

# U.S. Outlook

SCOTT ANDERSON, Ph.D | Chief Economist | 415.765.8020  
www.bankofthewest.com



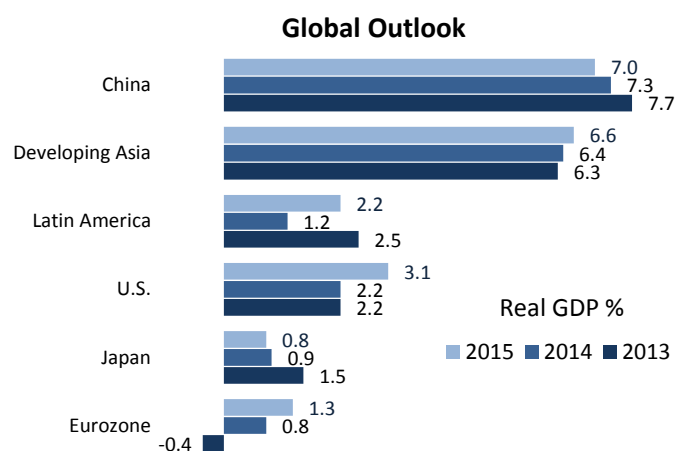
Date	Indicator	For	Estimate	Consensus*	Previous Period
14-October -2014	NFIB Small Business Optimism	SEP	N/A	N/A	96.1
15-October -2014	Empire State Manufacturing	OCT	22.00	20.00	27.54
15-October -2014	Retail Sales Advance MoM	SEP	-0.1%	-0.2%	0.6%
15-October -2014	Retail Sales Ex. Auto MoM	SEP	0.2%	0.2%	0.3%
15-October -2014	Producer Price Index MoM	SEP	0.0%	0.1%	0.0%
15-October -2014	PPI Ex. Food & Energy	SEP	0.1%	0.1%	0.1%
15-October -2014	Business Inventories	AUG	0.5%	0.4%	0.4%
16-October -2014	Initial Jobless Claims	10/11	293K	N/A	287K
16-October -2014	Industrial Production MoM	SEP	0.3%	0.4%	-0.1%
16-October -2014	Capacity Utilization	SEP	78.9%	79.0%	78.8%
16-October -2014	Philly Fed Business Outlook	OCT	18.0	20.0	22.5
16-October -2014	NAHB Housing Market Index	OCT	58	59	59
17-October -2014	Housing Starts	SEP	1040K	1,002K	956K
17-October-2014	Building Permits	SEP	1030K	1,035K	1003K
17-October-2014	Univ. of Michigan Confidence	OCT	84.0	84.2	84.6

\*Consensus from Bloomberg

## Fear Replaces Greed on Wall Street

The IMF dropped a grenade on the stock market this week. Marking down the global growth outlook for this year for the seventh time to 3.3% and trimming expectations again for growth next year.

### Global Economy Struggles for Lift-Off



Source: Bank of the West Economics, IMF, Bloomberg

The biggest cuts to the global GDP outlook came from the Euro area, Japan, Brazil, and Russia. The Euro area forecast was cut to 0.8% for 2014. Japan was cut to 0.9%, Brazil to 0.3%, while Russia was cut to 0.8% this year.

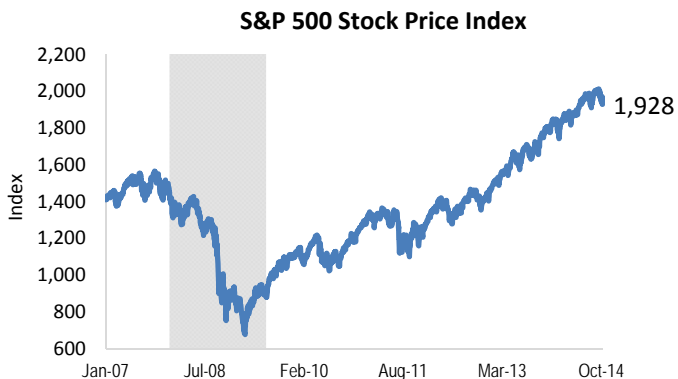
The Eurozone still poses the biggest challenge to the global economy and is the source of the greatest downside risk to the outlook. The IMF puts a 38% probability of recession in Euro area over the coming year, a 32% recession probability for the rest of the world, and 25% recession probability for Japan. Probability of deflation is also the highest in the Euro area at 30% over the coming year. For other regions, the risk of deflation is negligible.

