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Capital Perspectives

April 2017

As of March 31, 2017, unless otherwise noted.

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Our outlook

Economy looks sturdy, but we might get a weak 1Q figure

The U.S. economy remains solid although we are expecting a somewhat weak figure for the first quarter of the year. Most indicators of growth are very encouraging, from orders for manufactured goods and capital goods to surveys of businesses and the labor market. The one point of weakness has been consumer spending for the first two months of the year. This would be concerning were it not mostly attributable to mild weather. An unusually warm winter led to very weak consumer spending on utilities, which will drag on the first quarter GDP figure. We continue to expect growth for the year to be strong due to subsequent consumer spending, business capital expenditures, and exports. We still expect organic growth of 2.5% with the possibility of a 0.5% boost from fiscal policy later in the year.

Labor market:

Job growth slowed considerably in March to just 98,000 jobs following two consecutive months of more than 200,000. We believe the January and February figures were inflated due to warm weather which pushes up construction jobs among others. The slowdown in March was payback for the earlier strength. The average monthly gain for 1Q2017 is 178,000. The slowdown in March is actually encouraging, because it supports our core narrative that the labor market remains strong with high demand for workers from firms, but hiring conditions are challenging with the unemployment rate low at 4.5%. That tightness in the labor market is a key reason for accelerating wages and the Fed's stated intention of raising interest rates.

Inflation moving up as expected:

Inflation continued to move upward as we have anticipated and is supportive of more hikes from the Federal Reserve. The inflation gauge preferred by the Federal Reserve, the Personal Consumption Expenditures (PCE) Price Index, moved up to 2.1% y/y in February, the highest in five years and above the stated target. Energy prices are the main reason that inflation has accelerated so quickly over the past six months, but those impacts are now likely reaching their peaks. Core PCE, which excludes food and energy, is stable and trending upward. We expect continued wage growth, continued economic growth, and higher production costs abroad to continue pushing inflation slowly higher this year.

The Fed is set for more hikes this year:

The Fed hiked interest rates again in March, the third such action of this cycle. If the economy continues to unfold as expected with decent growth and slightly higher inflation figures, we expect it to follow the stated path of two more hikes this year. Importantly, the committee is actively studying when to start letting the balance sheet drift downward. This may have impacts on the longer end of the yield curve and would in turn impact the pace of rate hikes at the short end. We expect the Fed to announce a plan before the end of this year that would signal a start to balance sheet normalization at the start of 2018.

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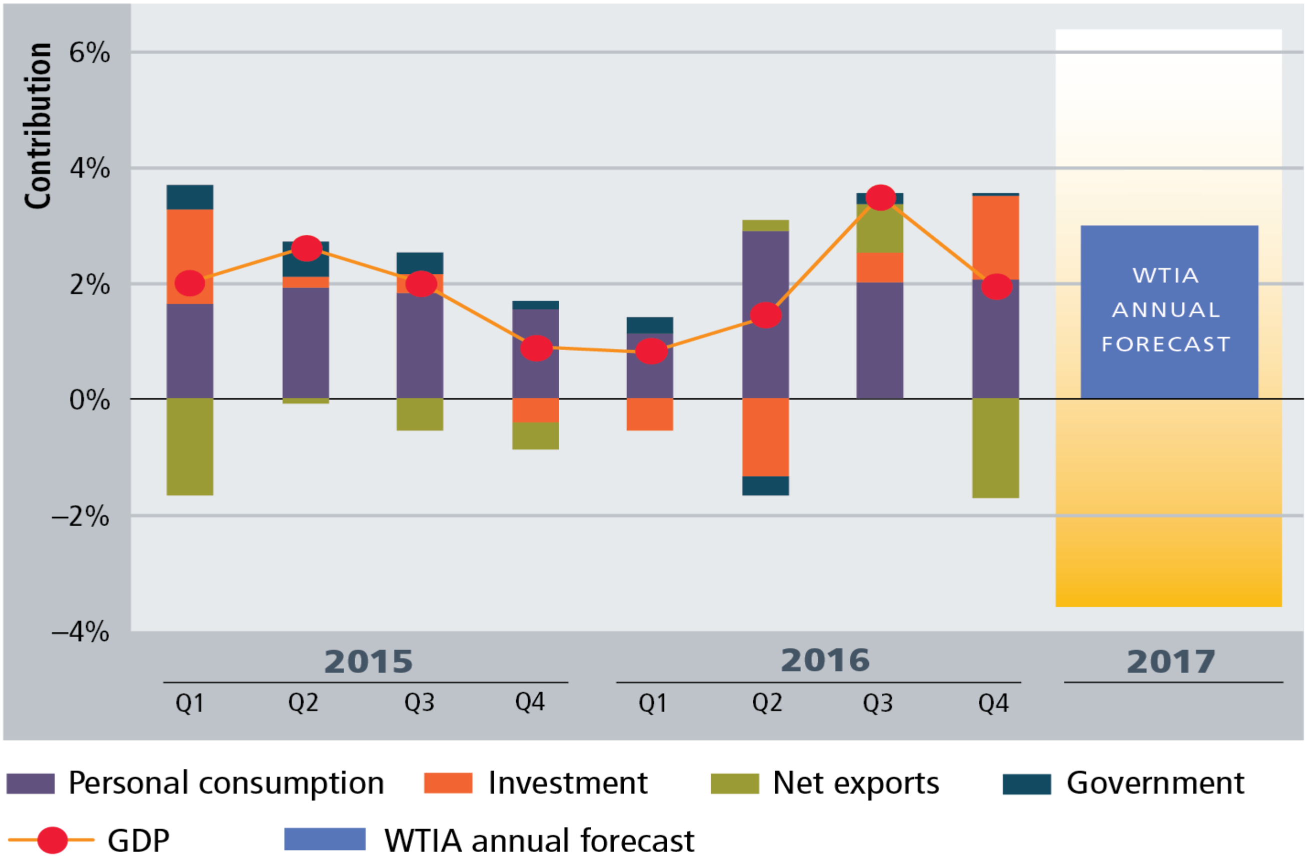
The U.S. economy

GDP growth continues and could possibly get a boost from fiscal policy in 2017

Real GDP and sector contribution (change quarter over quarter)



Sources: Bureau of Economic Analysis, WTIA (forecasted)

