



On the Other Hand ...

A Contrarian View of Global Economics

18 March 2016

G. Scott Clemons, CFA  
Chief Investment Strategist

140 Broadway  
New York, NY 10005  
scott.clemons@bbh.com

 @GSClemons

# Brown Brothers Harriman Snapshot

BBH is a global financial institution with over 5,000 employees in 17 offices worldwide and expertise in Private Banking, Investment Management, and Investor Services. Our Private Banking business serves both corporate and private clients throughout the cycle of wealth creation, transition and preservation in four primary practice areas: **Wealth Management, Corporate Advisory and Banking, Private Equity, and Trust.**

## About Wealth Management

**Assets under management:** \$27.1 billion\*

### Clients we serve:

- Private business owners
- Business executives
- Inheritors of family wealth
- Endowments
- Foundations

**Client minimum:** \$10 million

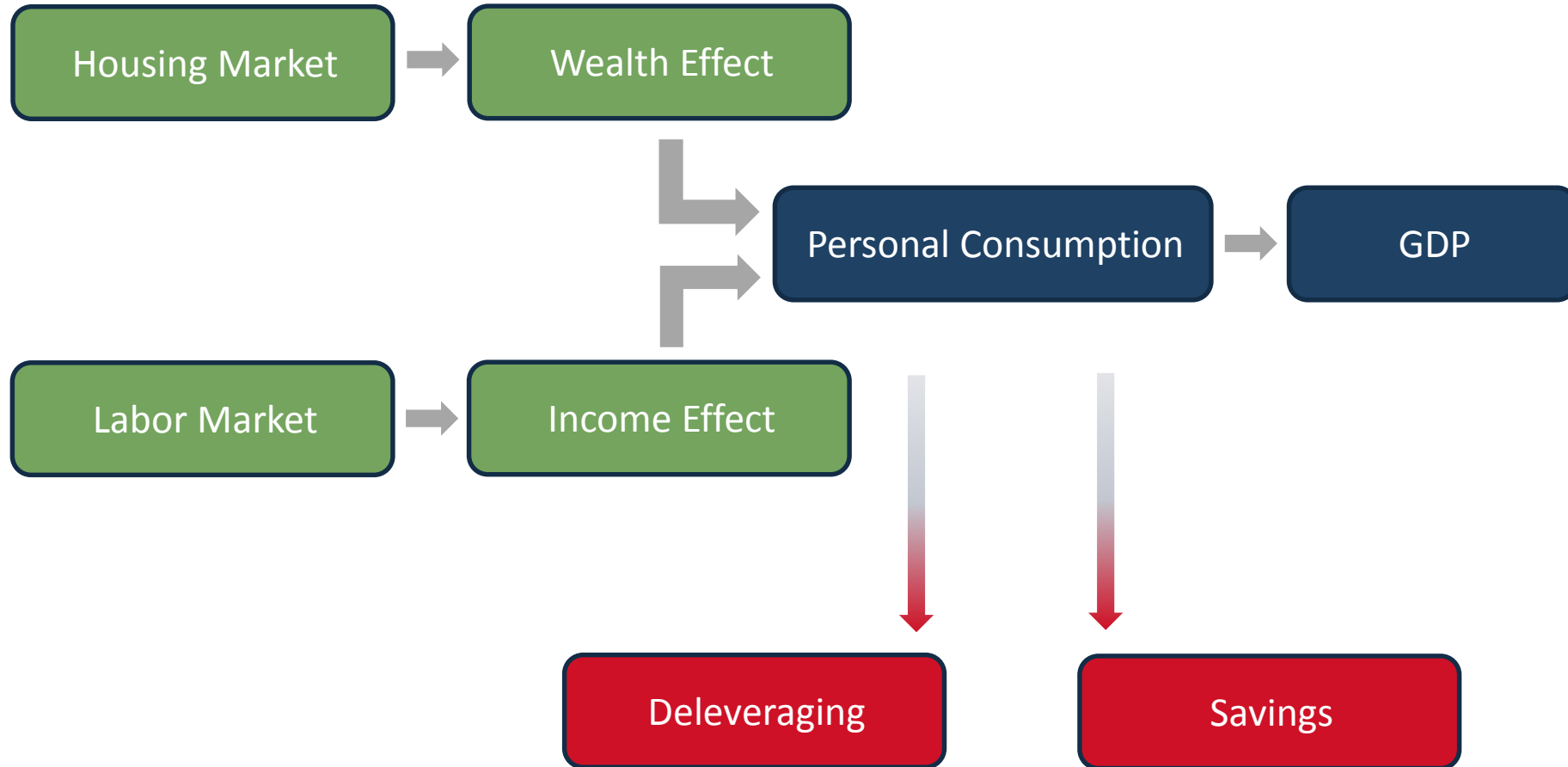
**Average client size:** \$22 million\*

**Locations:** New York, Boston, Charlotte, Chicago, Nashville, Philadelphia, Wilmington

*\*As of December 31, 2014*

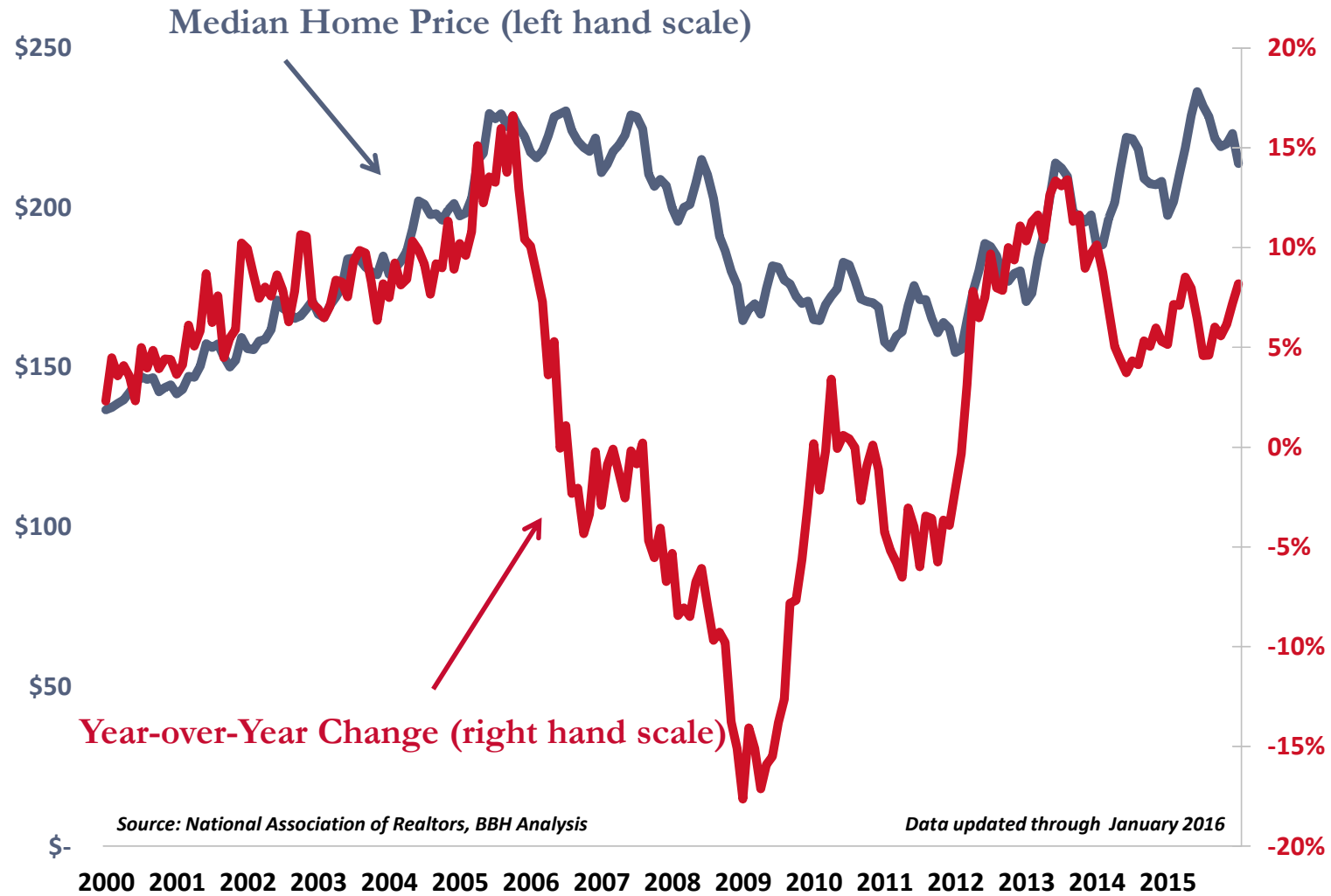


# Roadmap of the Domestic Economy



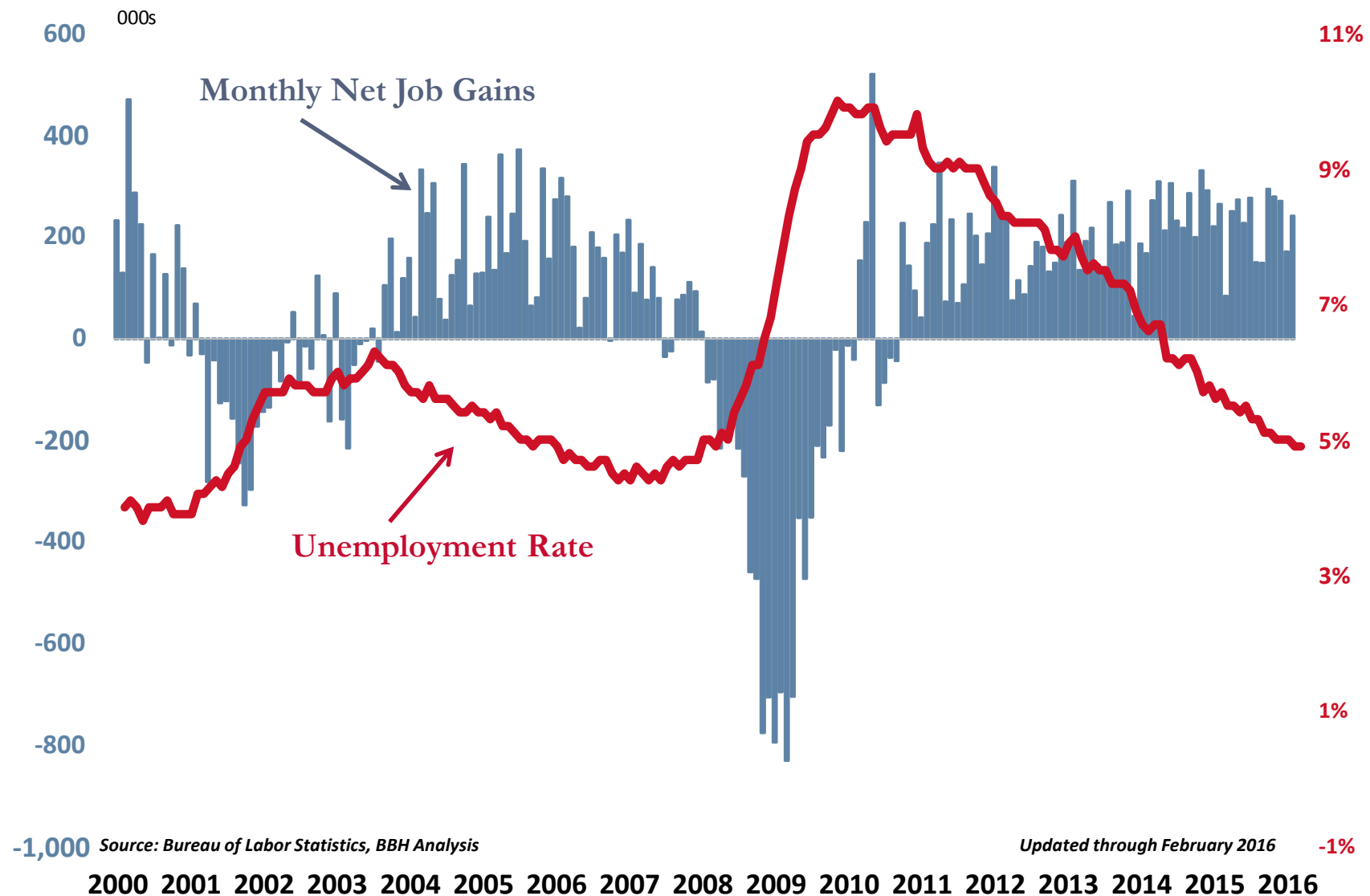
# The Housing Market

*Home Prices Rising at a 8% Annualized Pace...*



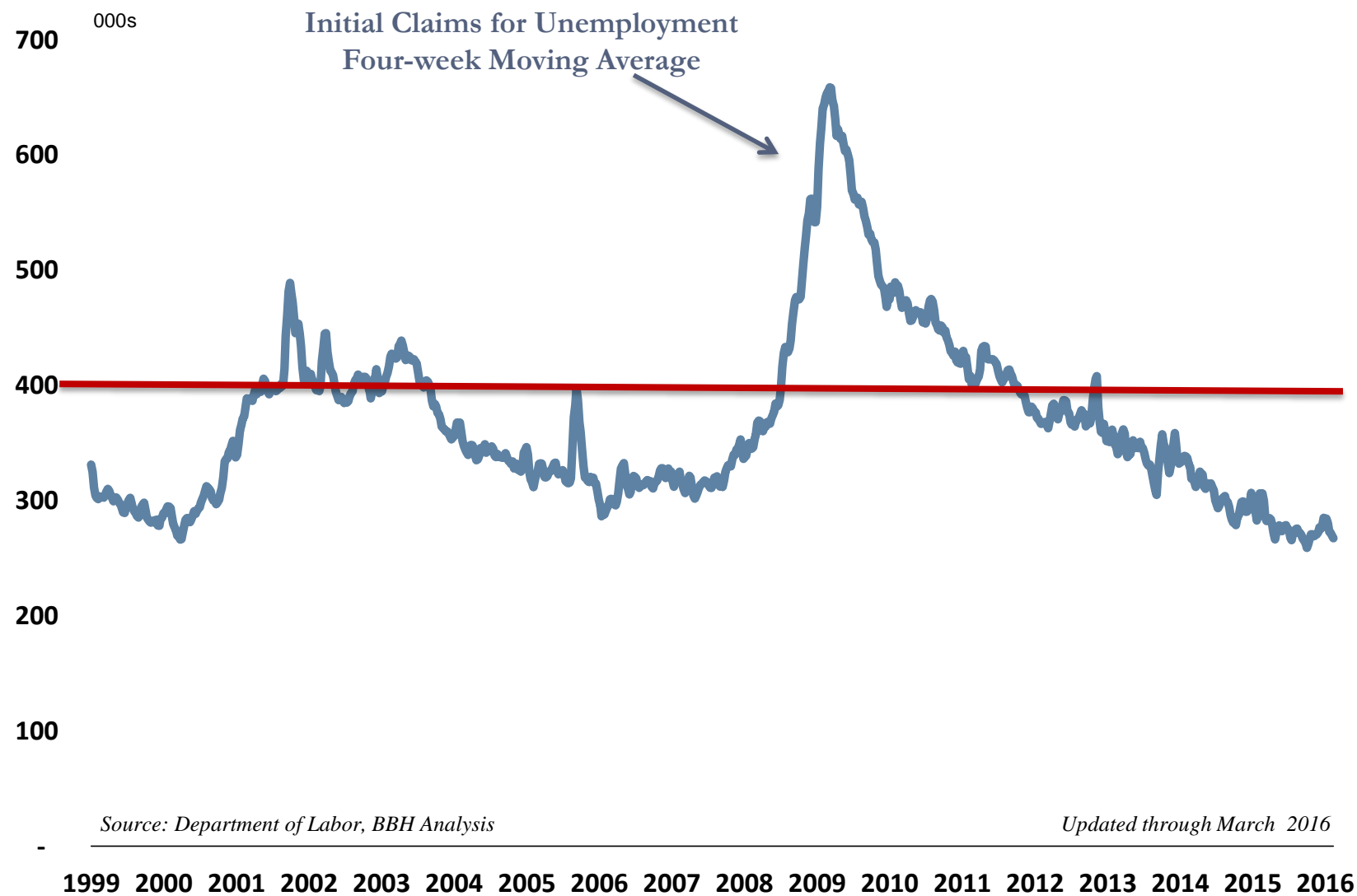
# The Labor Market

*2.7 million jobs added in the last year ...*



# The Labor Market

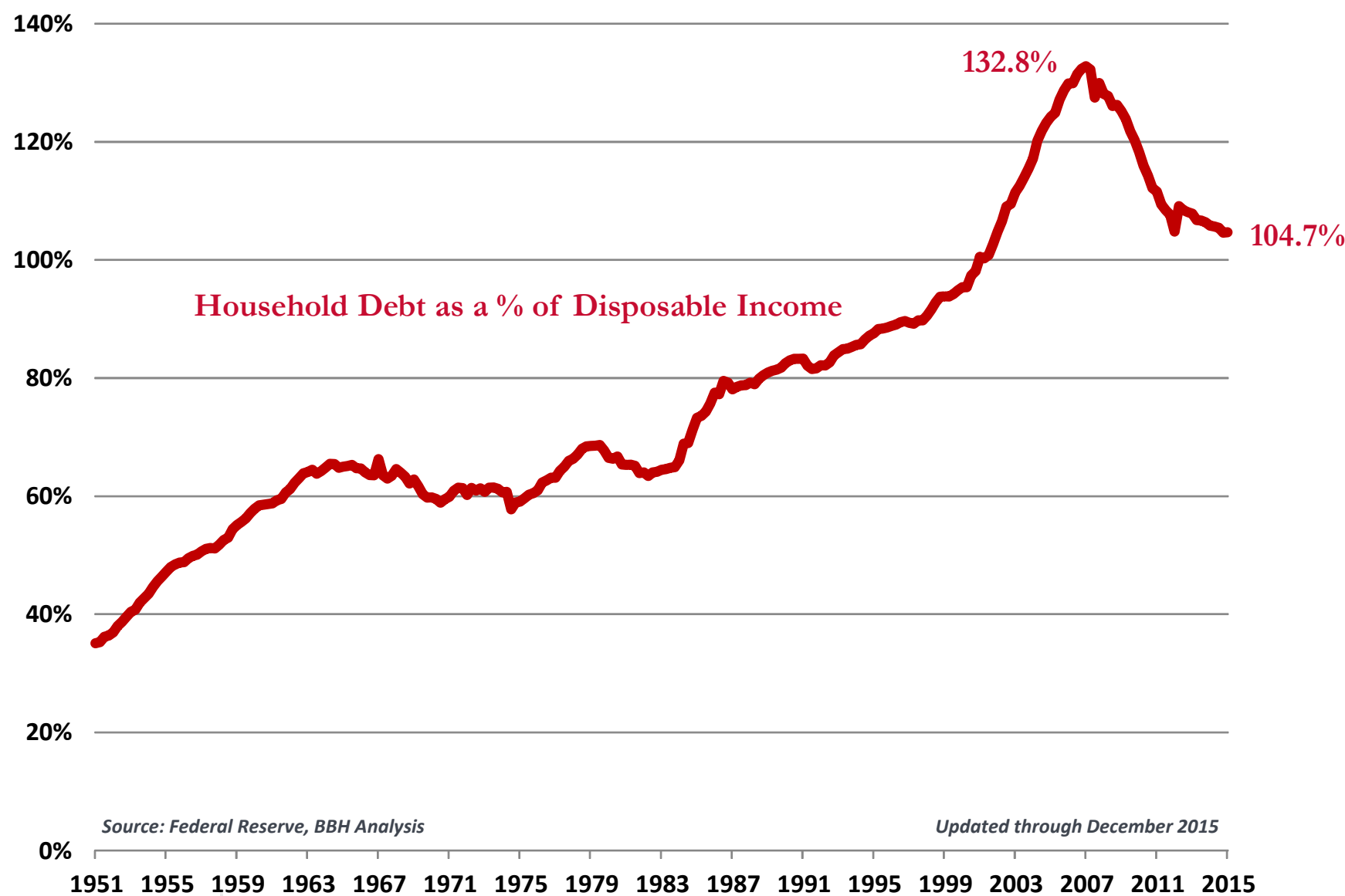
*Initial Claims Argue for Further Improvement*



