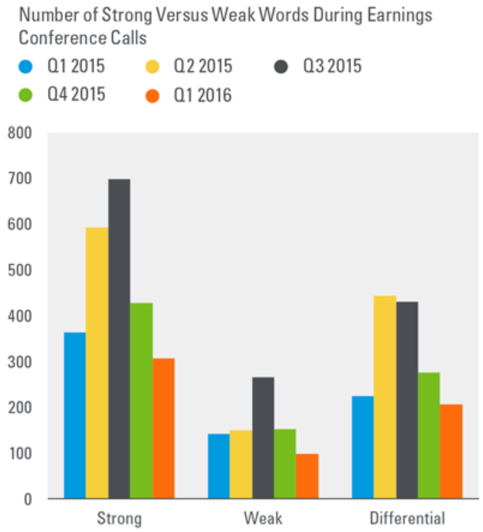
**Our forecast for GDP growth of between 2.5-3% is based on the historical mid-cycle growth rate of the last 50 years. Economic growth is affected by changes to inputs such as: business and consumer spending, housing, net exports, capital investments, and government spending.*

MIXED CORPORATE BAROMETER

When we count positive and negative words from earnings call transcripts, the picture is mixed, consistent with the slow growth environment of recent years. As shown in Figure 1, based on the difference between strong words and weak words, management sentiment was actually a bit less positive during the first quarter of 2016 than during the prior three quarters. Given how jittery markets were in early 2016, the quarter-over-quarter drop in sentiment by this measure is surprising.

Interestingly, the number of macroeconomic comments overall, good or bad, has been in decline in recent quarters. To adjust for that, we can look at the ratio of strong words to weak words and see that the strong words have been gaining share against weak words over the past three quarters, consistent with our sense that the mood has become a bit better [Figure 2].

1 LOWER DIFFERENTIAL (STRONG MINUS WEAK WORDS) SUGGESTS MUTED CORPORATE SENTIMENT



Source: LPL Research, Bloomberg 05/11/16

Data represent number of mentions during first quarter 2016 earnings conference calls for companies that have reported as of 05/06/16. Quarters reflect earnings periods, not quarters in which conference calls took place.

2 STRONG WORDS GAINED SLIGHTLY ON WEAK WORDS IN RECENT QUARTERS

Source: LPL Research, Bloomberg 05/11/16

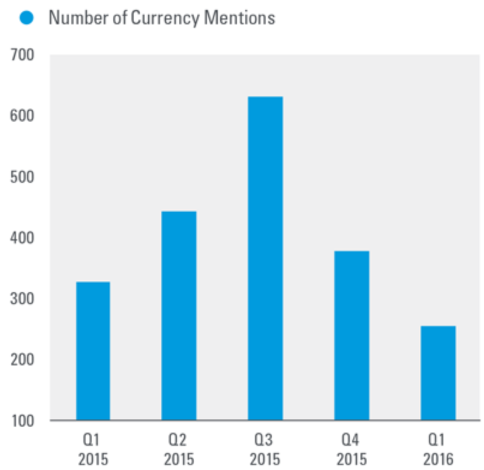
Data represent number of mentions during first quarter 2016 earnings conference calls for companies that have reported as of 05/06/16.

CURRENCY IMPACT FADING

The reversal in the U.S. dollar is a big piece of the transition out of the earnings recession. The improving year-over-year comparisons for the dollar have no doubt contributed to fewer mentions of currency on earnings calls [Figure 3]. Currency mentions have been halved since the third quarter of 2015, when the dollar's year-over-year change was 17% (recall that all else equal, a strengthening dollar reduces international profits of U.S.-based multinationals). Some of this decline reflects fewer macro comments from management teams in general, but the trend is clear. After a percentage point or so of drag on S&P 500 earnings in the first quarter of 2016, we expect currency to boost earnings over the balance of the year and perhaps contribute a full percentage point to S&P 500 earnings later in 2016.

Should the U.S. Dollar Index stay where it closed on May 13, 2016, for the rest of the year, the dollar would drop from a 2% headwind for earnings in the first quarter of 2016 to a tailwind of about 2% in the second and third quarters and over 3% in the fourth quarter.