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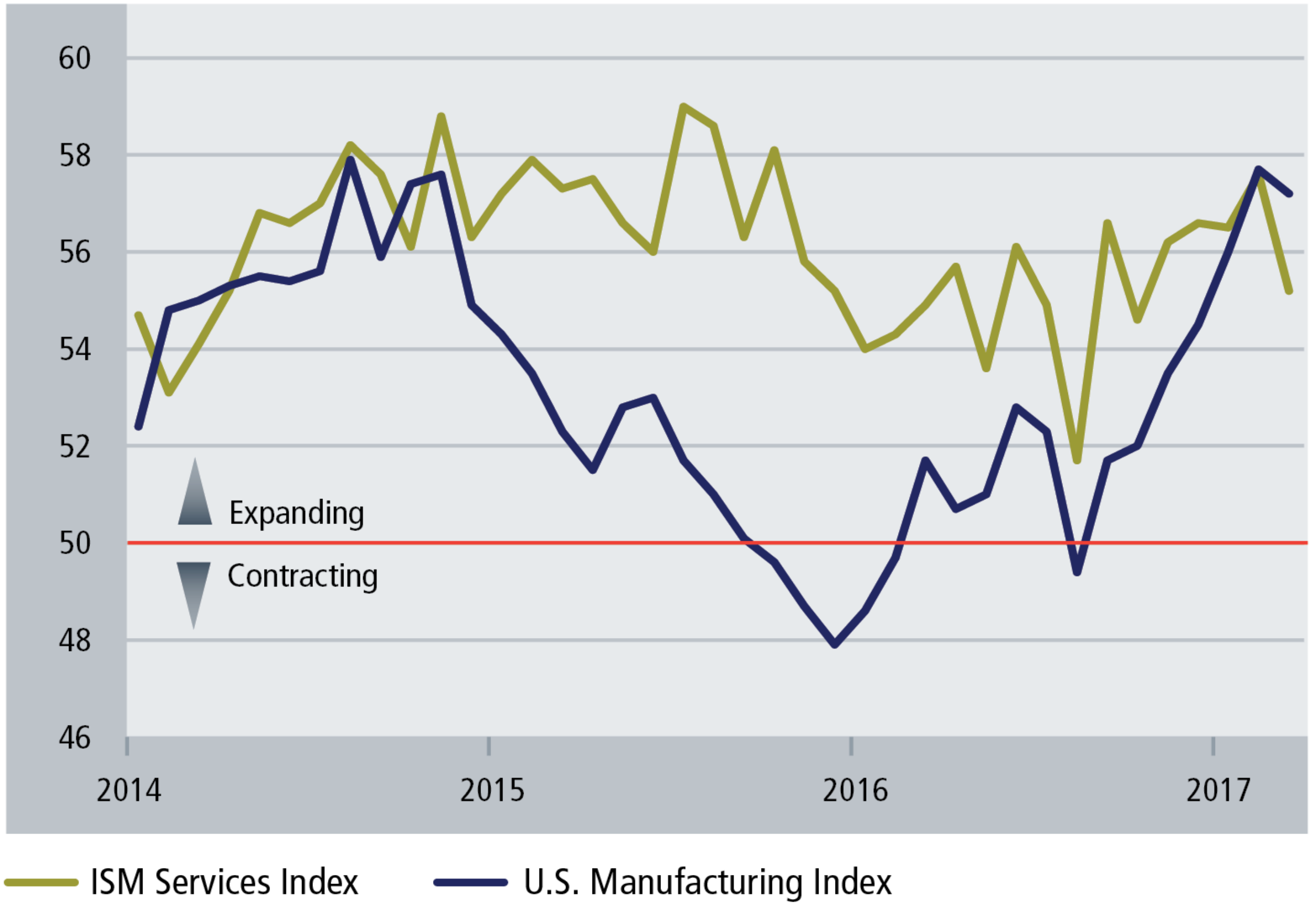
The U.S. economy

The manufacturing sector continued to improve through the end of 2016 and the beginning of 2017

U.S. Manufacturing and Services Index (>50 is expanding)



Source: Institute for Supply Management

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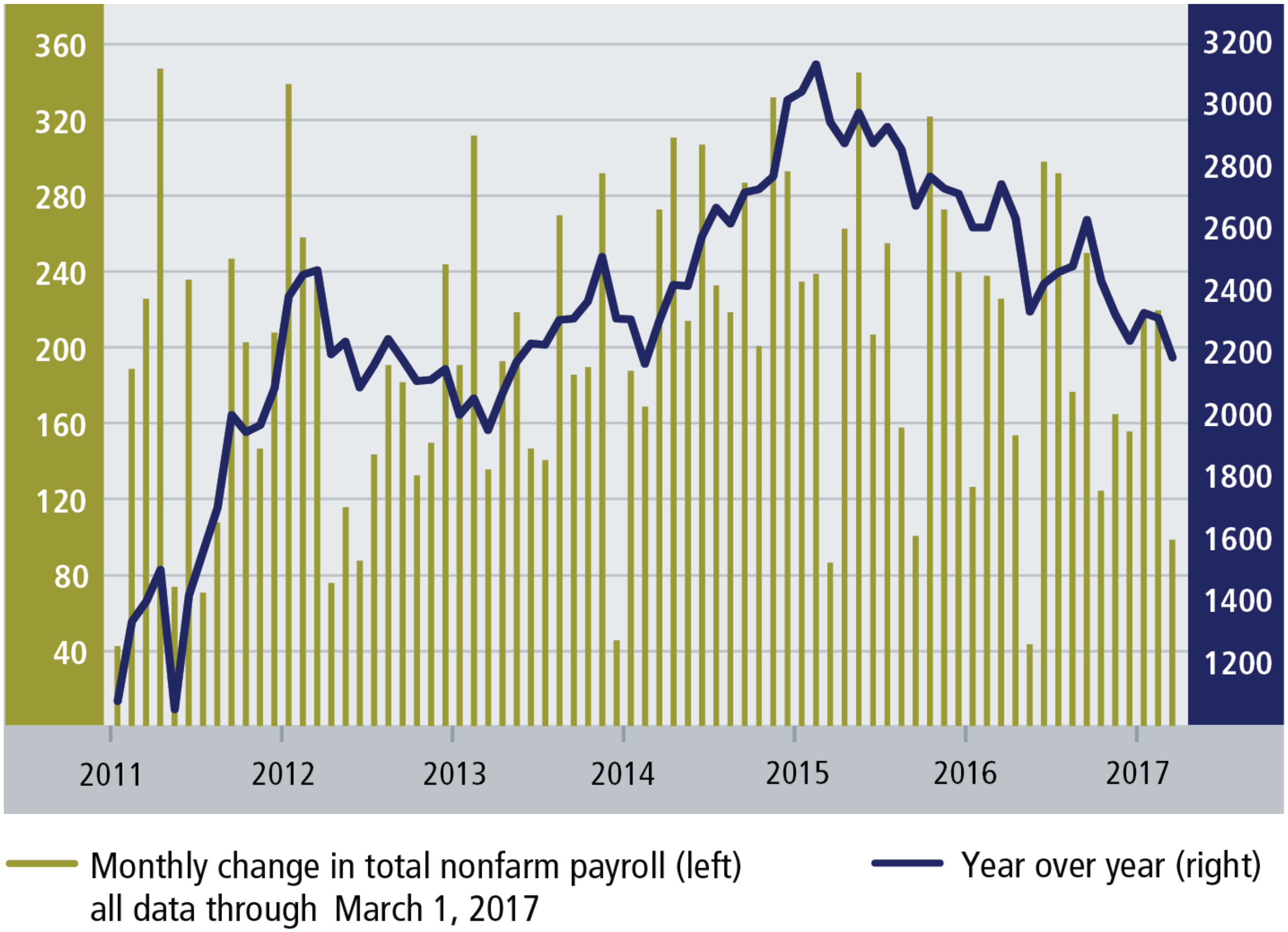
Labor market

Job growth in March was weak due to weather impacts, but does not change the story