Source: Department of Labor, BBH Analysis Updated through March 2016

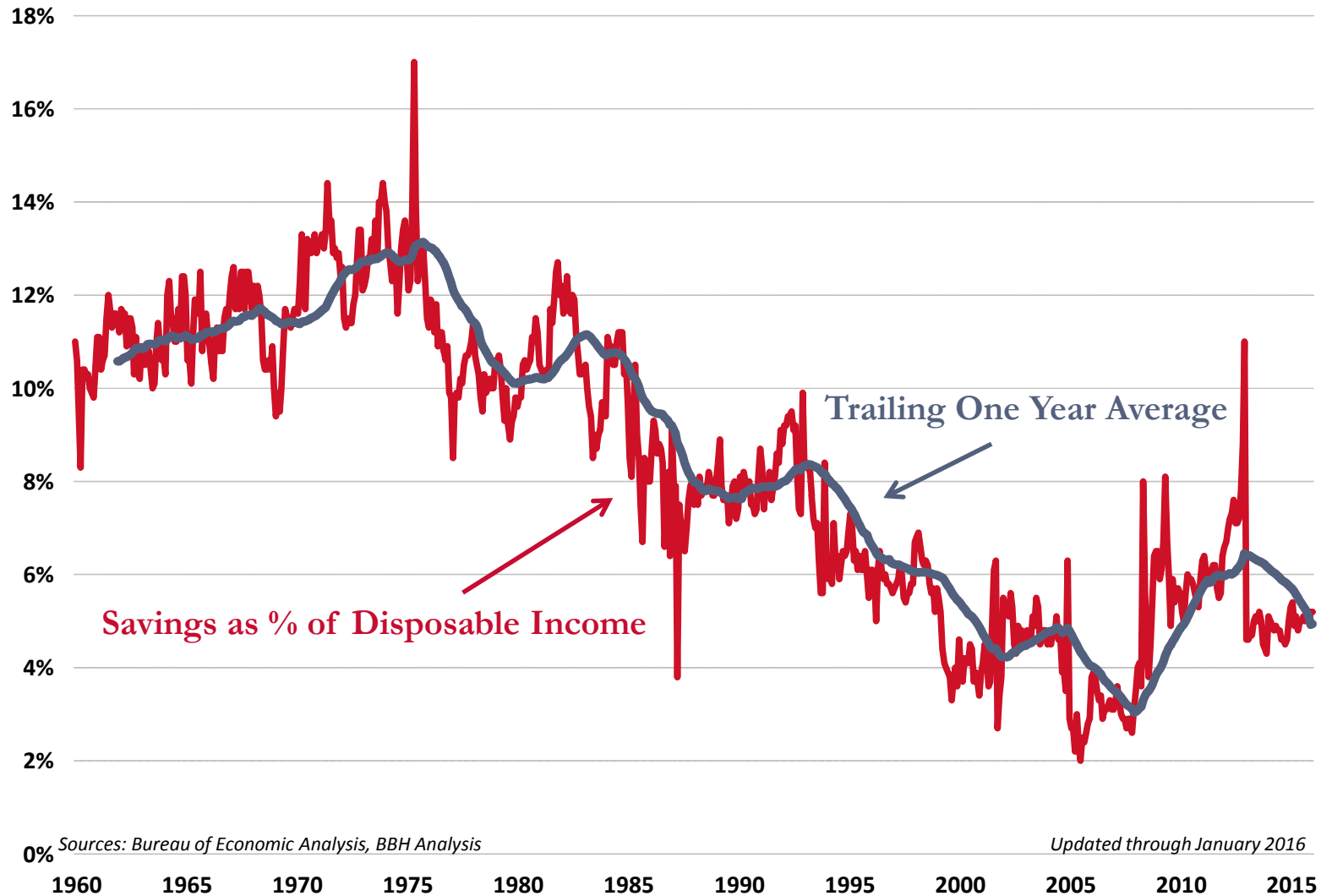
# Household Debt

*American Households Have Deleveraged Since the Financial Crisis ...*



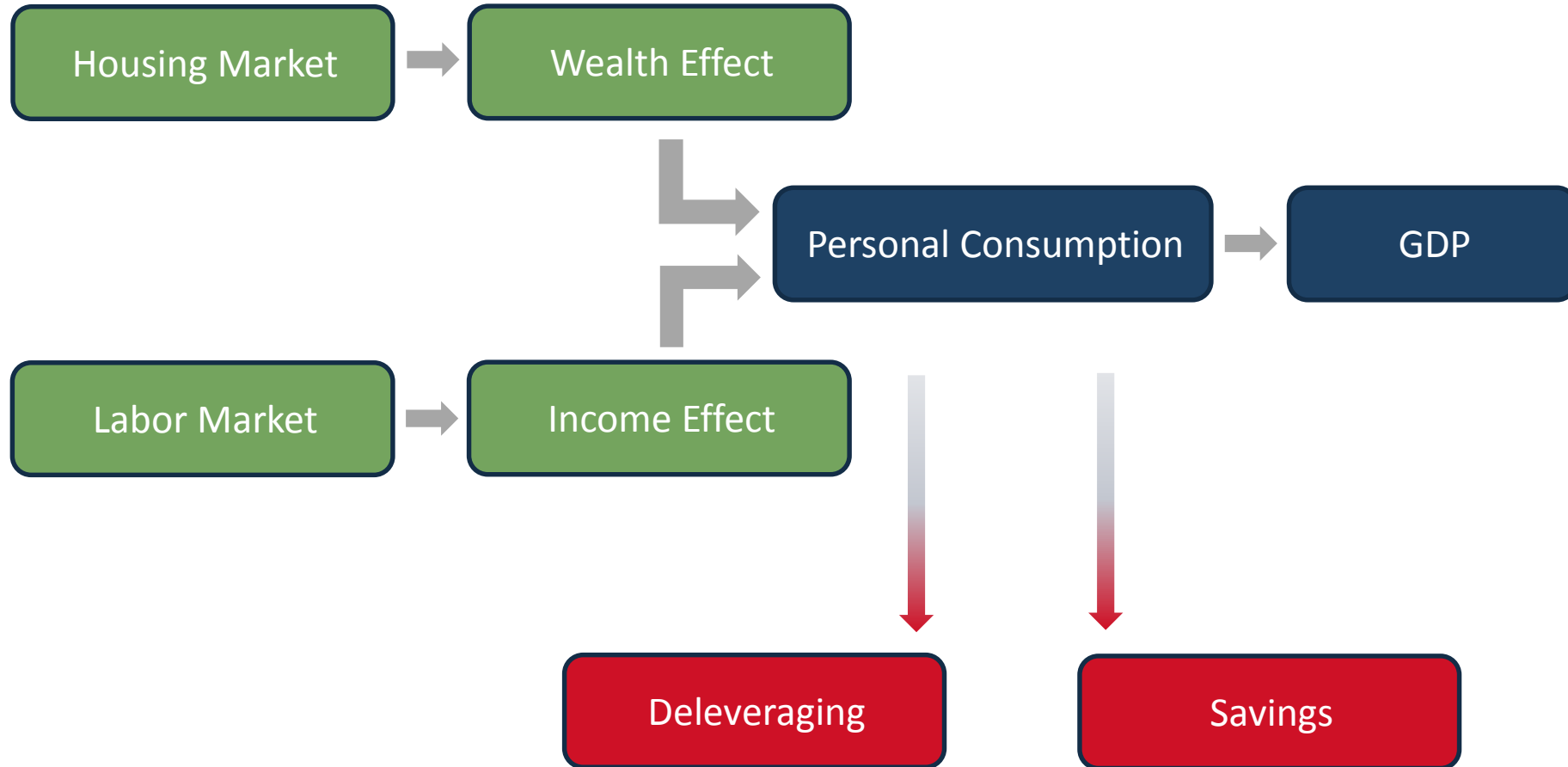
# Households Savings

... and Increased their Savings Rates





# Roadmap of the Domestic Economy

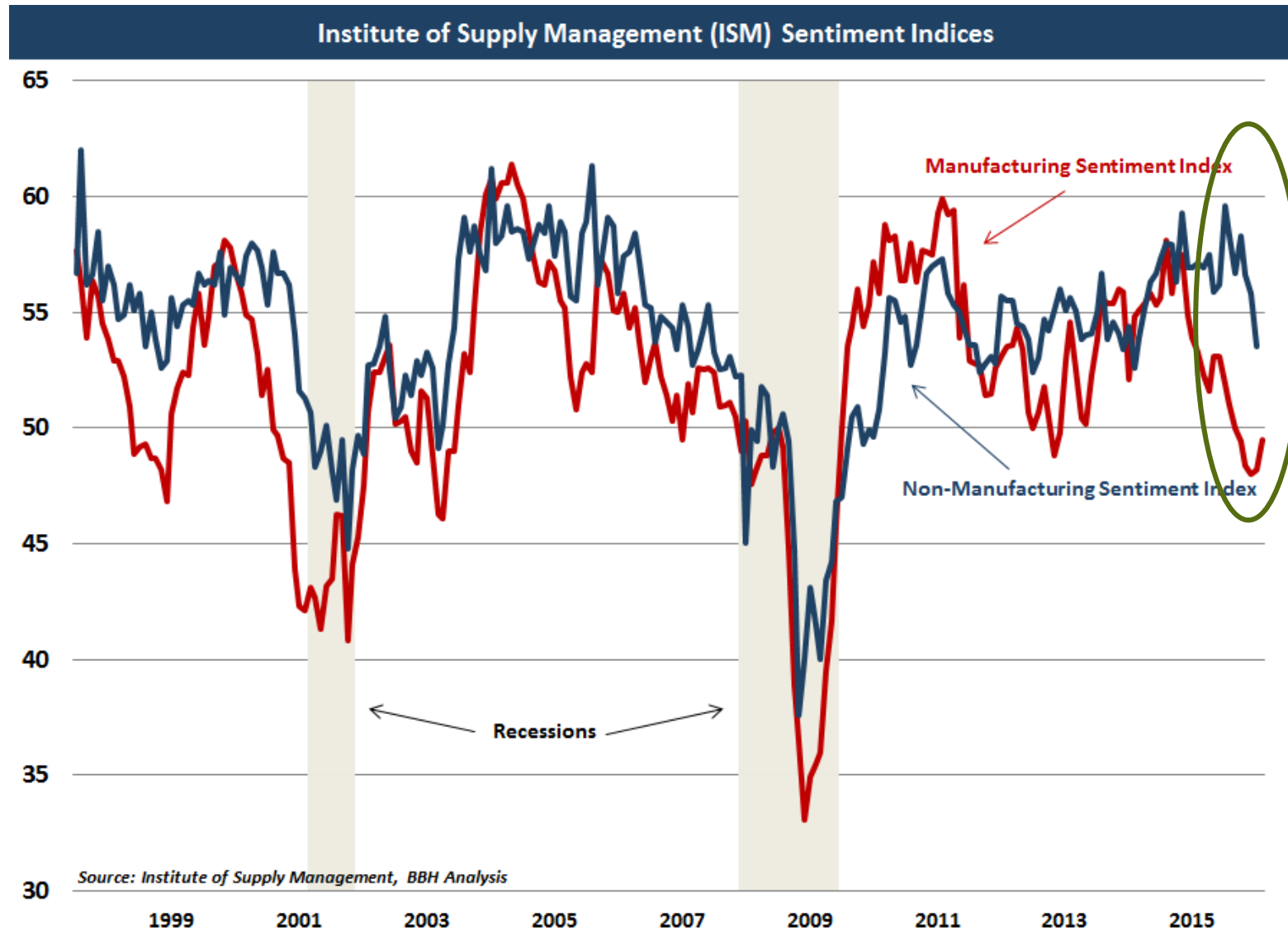


## Five Conundra of the US Economy ...

---

1. The divergence between economic activity in the manufacturing and service sectors
2. The absence of wage growth in this seventh year of a labor market recovery
3. The path and pace of monetary policy