3 LONG-LIVED CURRENCY DRAG BEGINNING TO FADE



Source: LPL Research, Bloomberg 05/11/16

Data represent number of mentions during first quarter 2016 earnings conference calls for companies that have reported as of 05/06/16.

With hundreds of companies commenting on currencies, it is not difficult to find interesting insights from management teams about the currency environment. Here are some examples:

- "And one positive is that we will get a big help from currency as it turns from a headwind into a tailwind beginning in the next quarter." (Airline)
- "The weakening U.S. dollar gave us some relief." (Chemicals producer)
- "So with the current circumstances of the world and what everybody is talking about in terms of real negative interest rates and so forth, that actually favors weakness to the dollar for us right now." (Healthcare products)

OIL STILL IN THE PICTURE

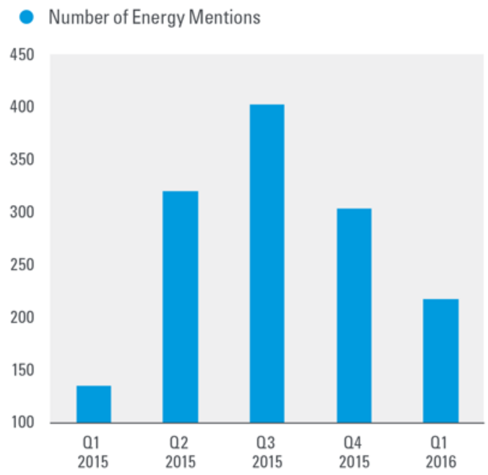
Oil's rise from the February 2016 lows in the mid-$20s per barrel to the mid-$40s (as of May 13, 2016) eased concerns about the negative impact of low prices and led to fewer oil mentions on conference calls [Figure 4]. The rebound in oil prices has provided some light at the end of the tunnel. Energy sector profit fears have begun to fade, as have concerns about the profitability of other commodity-sensitive areas. The topic did still get plenty of mentions.

Oil could show year-over-year gains in the third quarter if it stays in the range of mid- to high $40s. We believe this is possible, based on the trend in U.S. production cuts and expected continued growth in global demand (consistent with the Energy Information Administration, which raised its oil price forecasts on May 10, 2016).

Comments from oil and gas industry management teams reflect the ongoing uncertainty:

- "If a lower-price environment persists for longer, we will adjust and pursue even more significant cost savings and even greater cuts in capital to continue to lower our cash flow breakeven." (Energy producer)
- "We're focused on lowering the breakeven cost of the business. Now for perspective, if we were in a steady-state world of sustained $45 per barrel oil prices, we believe we could cover the capital required to maintain flat production and pay our dividend with cash from operations." (Energy producer)
- "In the first half of 2016, we're still oversupplied by about 1.5 million barrels per day. We do expect to see convergence in the second half with the seasonal demand growth, but that's going to widen again in the first half of 2017." (Energy producer)

4 OIL STILL GETTING PLENTY OF MENTIONS



Source: LPL Research, Bloomberg 05/11/16

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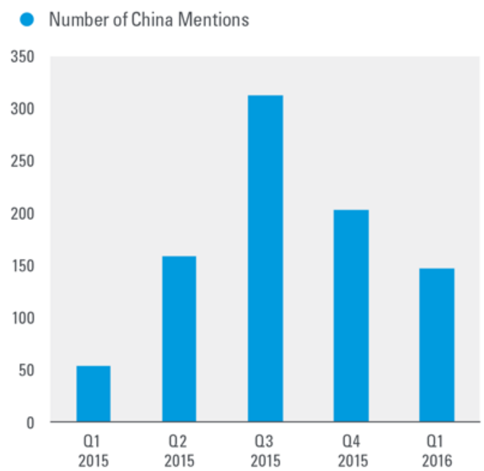
SLOWER CHINA EVIDENT

Stock market gains over the past three months have been partially due to more sensible policy and greater stability in China. Although risks remain, we see the drop in the number of China mentions on this quarter's earnings calls as encouraging [Figure 5].