Nonfarm payroll, monthly change

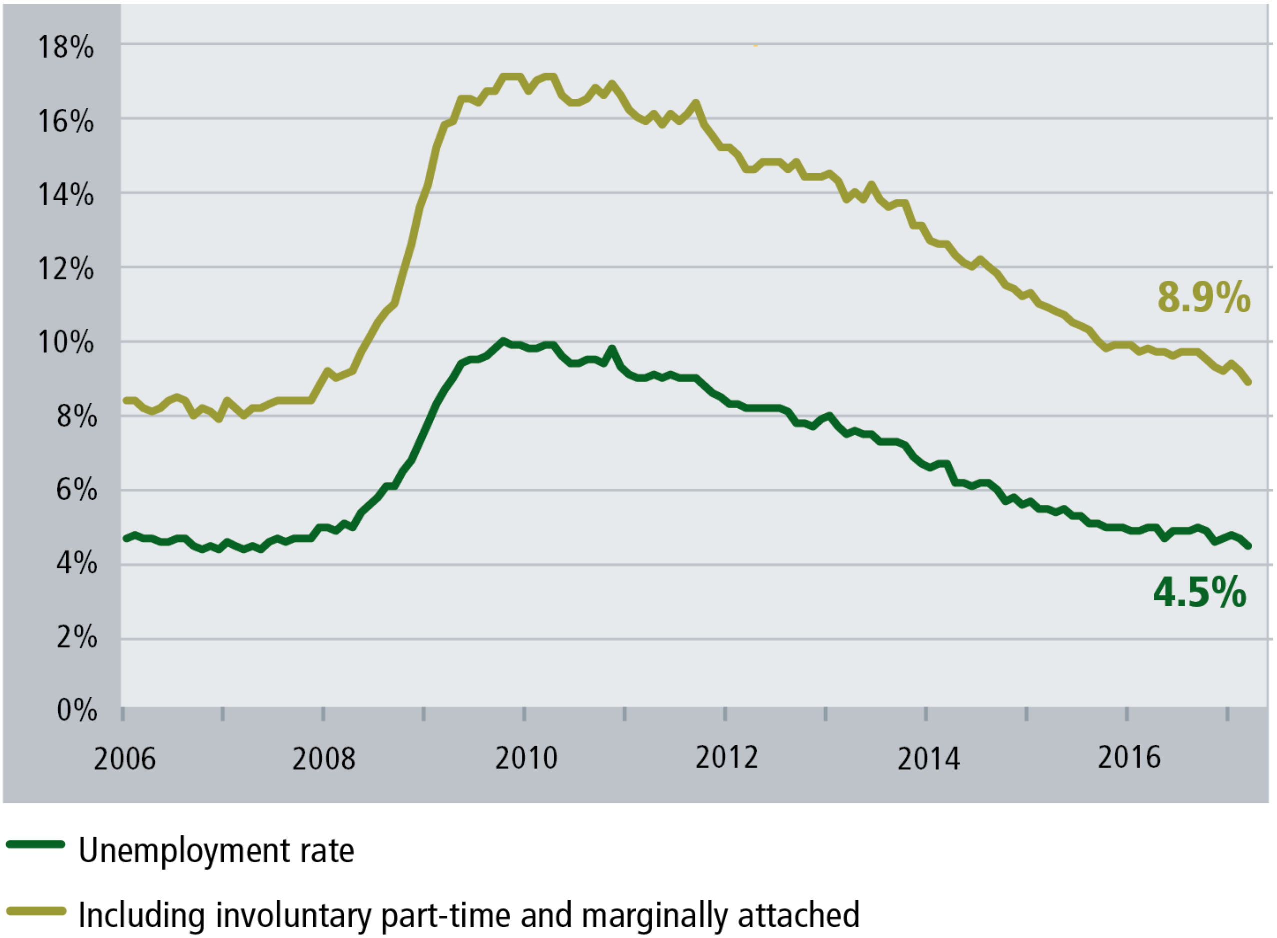


Source: Bureau of Labor Statistics

Labor market

The unemployment rate continued to move down in March, hitting 4.5%, the lowest since mid-2007

Unemployment rates (%)