4. The threat of disruption from global economies
5. The dichotomy of equity market activity

# The Divergence of Economic Activity

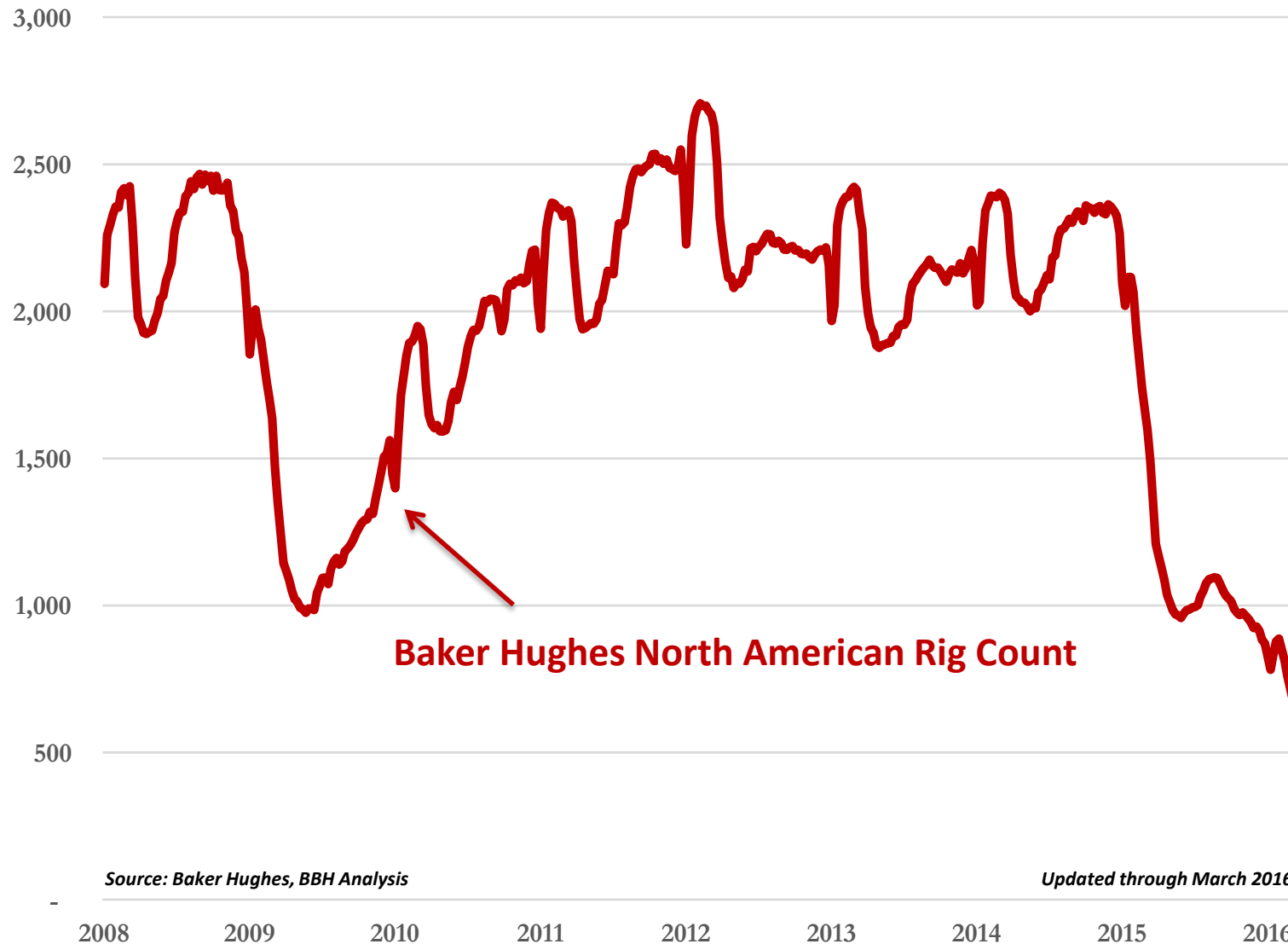


# Why the Divergence of Economic Activity?

---

1. 35% of the manufacturing sector is reliant directly or indirectly on the energy industry.

## Activity in the Energy Sector is Down 76%



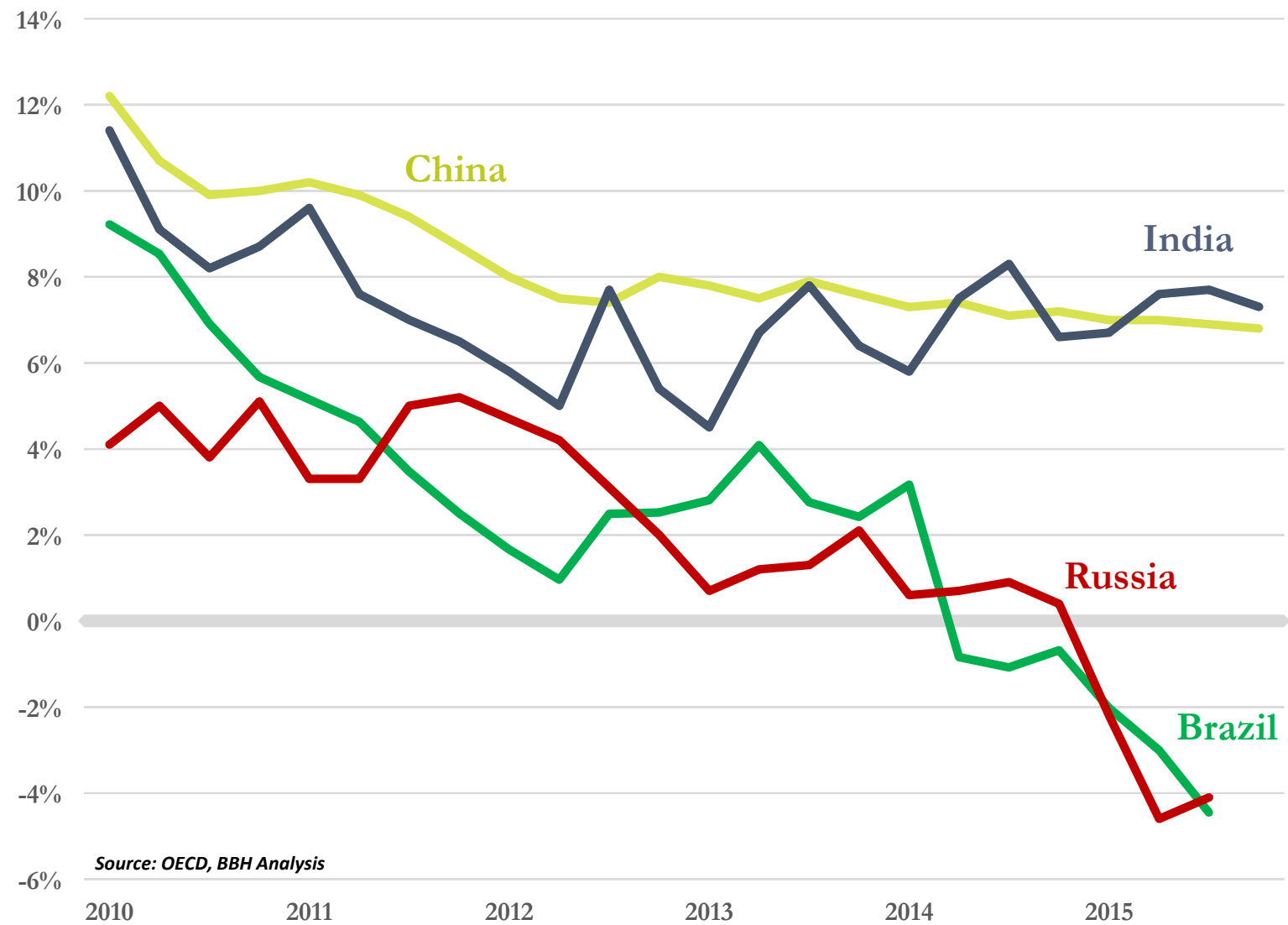
## Why the Divergence of Economic Activity?

---

1. 35% of the manufacturing sector is reliant directly or indirectly on the energy industry.
2. The slowdown in emerging economies impairs US exports of machine equipment.