Comments from some more China-focused companies generally reflect optimism amid slower growth:

- "In China, growth continued to decelerate; however, economies in Japan and Europe showed some modest improvement compared to the fourth quarter." (Energy company)
- "The world wrings its hands about slowing growth rates in China; and China was 6.5%. And I think if any other country of the world was growing 6.5%, we'd all be doing cartwheels and investing heavily." (Healthcare products)

5 CHINA SENTIMENT HAS IMPROVED BASED ON LESS ATTENTION



Source: LPL Research, Bloomberg 05/11/16

Data represent number of mentions during first quarter 2016 earnings conference calls for companies that have reported as of 05/06/16.

THE BOTTOM LINE

Earnings fell sharply during the first quarter of 2016 relative to the first quarter of 2015 and were about flat excluding the downtrodden energy sector. We did get a small upside surprise in earnings results this quarter, consistent with history, and a trough in the earnings growth rate has almost certainly been put in. But another decline--the third or fourth in a row depending on the data source--is hardly worth celebrating.

More encouraging though, we did see slightly more optimistic than usual guidance. Thomson-tracked consensus estimates for the next 12 months were revised lower by 1.4%, compared with the recent historical pattern of 2-3% negative revisions (fourth quarter 2015 earnings season saw a more than 5% haircut). The better economic environment during March and April 2016 helped, as did the dollar and oil reversals.

The most important earnings question is still tough to answer: Are consensus estimates for mid- to high-single-digit gains in earnings in the second half of 2016 more credible? This earnings season provided little evidence that companies are seeing a growth pickup (nor does our economic analysis). This casts some doubt regarding the strength of a potential second half earnings rebound, which may need help from the economy, market forces (oil and the dollar), and corporate efficiency (strong profit margins).

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

All investing involves risk including loss of principal.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The USD Index measures the performance of the U.S. dollar against a basket of foreign currencies: EUR, JPY, GBP, CAD, CHF and SEK. The U.S. Dollar Index goes up when the dollar gains "strength" compared to other currencies.

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A Net Worth Statement Helps Keep Retirees on Track

Taking stock of your assets and liabilities may require a bit of research at first, but the process will get easier each time you do it.

A number of planning tools can help retirees monitor their cash flow and make appropriate adjustments in response to changes in income and expenses. Not the least of these is a net worth statement.

By calculating your net worth, you are essentially taking a snapshot of your current financial status. That snapshot can then provide you with the information you need to make important financial decisions.

What is net worth? It is more than just your income -- it's your overall wealth. To determine your net worth, just add up your assets and subtract your liabilities. Your assets are everything you own, including the money in your bank accounts, retirement plans, and investments accounts as well as real estate and even possessions such as your car(s) or a boat. Your liabilities are what you owe. This may include the balance on your home mortgage, credit card debt, car payments, and even unpaid taxes.

Taking stock of your assets and liabilities may require a bit of research at first, but the process will get easier each time you do it. It's a good idea to review the calculation each year to make sure you stay on the right track.

Whether your net worth is higher or lower than you expected really should not be of concern. The main purpose of identifying your net worth is to give you a reference point for assessing your overall financial health.

The following worksheet will help you break down your assets and liabilities so you can reach your bottom line.

YOUR ASSETS	
Cash/bank accounts, CDs, etc.[1]	$
Vested share of retirement accounts (employer plans, pensions, profit-sharing plans, etc.)	$
Market value of investments (stocks, bonds, mutual funds, IRAs, annuities, etc.)[2]	$
Market value of real estate (home, other property)	$
Market value of vehicles (car, boat)	$
Cash value of insurance policies	$
Other (valuables, furnishings, etc.)	$
TOTAL ASSETS	$
YOUR LIABILITIES	
Balance due on home or real estate mortgage(s)	$
Balance due on loans (car, student, real estate)	$
Balance due on rental properties	$
Balance due on credit cards	$
Fixed monthly payments	$
Unpaid taxes	$
Other	$
TOTAL LIABILITIES	$
YOUR NET WORTH (Subtract liabilities from	$

assets)

[1]CDs are FDIC insured and offer a fixed rate of return if held to maturity.