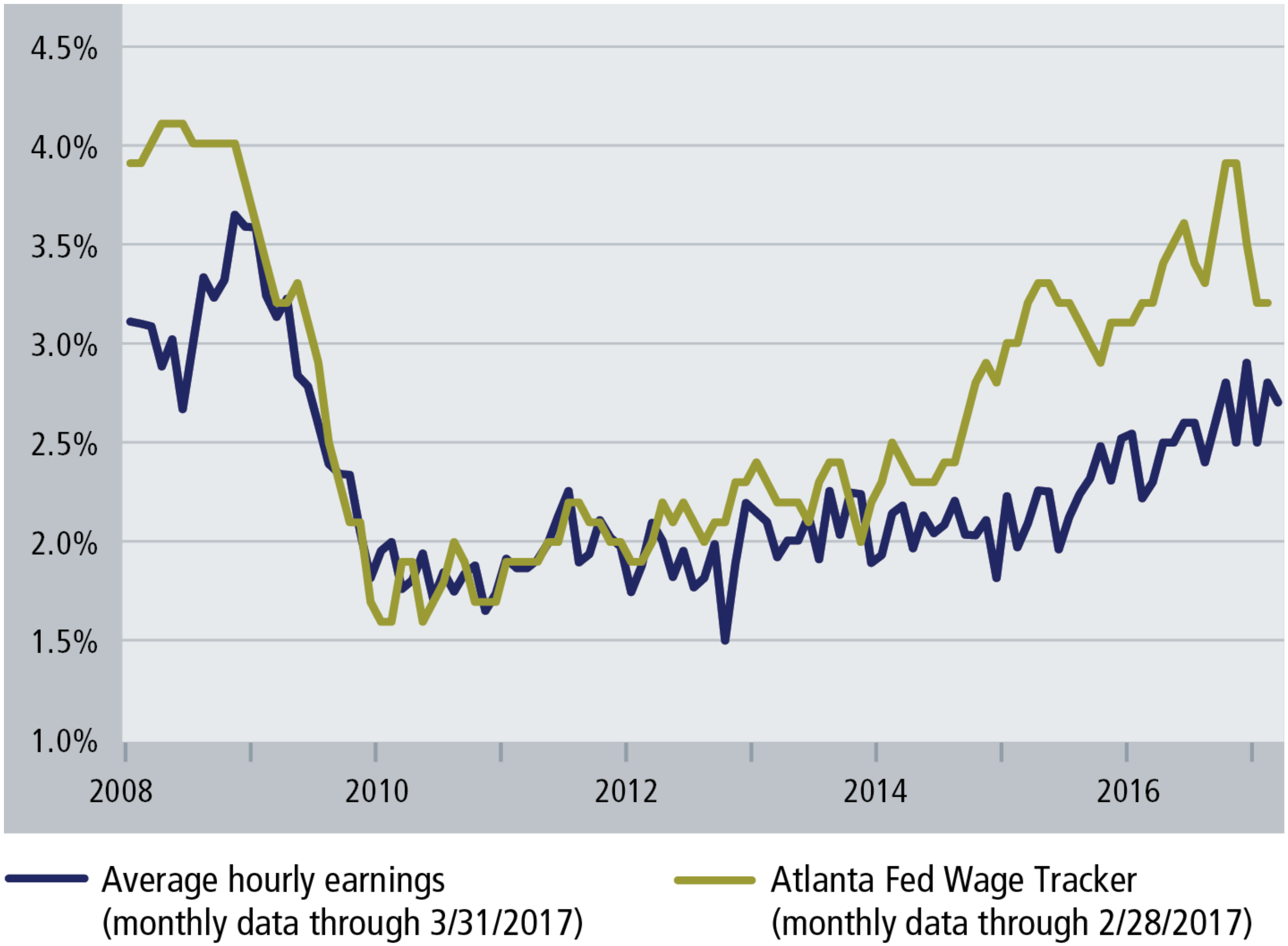


Source: Bureau of Labor Statistics

Wages

Wages remain in upward trend

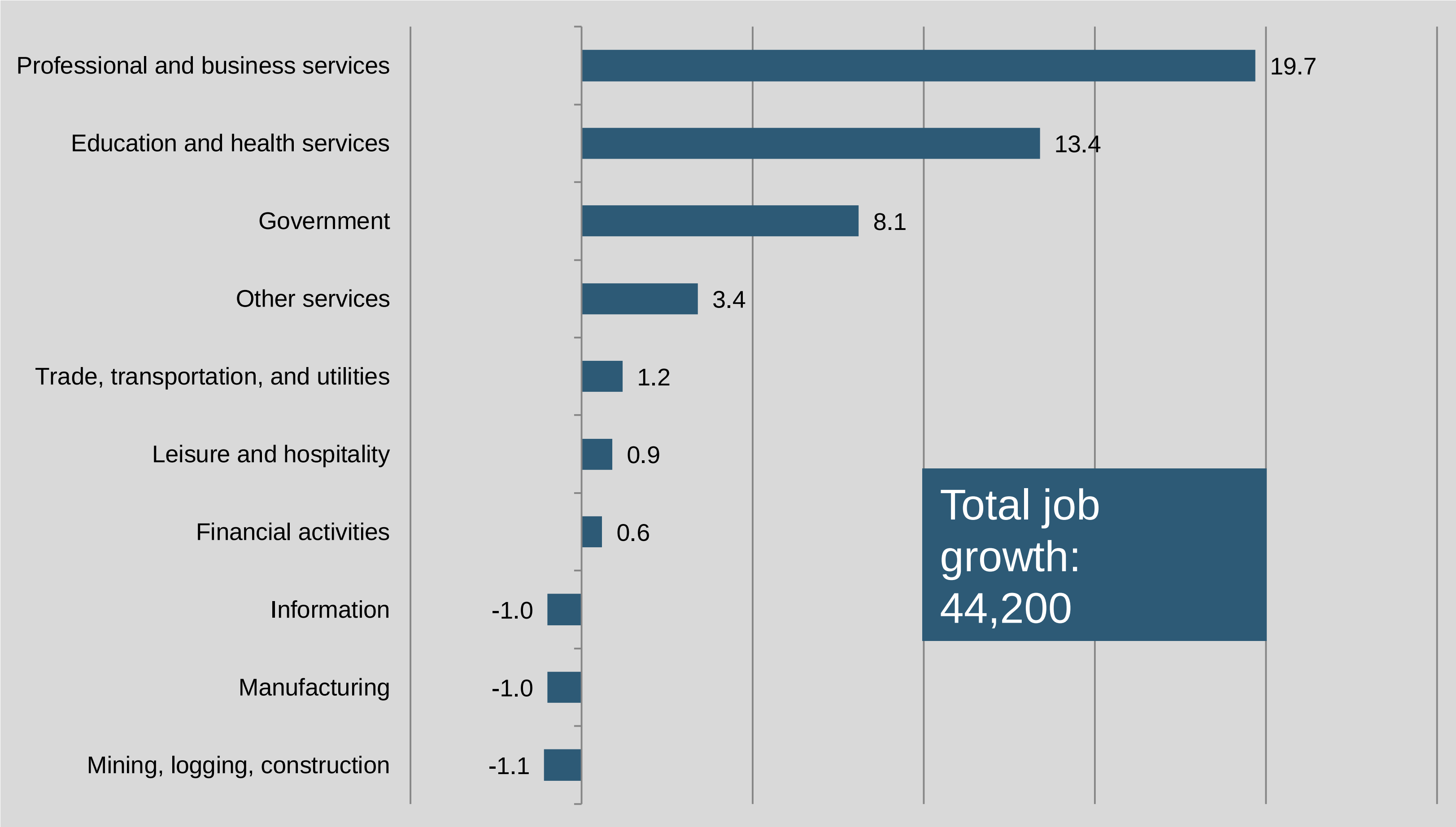
Compensation (change year over year)



Source: Bureau of Labor Statistics

Maryland

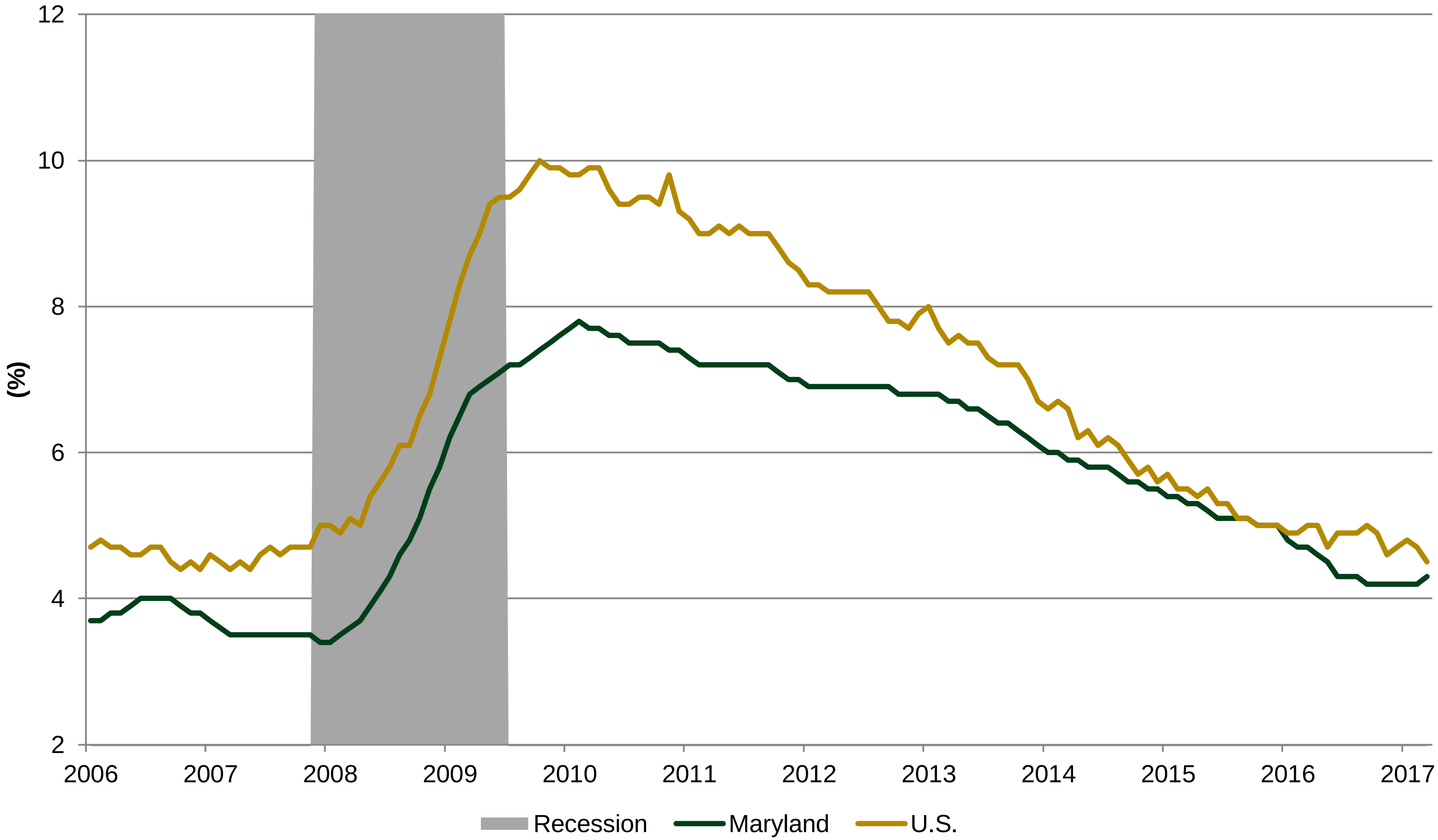
Job growth by sector in March 2017 (thousands of jobs, year over year)