The IMF is raising a number of downside concerns that have clouded the outlook for the global economy. It cites worsening geopolitical tensions, a reversal of sanguine financial conditions, and in the medium-term, stagnation and lowered potential growth rates in both developed and developing countries. As if on cue, the German government released data that industrial production and exports plunged a worse-than-expected 4.0% and 5.8% in August. After the news, global stock markets sold off.

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Since peaking on September 18 at 2,011, the S&P 500 stock market index has dropped 4.1%. This is the biggest drop since January when the market was fretting about the dismal economic data coming from unseasonably bad winter weather in the United States. Today, the source of volatility is coming from abroad. The stock declines in Europe have been twice as severe as in the U.S. over the past month.

**Stock Market Advance Has Been Relentless Since 2012**

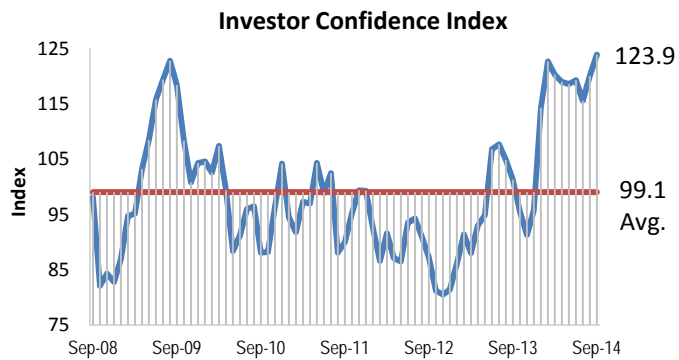


Source: Standard and Poor's

By our estimation the stock market was ripe for a little shaking up. Investors have gotten complacent with steady gains over the past few years. The stock market has been advancing so relentlessly over the past two years that one is hard pressed to find a rosier period for stock investing.

Investor confidence had gotten to unsustainable levels. The investor confidence index, shown below from State Street Global Advisors, measures investor risk appetite quantitatively by analyzing the actual buying and selling patterns of institutional investors. The greater the percentage allocation to equities, the higher the risk appetite or confidence. A reading of 100 is neutral. It is the level at which investors are neither increasing nor decreasing their long-term allocations to risky assets.

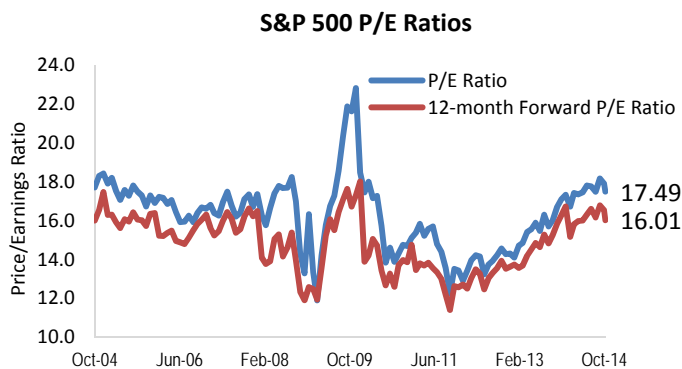
**Investor Confidence Had Reached Unustainable Levels**



Source: State Street; Bloomberg

At the same time, valuations have gotten stretched on both a trailing and expected earnings basis. According to Bloomberg, at the start of September the historical and forward P/E ratios for the S&P 500 were the highest we have seen since 2009 and before the "Great Recession".

**Stocks Have Been Looking Expensive On A P/E Basis**



Source: Bloomberg

So where do we go from here? No one knows for sure, but the stock declines could last for a while longer in my opinion. The equity markets go from celebrating continued loose monetary policy, as they did with the September FOMC Minutes, to wringing their hands about what that means for future growth prospects. We at Bank of the West Economics, along with the Fed, it seems, have grown more concerned about what the U.S. dollar strength and weak global economy means for the U.S. growth and inflation outlook next year.