# Emerging Economic Activity

Quarterly GDP Growth (at Annual Rates)



Source: OECD, BBH Analysis

## Why the Divergence of Economic Activity?

---

1. 35% of the manufacturing sector is reliant directly or indirectly on the energy industry.
2. The slowdown in emerging economies impairs US exports of machine equipment.
3. The strength of the US dollar impairs export competitiveness even further.

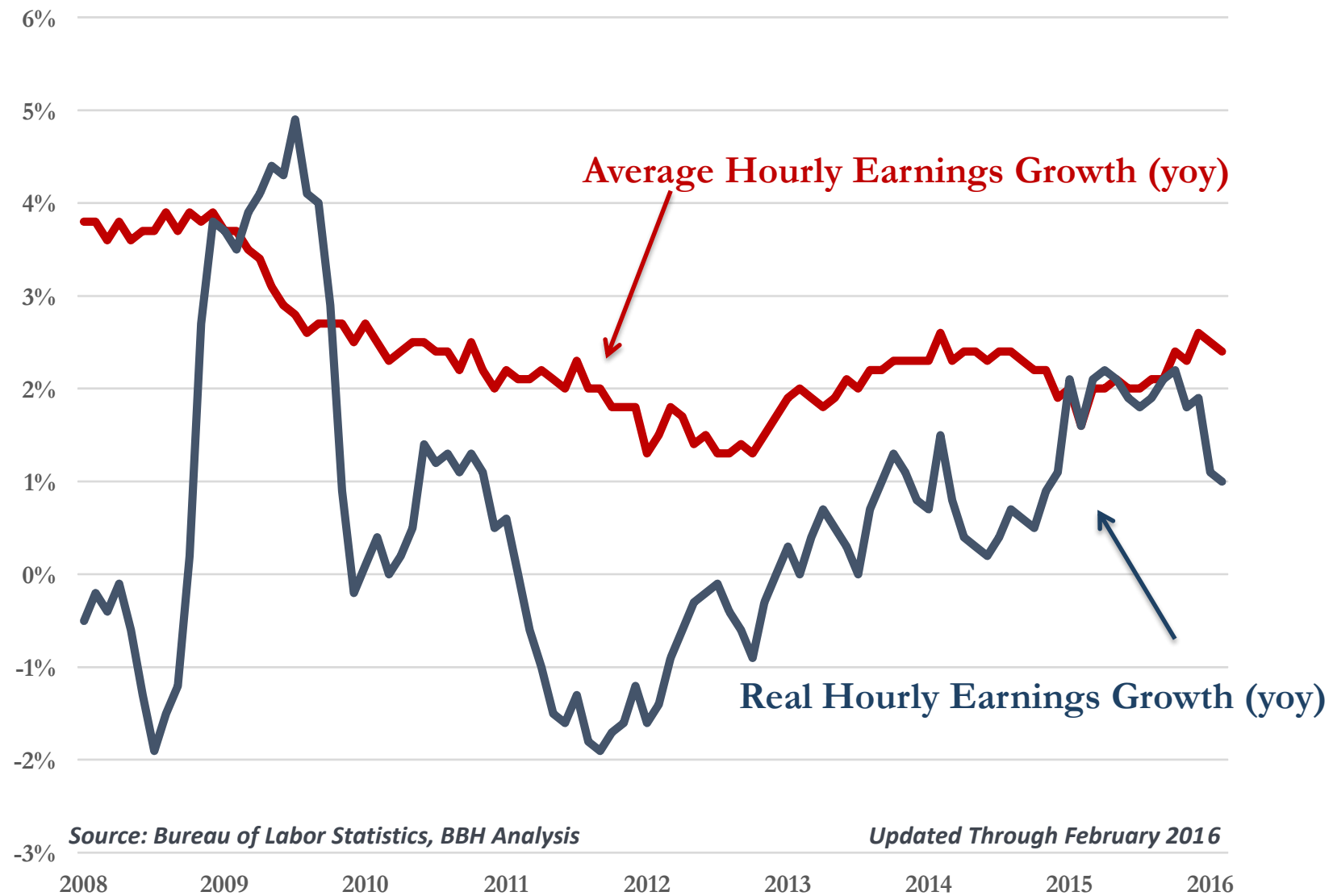


## US Dollar Up 20% Versus Trading Partners Over Past Two Years

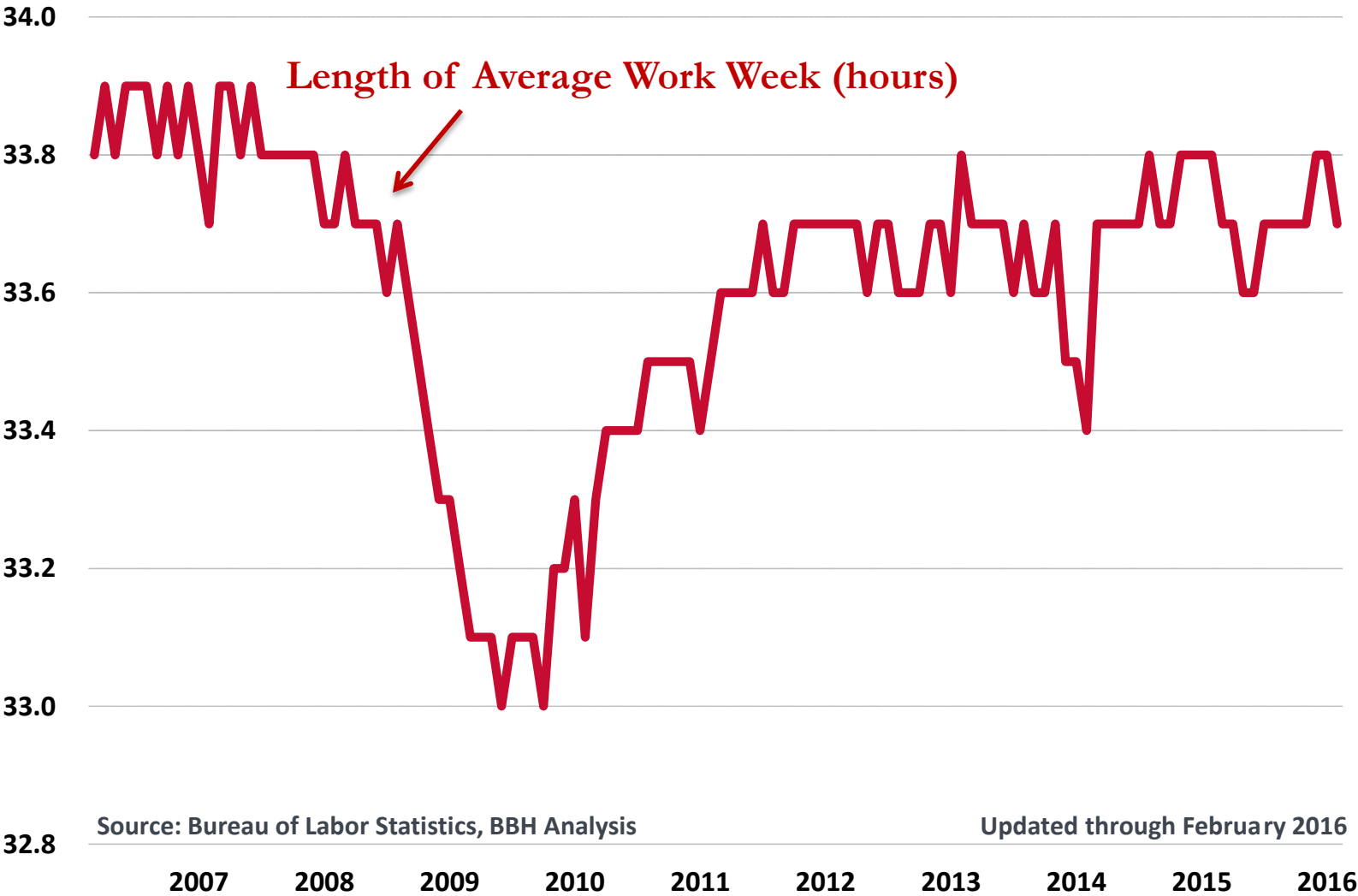


Source: Bloomberg, BBH Analysis

# Whither Wages?



# The Work Week is Increasing



# Monetary Policy

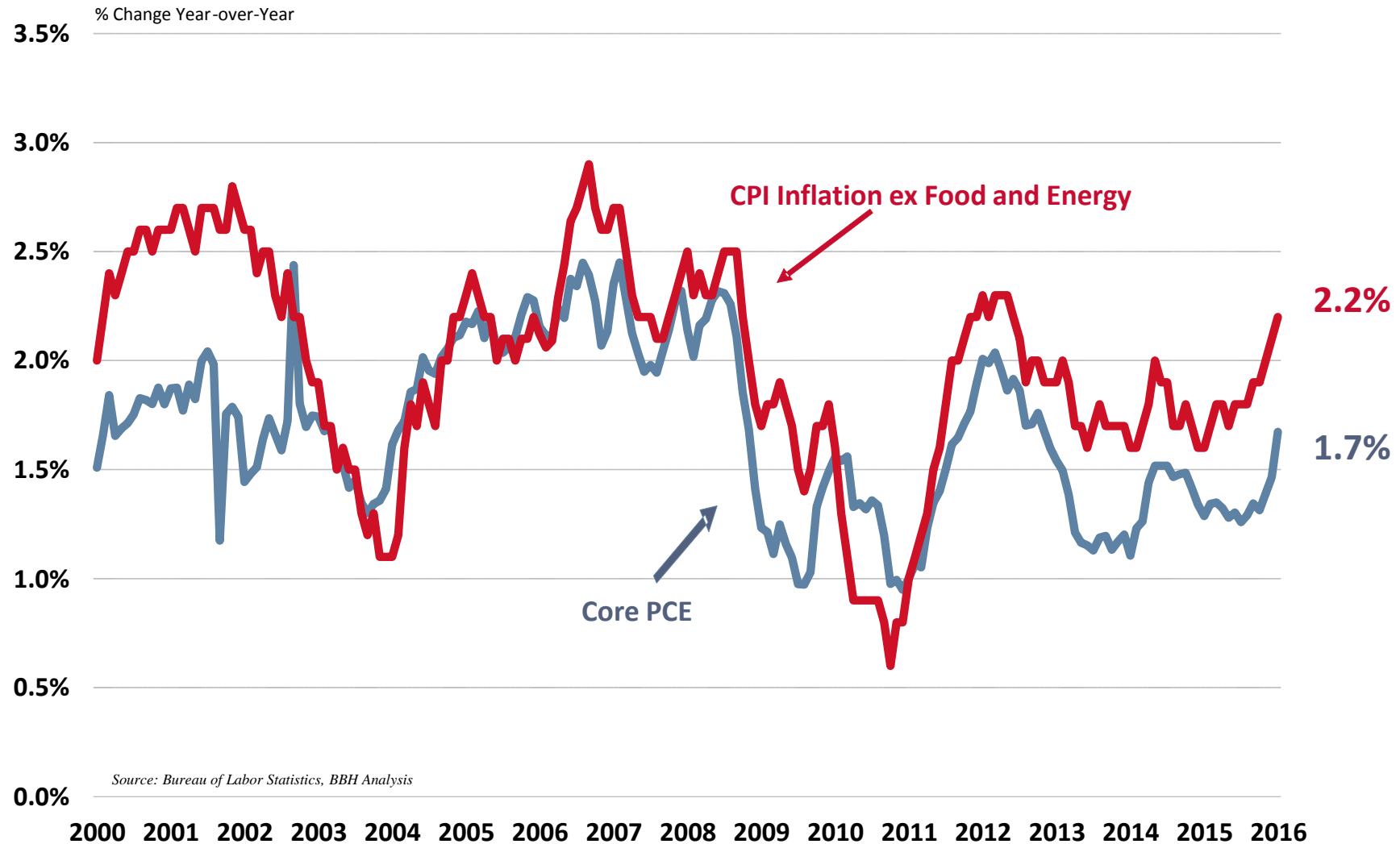
## *The Beginning of the End of Easy Money ...*