Source: Bureau of Labor Statistics

Maryland

Unemployment rate

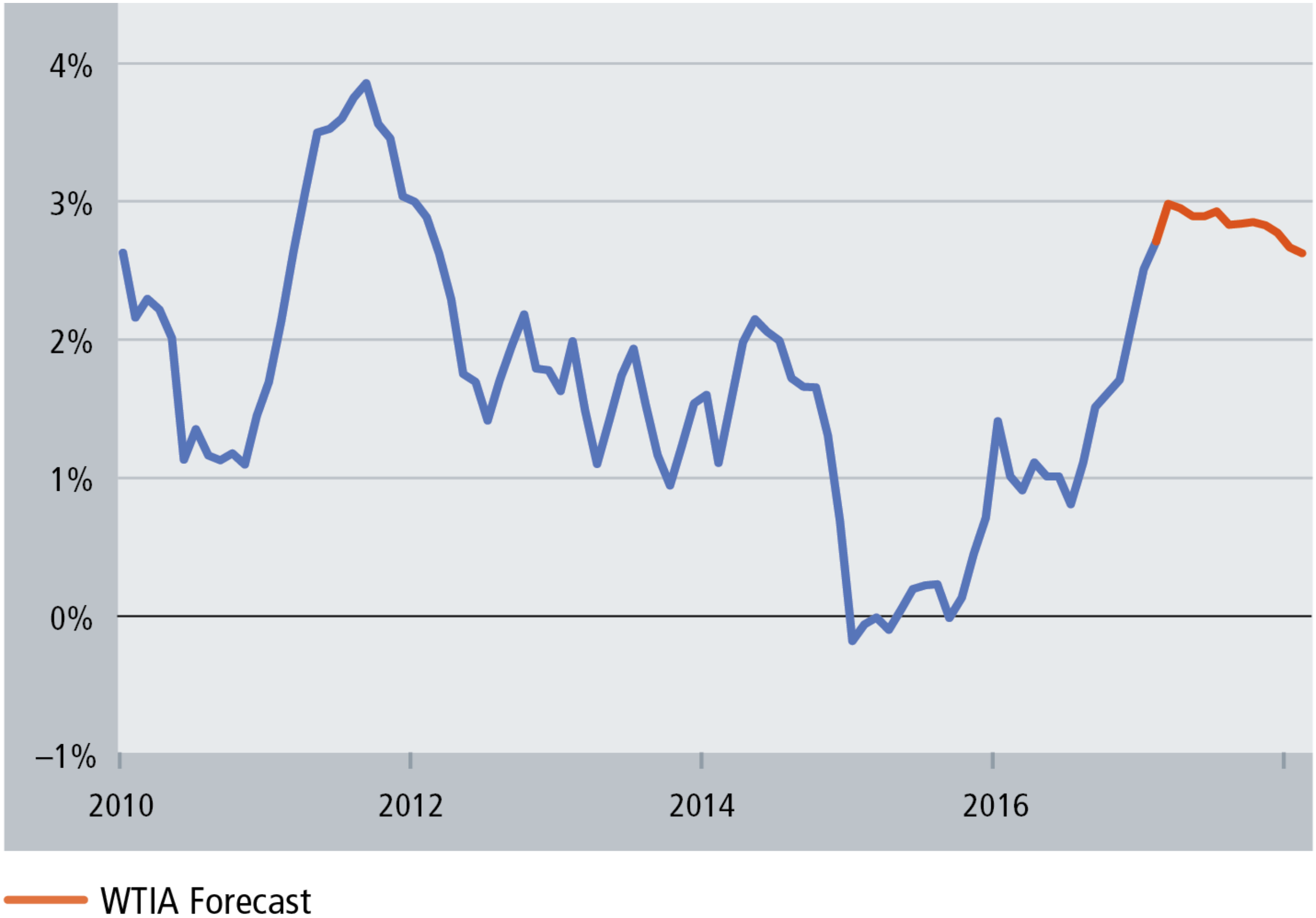


Source: Bureau of Labor Statistics

Inflation and wages

Consumer prices keep moving up

CPI inflation

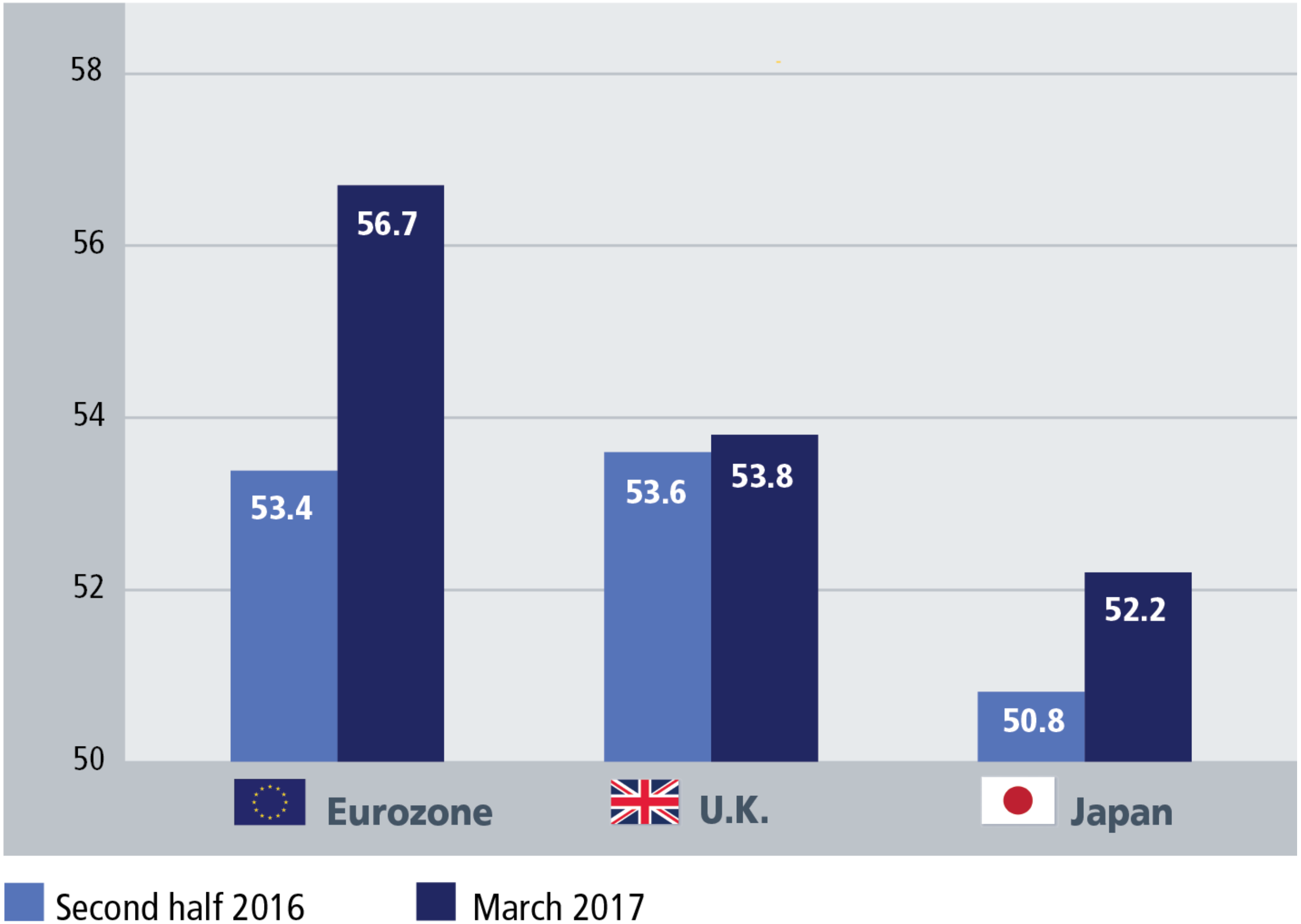


Sources: Bureau of Labor Statistics, WTIA

International developed

Economic activity in large developed economies has improved

Composite PMIs (>50 is increasing)