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## Major Economic Indicators

Economic Data	History								Forecast				Yr/Yr % chg or Annual Avg.			
	2013.1	2013.2	2013.3	2013.4	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2012	2013	2014	2015
Real GDP*	2.7	1.8	4.5	3.5	-2.1	4.6	3.1	3.1	3.0	3.0	2.9	2.9	2.3	2.2	2.2	3.1
Personal Consumption Expenditures*	3.6	1.8	2.0	3.7	1.2	2.5	2.0	2.9	2.9	2.8	2.7	2.7	1.8	2.4	2.3	2.7
Non-residential Fixed Investment*	1.5	1.6	5.5	10.4	1.6	9.7	6.9	5.5	4.9	4.9	4.9	4.9	7.2	3.0	6.1	5.6
Private Housing Starts (000s units)	947	865	882	1,025	925	997	1,040	1,096	1,100	1,121	1,143	1,155	784	930	1,015	1,130
Vehicle Sales (mill. Units, annualized)	15.3	15.5	15.7	15.6	15.6	16.5	16.7	16.8	17.0	17.1	17.2	17.3	14.4	15.5	16.4	17.2
Industrial Production*	4.2	1.9	2.5	4.9	3.9	5.5	2.0	5.0	4.5	4.4	4.4	4.3	3.8	2.9	3.9	4.4
Nonfarm Payroll Employment (mil.)	135.5	136.1	136.6	137.2	137.8	138.5	139.1	139.7	140.4	141.4	141.7	142.3	134.1	136.4	138.8	141.4
Unemployment rate	7.7	7.5	7.2	7.0	6.7	6.2	6.1	5.8	5.7	5.6	5.5	5.5	8.1	7.4	6.2	5.6
Consumer Price Index* (percent)	1.2	0.4	2.2	1.1	1.9	3.0	0.5	1.5	1.8	1.8	1.9	1.9	2.1	1.5	1.7	1.7
"Core" CPI* (percent)	2.0	1.4	1.8	1.6	1.6	2.5	0.9	1.8	1.8	1.8	1.8	1.8	2.1	1.8	1.7	1.7
PPI (finished goods)* (percent)	0.8	-1.0	2.3	1.2	3.9	3.7	-0.3	1.8	1.5	1.4	1.3	1.4	2.0	1.2	2.2	1.4
Trade Weighted Dollar (Fed BOG, major)	74.8	76.6	76.8	76.0	77.1	76.6	77.1	78.0	79.0	79.5	80.2	80.8	73.6	76.1	77.2	79.9
Crude Oil Prices -WTI (\$ per barrel)	94	94	106	98	99	103	98	94	97	97	97	96	94	98	99	97

\*Quarterly Data Percent Change At Annual Rate; Annual Data Year-on-Year % Chg, or Annual Average.

Financial Data	History								Forecast				Annual Average			
	2013.1	2013.2	2013.3	2013.4	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2012	2013	2014	2015
S & P 500	1,514	1,610	1,675	1,769	1,835	1,900							1,379	1,644		
Dow Jones Industrial Average	13,994	14,959	15,286	15,736	16,177	16,604							12,965	15,010		
Federal Funds Rate (effective)	0.15	0.12	0.09	0.09	0.07	0.07	0.08	0.08	0.10	0.25	0.38	0.87	0.14	0.11	0.08	0.40
Treasury-3 Month Bills (yield)	0.09	0.05	0.03	0.06	0.05	0.04	0.02	0.03	0.05	0.20	0.33	0.83	0.09	0.06	0.04	0.35
Treasury-2 Year Notes (yield)	0.26	0.27	0.37	0.33	0.37	0.38	0.50	0.62	1.00	1.06	1.29	1.59	0.28	0.31	0.47	1.24
Treasury-5 Year Notes (yield)	0.82	0.91	1.50	1.44	1.60	1.63	1.68	1.87	1.93	2.14	2.35	2.63	0.76	1.17	1.70	2.26
Treasury-10 Year Notes (yield)	1.95	1.99	2.71	2.74	2.77	2.69	2.50	2.70	3.00	3.17	3.41	3.56	1.80	2.35	2.67	3.29
Treasury-30 Year Notes (yield)	3.13	3.14	3.71	3.79	3.68	3.55	3.30	3.45	3.76	3.96	4.06	4.16	2.92	3.44	3.50	3.99
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.38	3.87	3.25	3.25	3.25	3.44
Libor 3-Mo. U.S. Dollar	0.29	0.28	0.28	0.28	0.26	0.24	0.24	0.25	0.27	0.36	0.60	0.97	0.42	0.28	0.25	0.55
Mortgage-30 Year (yield)	3.50	3.67	4.44	4.29	4.36	4.23	4.12	4.30	4.50	4.69	4.93	5.07	3.66	3.98	4.25	4.80
BAA Corporate (yield)	4.81	4.82	5.40	5.36	5.12	4.85	4.72	4.97	5.00	5.18	5.40	5.56	4.94	5.10	4.92	5.29

Source: Bank of the West Economics, Bloomberg, Federal Reserve