---

- Even with the long-awaited hike in interest rates and the end of quantitative easing, Fed policy remains very accommodative ...
  - The size of the Fed's balance sheet remains the same.
  - Interest rates remain very low.
- The pace of interest rate increases is a function of the strength of the economy and the threat of inflation.
- With inflation no real and present danger, the Fed can afford to be patient in raising interest rates.

# Inflation

... Or the Lack Thereof



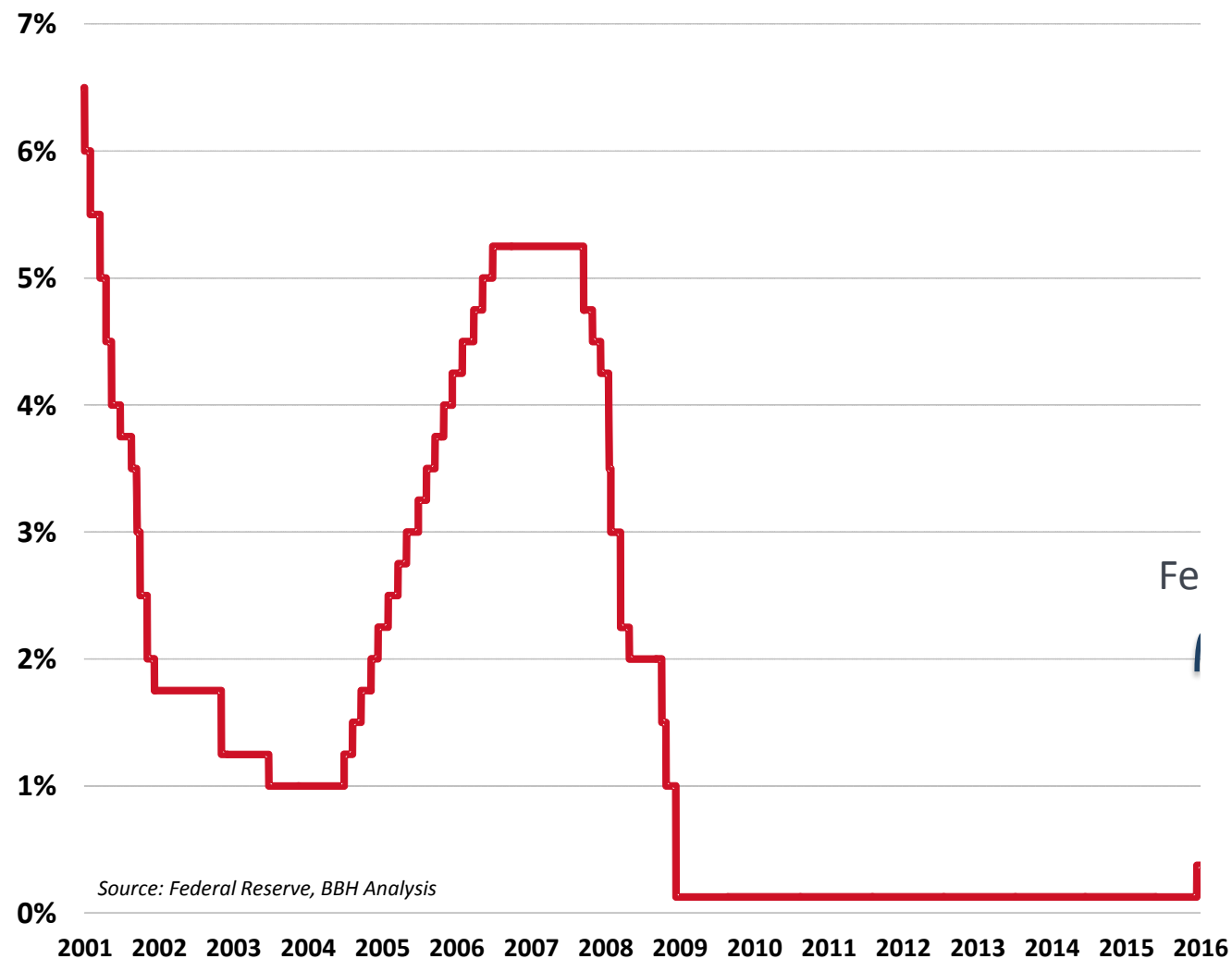
# Inflation

... Or the Lack Thereof



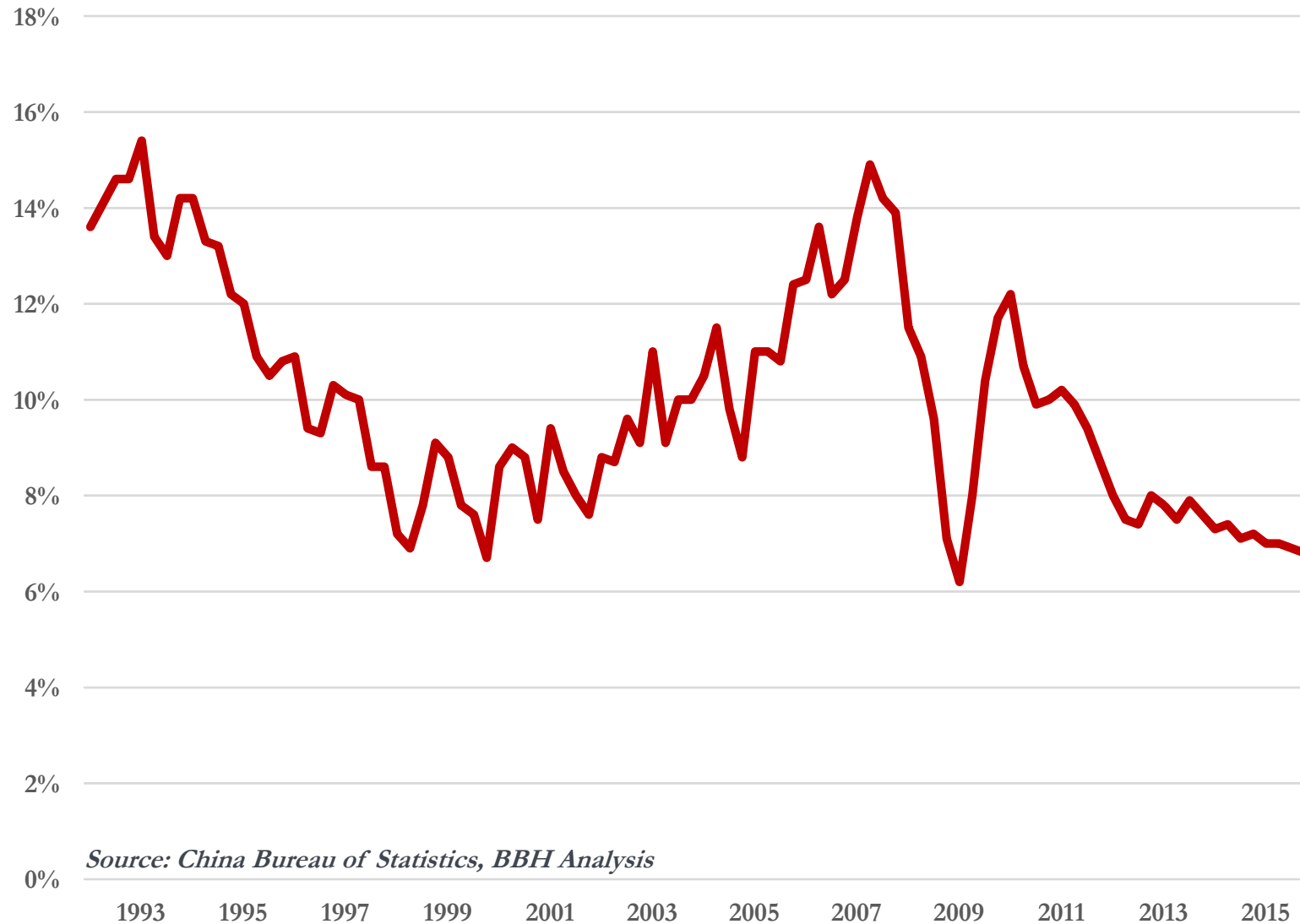
# Monetary Policy

*Interest Rates Expected to Normalize at a Slow Pace*



# Chinese GDP Growth

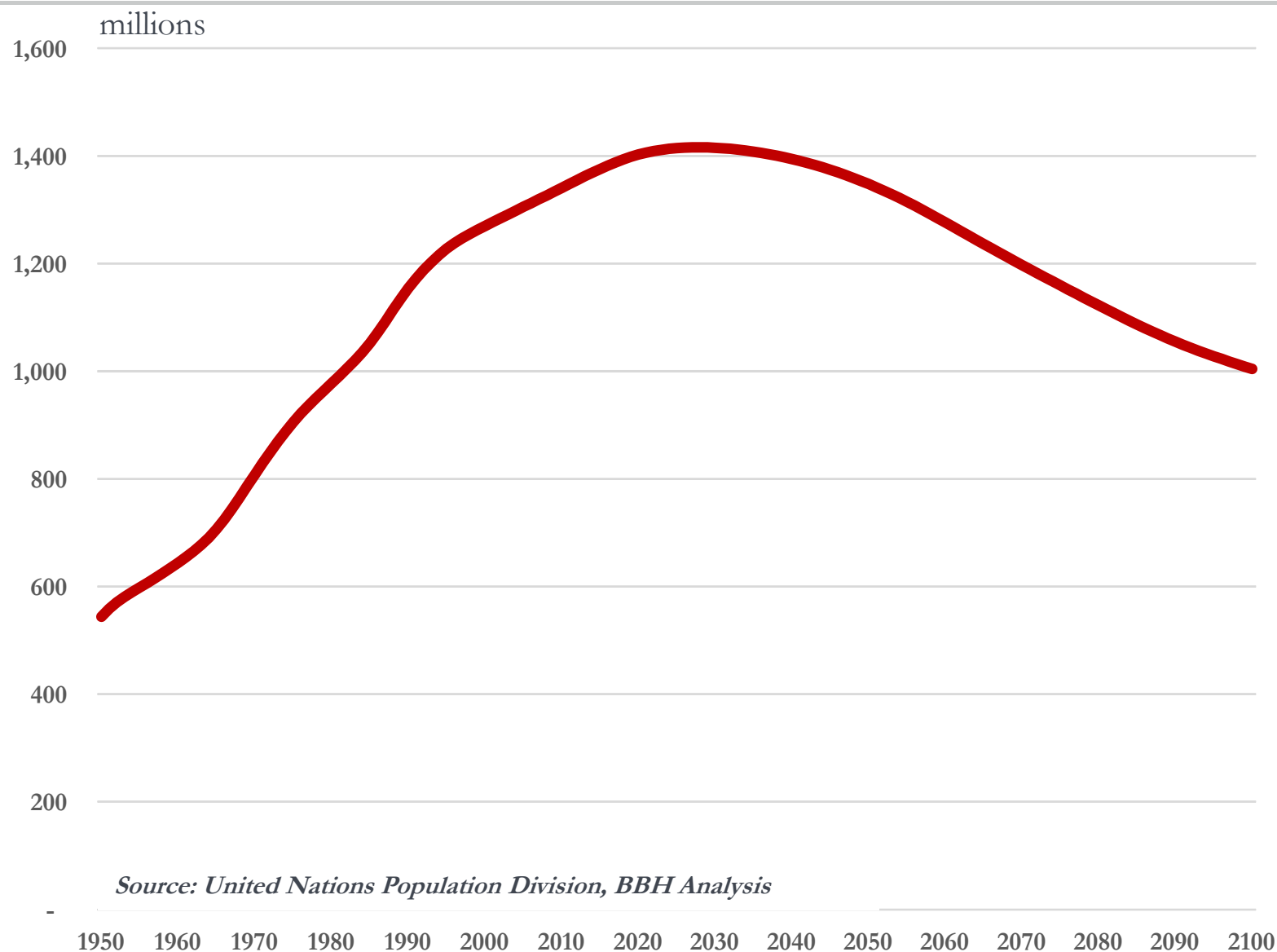
*Beginning of the End ... or the End of the Beginning?*