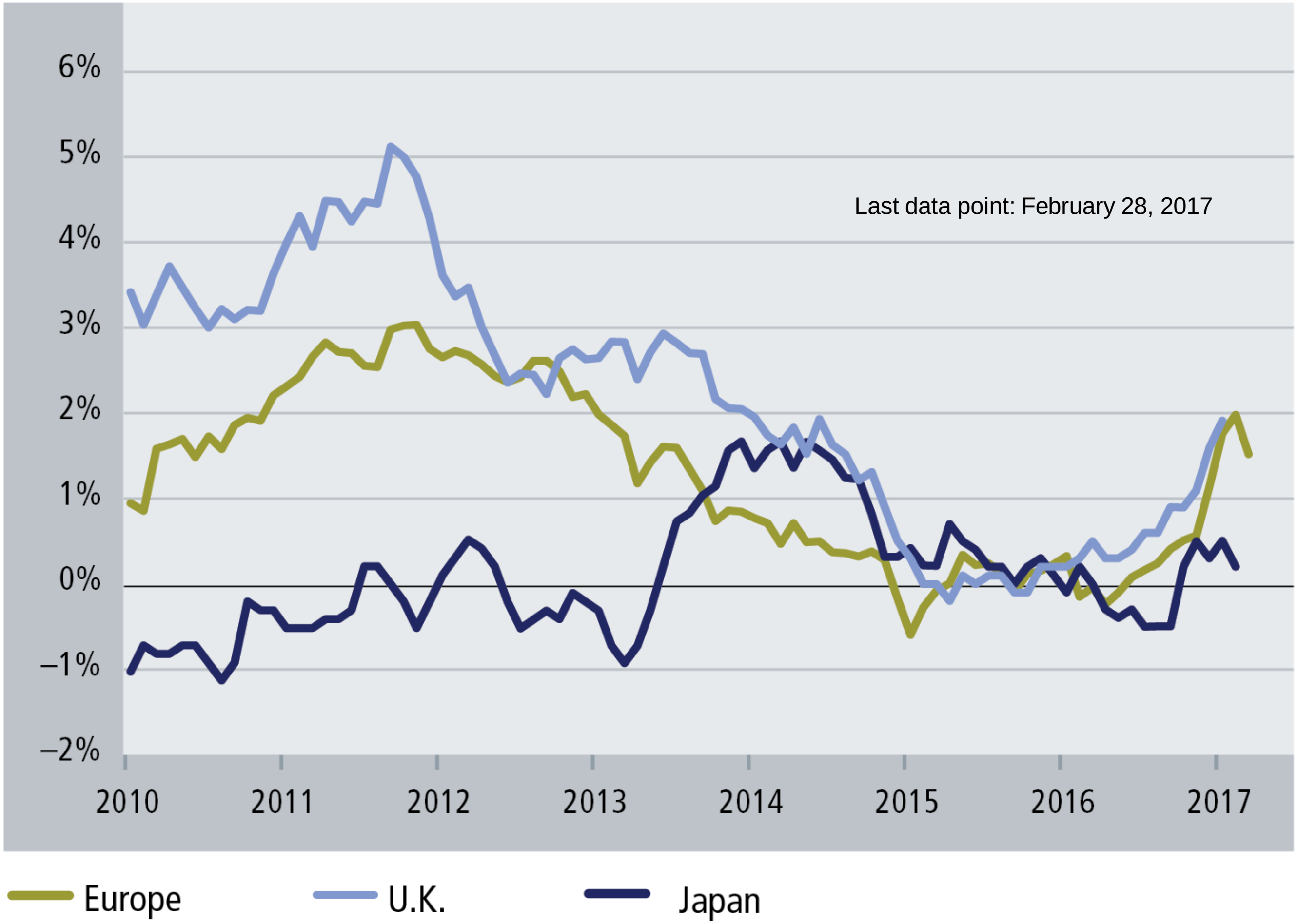


Source: Markit, Nikkei, WTIA

International developed

Inflation in the major international economies has picked up in the past several months

Inflation (change year over year)

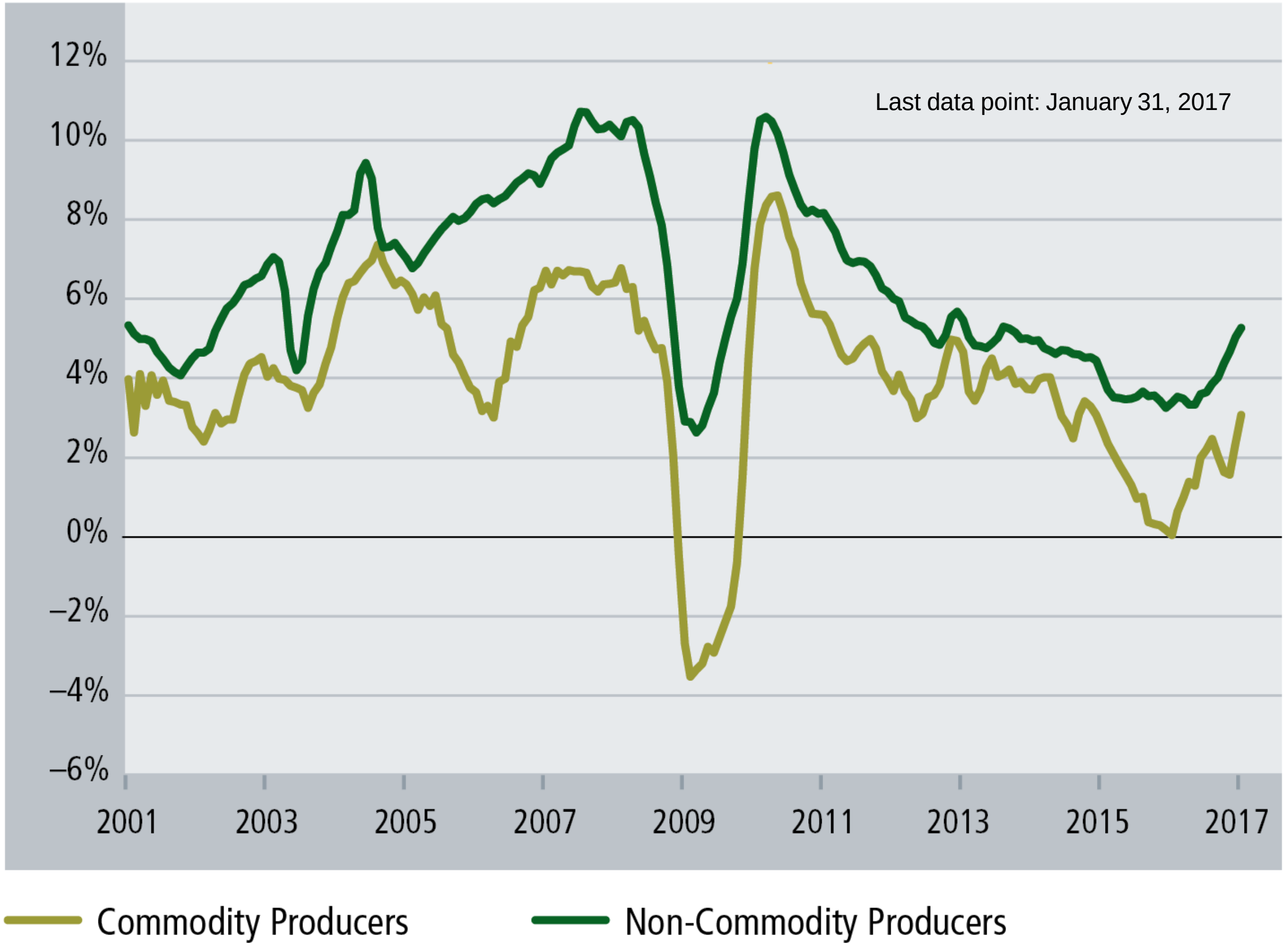


Source: Bloomberg

Emerging markets

Emerging markets growth has improved in recent months

Emerging markets GDP trackers (change year over year)