[2]Investing in stocks involves risks, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Investing in mutual funds involves risk, including loss of principal. Mutual funds are offered and sold by prospectus only. You should carefully consider the investment objectives, risks, expenses and charges of the investment company before you invest. For more complete information about any mutual fund, including risks, charges and expenses, please contact your financial professional to obtain a prospectus. The prospectus contains this and other information. Read it carefully before you invest.

An annuity is a long-term, tax-deferred investment vehicle designed for investment purposes and contains both an investment and an insurance component. They are sold only by prospectus. Guarantees are based on the claims-paying ability of the issuer and do not apply to an annuity's separate account or its underlying investments. The investment returns and principal value of the available subportfolios will fluctuate so that the value of an investor's unit, when redeemed, may be worth more or less than their original value. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal.

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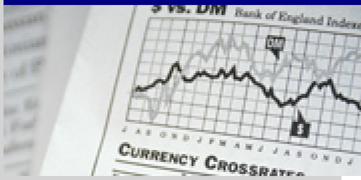

Strong Dollar, Weak Dollar -- What It Means for You

For a U.S. investor, a currency gain or loss stems from a fall or rise in the value of the dollar against the currency in which the investment is made.

You may have heard news reports about the decline or strength of the U.S. dollar. Your reaction? Likely a yawn. But the truth is that the value of the dollar has ripple effects throughout the economy, ultimately affecting your day-to-day finances as well as your investments.

Making Sense of the Exchange Rate

What does it mean when the value of the U.S. dollar has declined or increased? In plain English, it refers to the amount of money you get when you exchange a dollar for another country's currency. When the dollar rises, you get more bang for your buck. When it declines, the opposite occurs.

If you have traveled abroad, you've experienced the effect firsthand. If the dollar is weak vis-à-vis other currencies, it costs you more when visiting another country because you won't receive as much of the foreign currency when you exchange your dollars.

Here at home, the relative strength or weakness of the U.S. dollar affects you both in the interest rate you are charged for loans and in everyday purchases. Think about the car you drive, the clothes you wear, your cell phone, or computer. Chances are many of these items are produced and imported from abroad. So the price you pay for these goods is going to depend on the value of the dollar.

When the dollar is strong, prices of consumer goods tend to be stable and/or increase more slowly. When the dollar is weak, prices may increase. Higher consumer prices also can lead to inflation and higher interest rates, which can affect the rate you'll be charged for a mortgage or car loan.

What About Your Investments?

As more individuals invest overseas as a way to stay adequately diversified and to potentially benefit from enhanced portfolio performance, currency risk is becoming a major factor to consider.[1,2] For a U.S. investor, a currency gain or loss stems from a fall or rise in the value of the dollar against the currency in which the investment is made: a fall in the value of the dollar relative to the local currency will increase your return; a rise in the dollar will lower your return.

Currency fluctuations arise from a number of factors, including the relative economic strength of each country and local political conditions. There are also indirect influences on exchange rates, such as trade balances, which can result in adverse movements of exchange rates and equity prices.

Managing Currency Risk

Portfolio managers use three basic approaches to manage currency risks. The first approach is not to hedge at all, assuming that currency fluctuations will wash out over a period of time; the second approach is to hedge fully, which may reduce the volatility of the portfolio. The third approach is to actively manage hedging, choosing when and how much to hedge. This approach is gaining popularity; most investment firms now offer some kind of currency service, and some firms with substantial international investments even appoint a separate manager to handle currency as a distinct asset class.

Currency fluctuations are a fact of your financial life. This article offers only an outline; it is not a definitive guide to all possible consequences and implications of any specific investment strategy. For this reason, be sure to seek advice from knowledgeable financial professionals.

[1]*Changes in foreign currency exchange rates will affect the value of currency investments. Foreign investments may entail greater risks than domestic investments due to currency exchange rates; political, diplomatic, or economic conditions; and regulatory requirements in other countries. Financial reporting standards in foreign countries typically are not as strict as in the United States, and there may be less public information available about foreign companies. These risks can increase the potential for losses.*

[2]*Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors.*

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