# Chinese Population

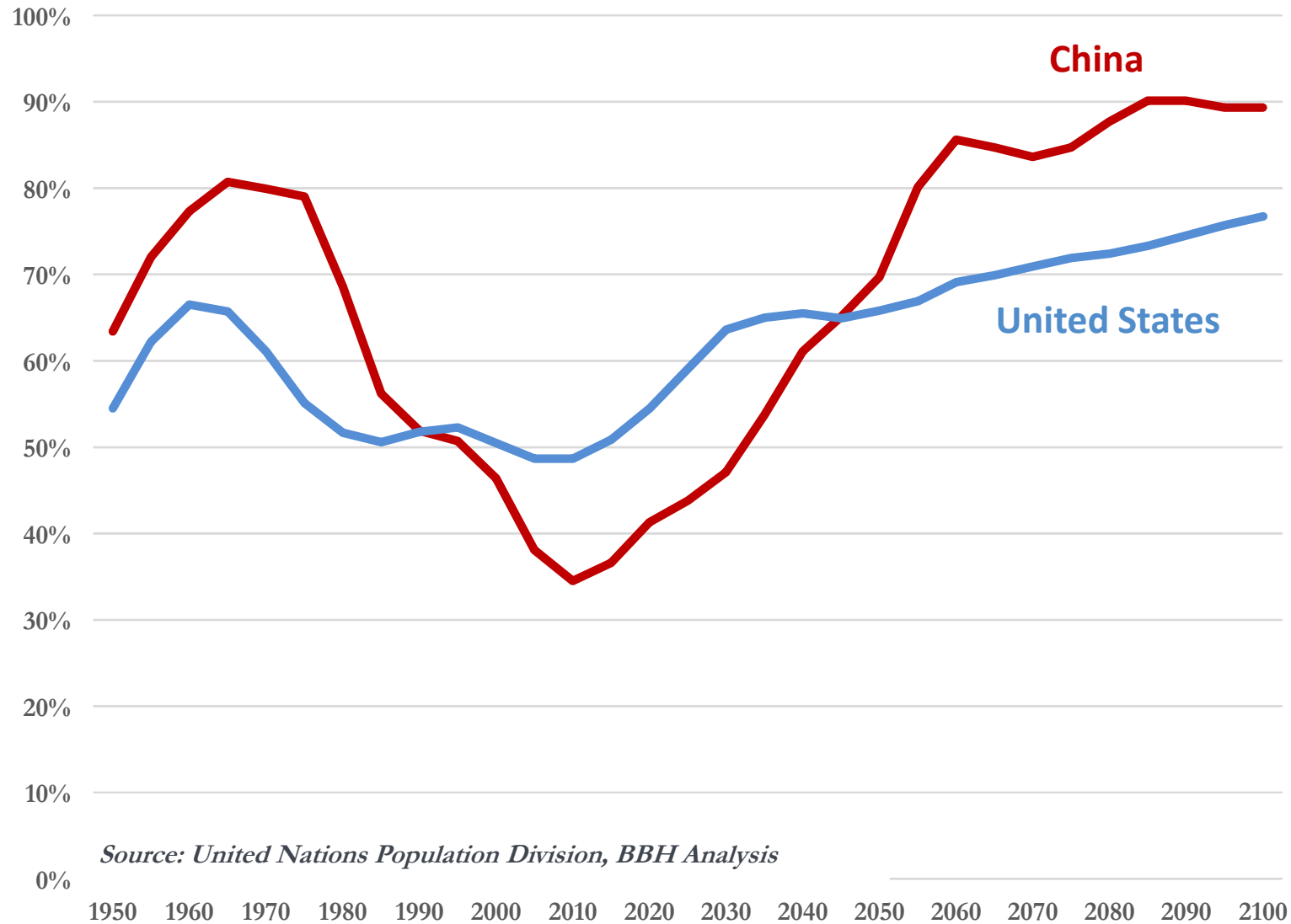
*Projected to Peak in 2028*



*Source: United Nations Population Division, BBH Analysis*

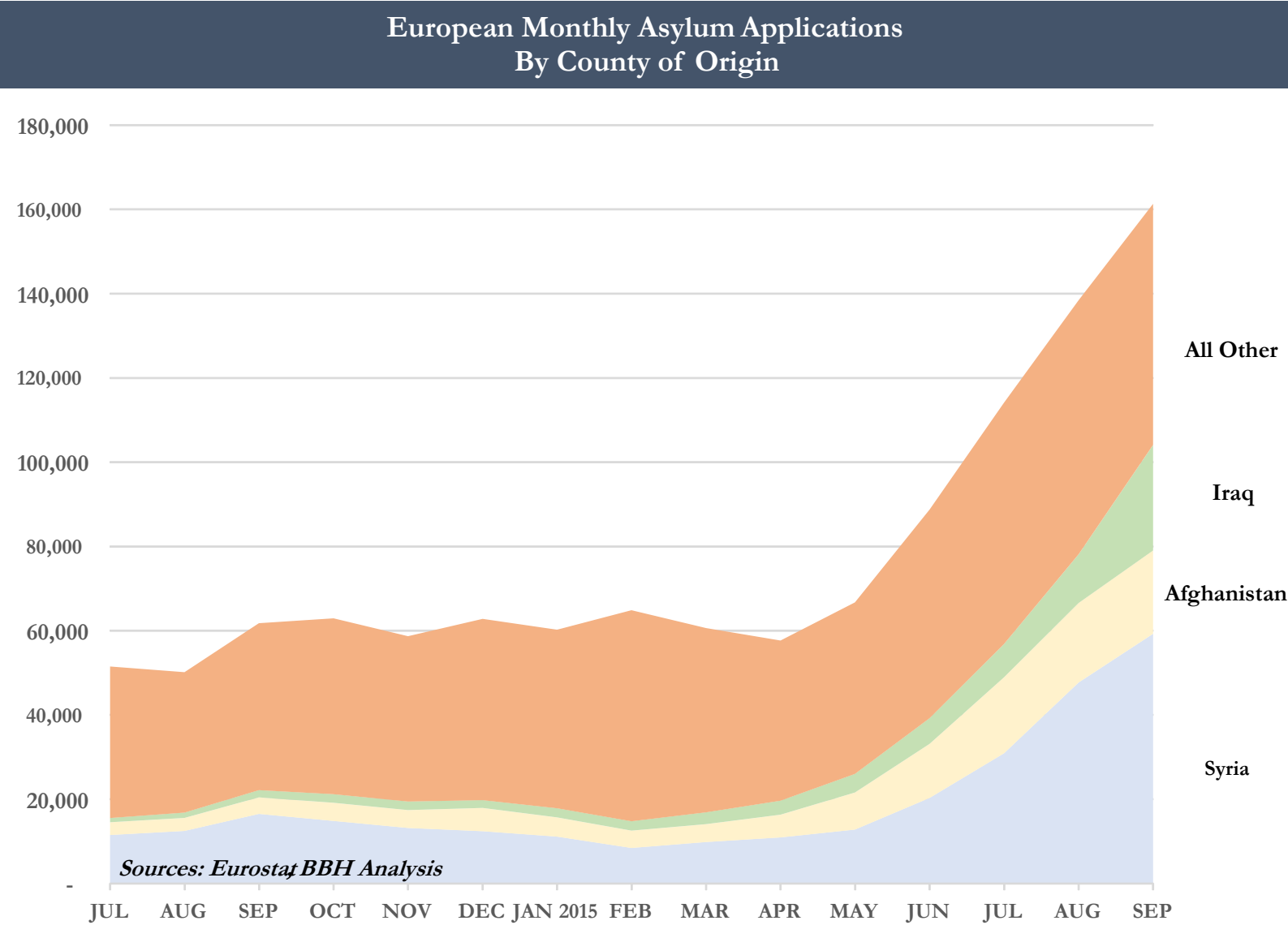
# Rising Chinese Dependency Ratio

*Population Aged <15 and >65 as a Percentage of Population Aged 15-64*



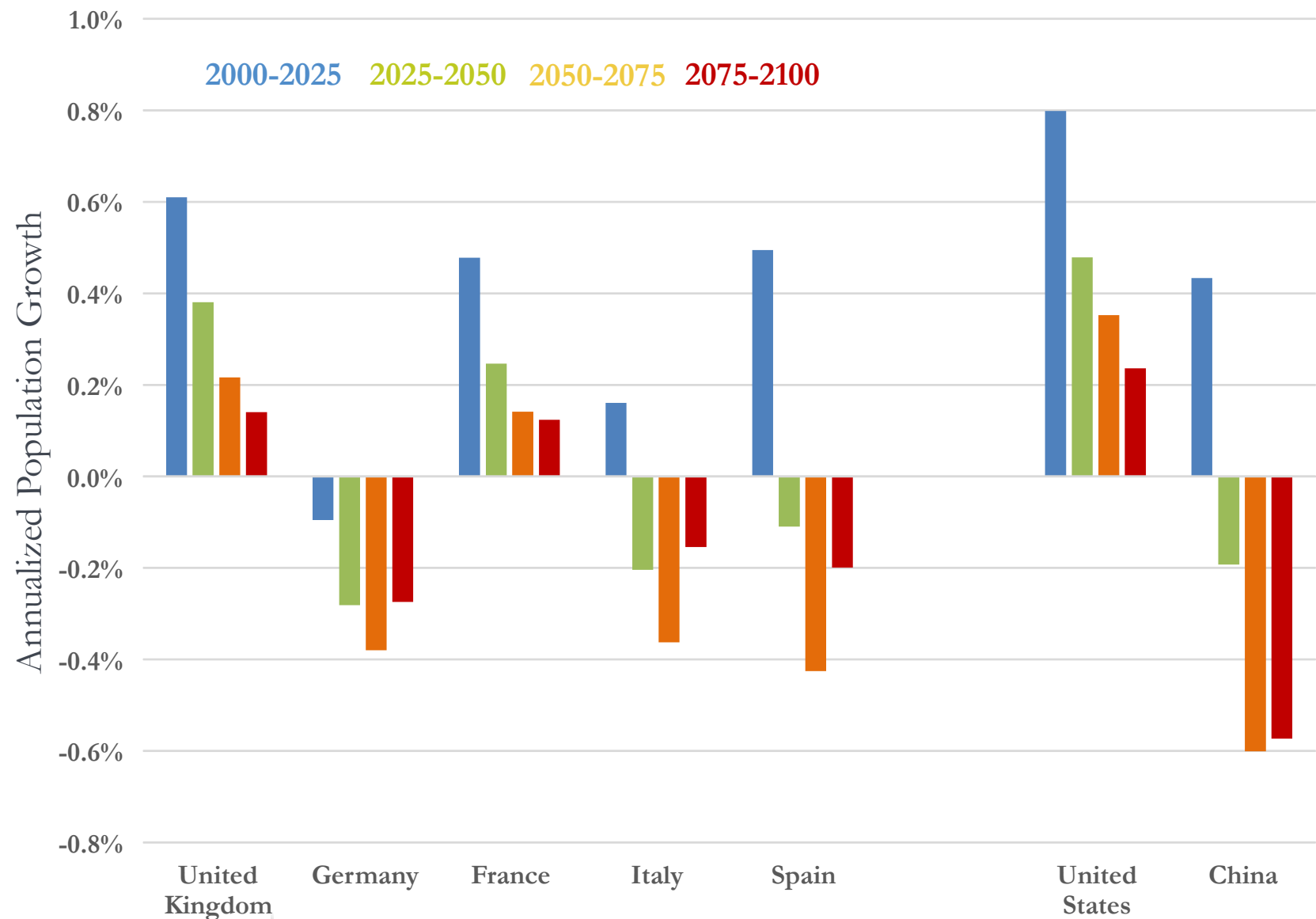
# European Immigration

*A Double Edged Sword*



# European Population Growth

... or the Lack Thereof



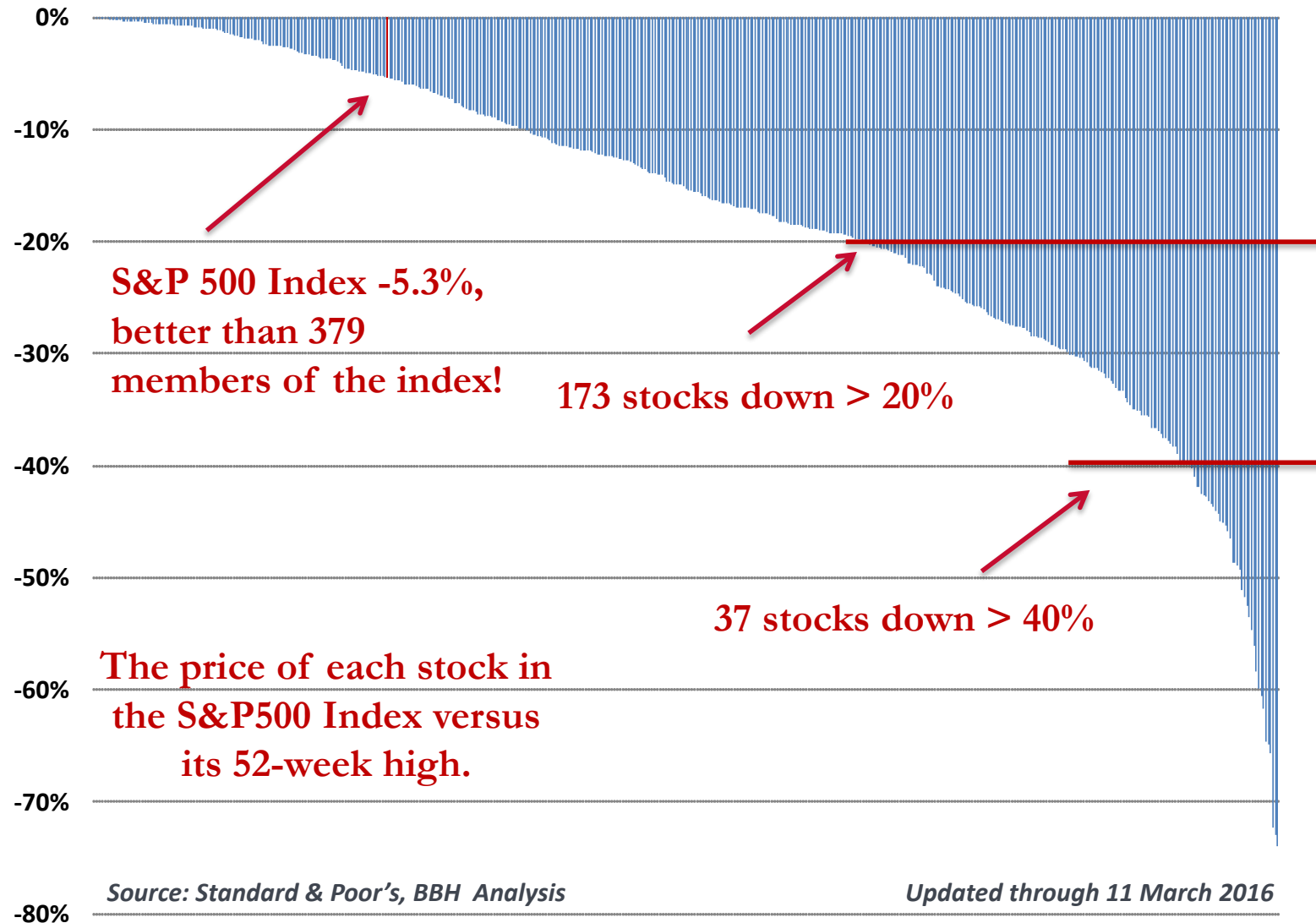
# A Tale of Two Markets

*The S&P 500 is Down 5% From its 52-week High ...*



# A Tale of Two Markets

... But 35% of the Stocks Within the Index are in Bear Market Territory



The **bad news** is that the equity market is in worse shape than headline index levels indicate. Leadership is narrow, valuations are lofty, and earnings are waning.

The **good news** is that not every company in the index (or the market) suffers from weak earnings and lofty valuations. There are opportunities lurking beneath the surface of the index!

## Implications and Conclusions

---

The divergence between manufacturing and services should not spill over into the broad economy.

An acceleration in wage growth would support consumption even further, but too much wage growth could lead to inflation and tighter monetary policy.

China is not in terminal decline, and Europe faces a twin challenge and opportunity that could address demographic obstacles to growth.

The divergence of market action creates opportunities for active investors. A passive approach embraces general market risk without taking advantage of opportunities within the index.





## On the Other Hand ...

### A Contrarian View of Global Economics

*18 March 2016*

G. Scott Clemons, CFA  
Chief Investment Strategist

140 Broadway  
New York, NY 10005  
scott.clemons@bbh.com

 @GSClemons