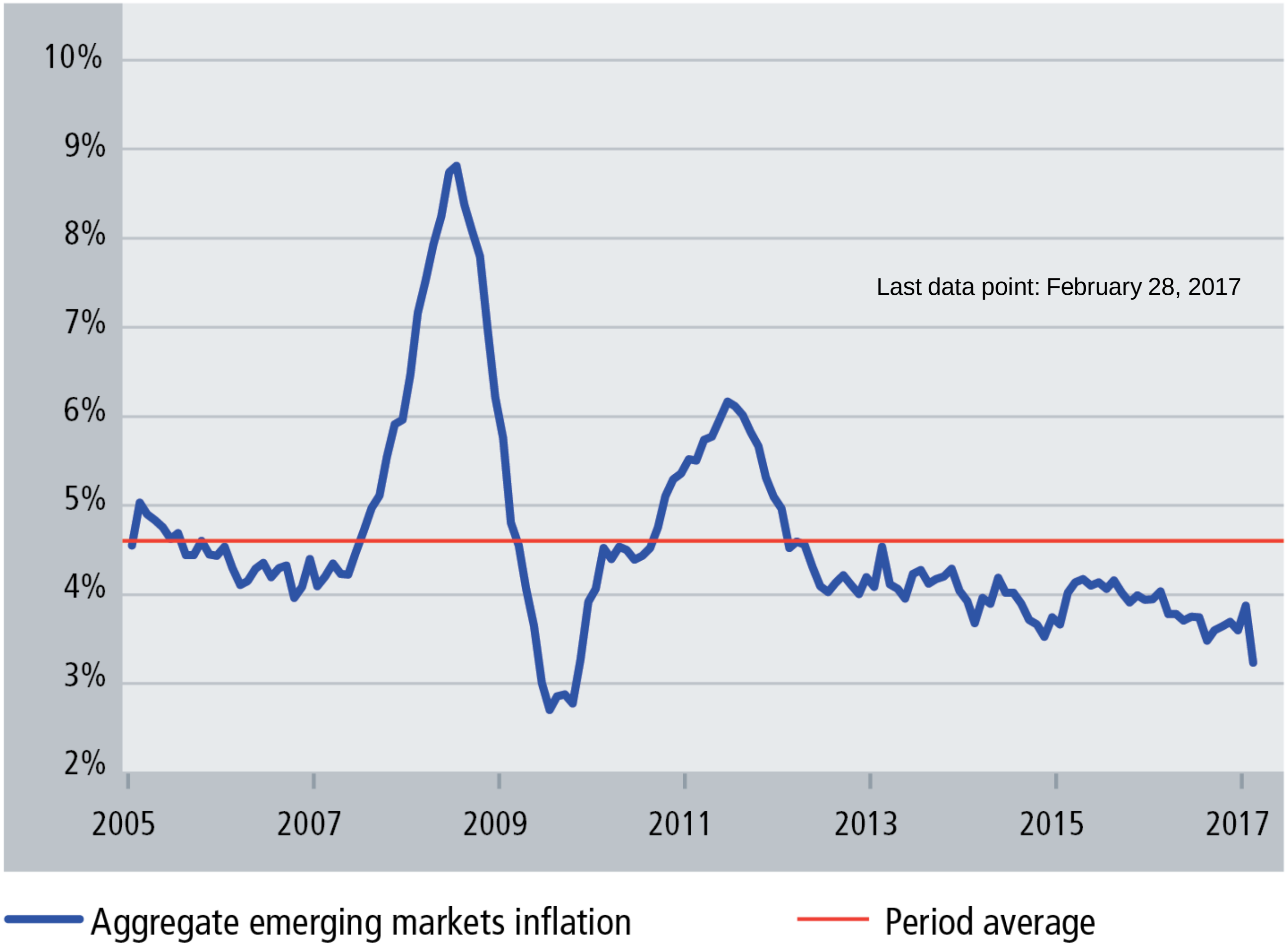


Source: Capital Economics

Emerging markets

Economic conditions continued to improve without pressure on inflation

Emerging markets* consumer prices (change year over year)



* Excluding Venezuela and Argentina
Source: Capital Economics

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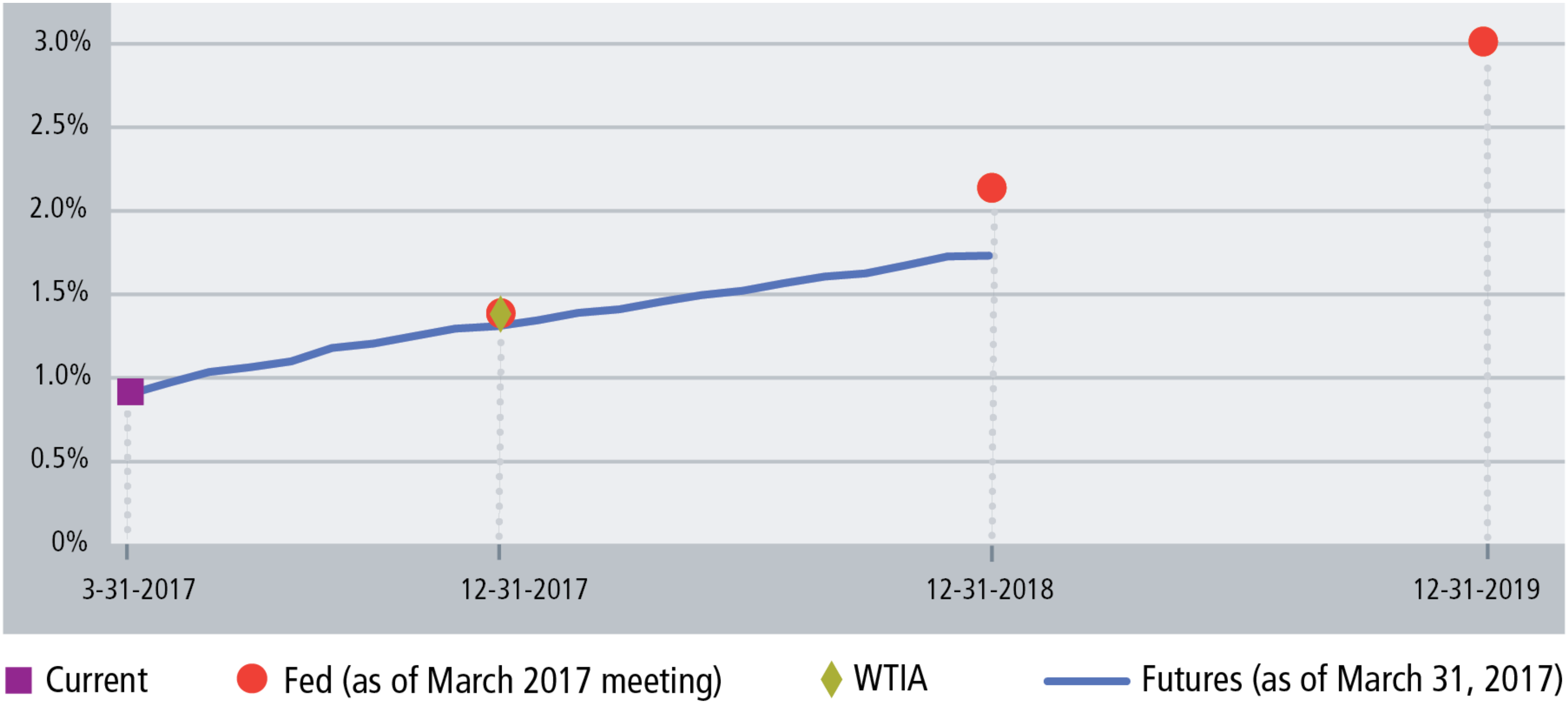
Federal Reserve

The Fed remains on track for interest rate hikes in 2017

Federal funds rate projections



The Fed hiked rates again at their March 2017 meeting. It was the third hike of this cycle, which came much more quickly (12 weeks) after the second than preceding hikes. The gap between the first and second was a full year. At the March meeting, the committee also updated their expectations for rates going forward. The median expectation by Fed committee members is for two more hikes in 2017, the same as our view and the market's, as measured by the futures. Importantly, we expect continued deliberations about when the Fed will begin to unwind its large balance sheet. We expect an announcement of the plan to be made before the end of 2017 and implementation in early 2018.

Source: Bloomberg; WTIA

How are the major central banks responding?

Tightening policy

中国人民银行 THE PEOPLE'S BANK OF CHINA

- China is slowly tightening monetary policy, started in January 2017
- Raising interest rates on all short- and mid-term liquidity tools but in very small increments
- Is simultaneously injecting liquidity through lending facilities
- Has not raised the targets for benchmark lending rates

Easing policy

BANK OF ENGLAND

- Policy interest rate is targeted at 0.25%
- Conducting quantitative easing (QE) purchases of investment-grade corporate bonds and government bonds
- Governor Mark Carney indicated the committee sees “some modest withdrawal of stimulus” in the next few years

EUROSYSTEM

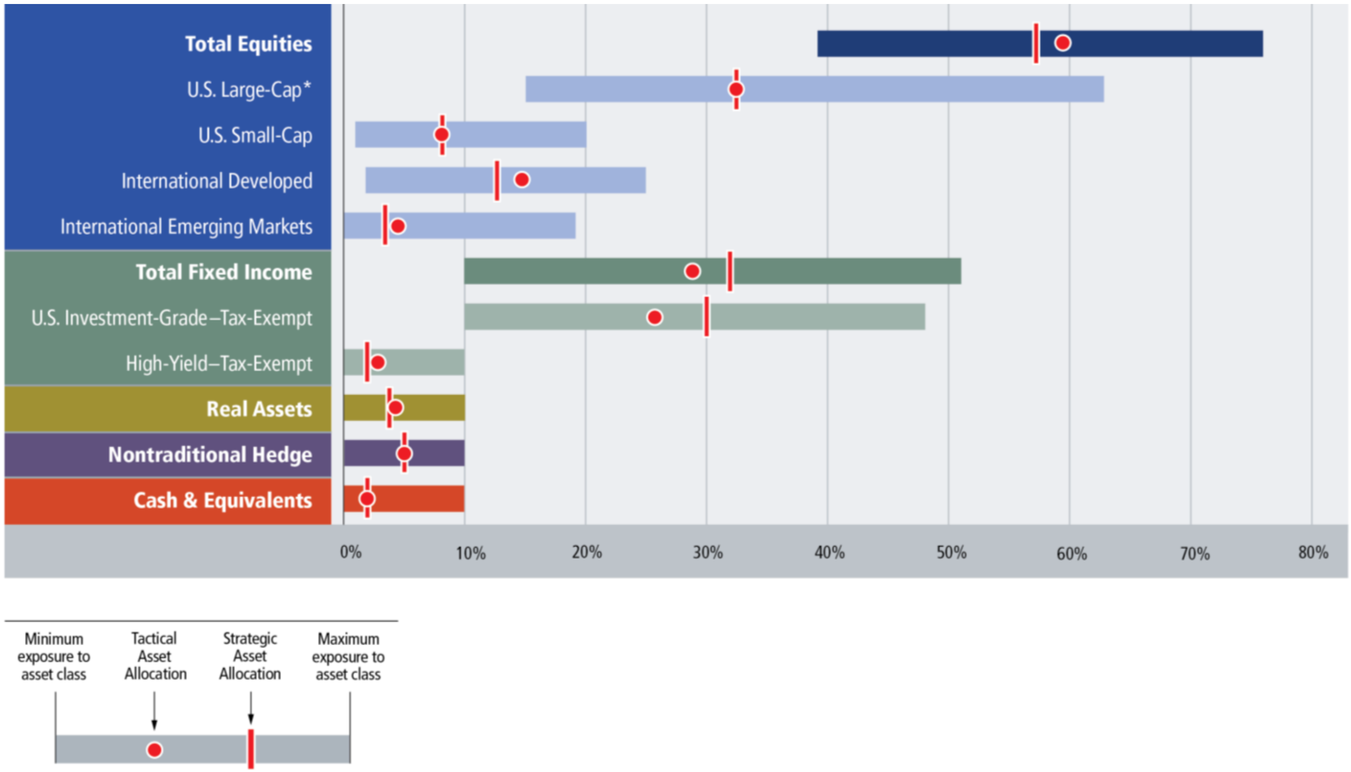
- Committed to QE through December 2017
- Maintained dovish language at the March meeting to encourage continued recovery
- If economy continues to improve and “Frexit” is not realized, there is a good chance of tapering of QE purchases in early 2018, to be announced in second half of 2017

BANK OF JAPAN

- Maintaining a negative 0.1% interest rate on selected bank balances held at Bank of Japan
- Conducting QE purchases of government bonds to target a 0% rate for the 10-year maturity
- Conducting QE purchases of ETFs, REITs, commercial paper, and corporate bonds
- “No reason” to withdraw stimulus, with inflation so far below target

Positioning in response to our outlook (for HNW Investors)

A big-picture glimpse of our overall positions, as of April 1, 2017



Based on current Growth & Income Strategy for High-Net-Worth with Nontraditional hedge (liquid alternatives), this chart represents current weights relative to our strategic asset allocations, with high and low boundaries reflecting our maximum and minimum weightings.

Our positioning is as follows:

- Neutral to cash, U.S. equities (large and small cap), and nontraditional hedge
- Overweight international developed, and emerging markets equities
- Slight overweight tax-exempt high yield
- Slight overweight to real assets due to higher inflation rates

* Going forward, our positioning chart replaces “U.S. Large-Cap Core Equity” and “Large-Cap Sector Equity” with a single line item, “U.S. Large-Cap.” This change reflects the continued responsibility of our Investment Committee to set the sector weights within the Large-Cap Sector Strategy and recognizes the role of the Portfolio Management Committee to set the weights allocated to this strategy alongside other large-cap manager allocations.

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Our estimate of March 31, 2018 S&P 500 index level

We forecast a wide range of 2380 – 2520

S&P 500 index levels, a function of earnings and valuations

As of 3/31/2017 S&P 500 = 2362		Earnings per share, 12 months ending March 2019						
		$134	$136	$138	$140	$142	$144	$146
Forward P/E ratio	15.5	2077	2108	2139	2170	2201	2232	2263
	16.0	2144	2176	2208	2240	2272	2304	2336
	16.5	2211	2244	2277	2310	2343	2376	2409
	17.0	2278	2312	2346	**2380**	2414	2448	2482
	17.5	2345	2380	2415	2450	2485	2520	2555
	18.0	2412	2448	2484	**2520**	2556	2592	2628
	18.5	2479	2516	2553	2590	2627	2664	2701
	19.0	2613	2584	2622	2660	2698	2736	2774
	19.5	2613	2652	2691	2730	2769	2808	2847

To generate our range, we are focusing on 2 forward P/E ratios that reflect potential fiscal support we could see by March of 2018. Current market is priced at 18.0x forward earnings and this reflects initial positive impacts from the new administration’s policies.

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Source of bottom-up analysts’ earnings estimates: Thomson Reuters.

Luke Tilley

Administrative Vice President, Chief Economist

As a member of Wilmington Trust's Investment Committee, Luke develops forecasts of the U.S. and international economies, as well as researches emerging issues to support and enhance the firm's investment strategy. Luke is also responsible for communicating the economic outlook and investment strategy to clients and the public.

Prior to joining Wilmington Trust in 2015, Luke was Officer and Economic Advisor with the Federal Reserve Bank of Philadelphia. Earlier in his career, Luke worked as a senior economist at IHS Global Insight and as an economist for the U.S. Department of Housing and Urban Development.

Luke holds a master's degree and Ph.D. in Economics from Temple University, and a bachelor's degree in Economics and History from James Madison University. He is an former adjunct faculty member at Temple University and formerly served on the board of directors of the Pennsylvania Economic Association. In addition, Luke is President of the Philadelphia Council for Business Economics, a chapter of the National Association for Business Economics.

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EXPERTISE IN

- Economics
- Monetary policy

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An Overview of Our Asset Allocation Strategies
Wilmington Trust offers seven asset allocation models for taxable (high net worth) and tax-exempt (institutional) investors across five strategies reflecting a range of investment objectives and risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. The seven models are High Net Worth (HNW), HNW with Liquid Alternatives, HNW with Private Markets, HNW Tax Advantaged, Institutional, Institutional with Hedge LP, and Institutional with Private Markets. As the names imply, the strategies vary with the type and degree of exposure to hedge strategies and private market exposure, as well as with the focus on taxable or tax-exempt income. On a quarterly basis we publish the results of all of these strategy models versus benchmarks representing strategic implementation without tactical tilts.

Model Strategies may include exposure to the following asset classes: U.S. large-capitalization stocks, U.S. small-cap stocks, developed international stocks, emerging market stocks, U.S. and international real asset securities (including inflation-linked bonds and commodity-related and real estate-related securities), U.S. and international investment-grade bonds (corporate for Institutional or Tax Advantaged, municipal for other HNW), U.S. and international speculative grade (high-yield) corporate bonds and floating-rate notes, emerging markets debt, and cash equivalents. Model Strategies employing nontraditional hedge and private market investments will, naturally, carry those exposures as well. **Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.**

Disclosures

Continued

Risk Assumptions
All investments carry some degree of risk. The volatility, or uncertainty, of future returns is a key concept of investment risk. Standard deviation is a measure of volatility and represents the variability of individual returns around the mean, or average annual, return. A higher standard deviation indicates more return volatility. This measure serves as a collective, quantitative estimate of risks present in an asset class or investment (e.g., liquidity, credit, and default risks). Certain types of risk may be underrepresented by this measure. **Investors should develop a thorough understanding of the risks of any investment prior to committing funds.**

Quality Ratings
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