Economic Perspectives

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Economic Outlook: U.S. economic growth is likely to be a bit slower this year and next, but recession odds remain low, in our view. Threats to the outlook, however, remain elevated.

Our "base-case" outlook for the U.S. economy has not changed materially since our last update; and it has not materially changed since our revisions of last July. We believe U.S. economic growth is likely to decelerate modestly over the next two years, yet solid underlying fundamentals should continue to offer support, thus allowing the economy to remain in expansion.

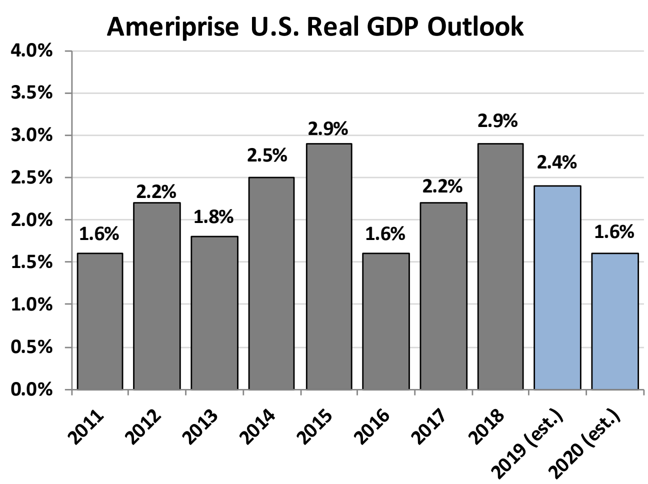
However, there are tangible risks, mostly from an international perspective. The ongoing U.S. /China trade dispute has slowed momentum, not just in the two countries involved, but in other regions as well. The United Kingdom's pending separation from the European Union (Brexit) also poses a risk to economic momentum, particularly in Europe. The March 29th deadline is just weeks away and significant divisions remain on both sides of the Channel as to the post-separation relationship. A push-back of the March 29th separation date seems most likely, in our view.

We have our concerns regarding both issues (U.S. /China and Brexit) but we believe neither is likely to follow a worst-case scenario. The incentives for all parties to reach reasonable resolutions are just too great. (See page 3 for more.)

We are also comforted against these risks by what we see as generally strong underlying U.S. economic fundamentals. Although the financial market downdraft experienced in the final months of 2018 fueled a surge of recession fears, we believe U.S. economic recession odds remain low, primarily based on what we see as good consumer financial health. (See page 3 for more.)

Base case outlook: Slower, yet sound. In mid-2018, we lowered our 2019 U.S. GDP forecast to +2.4% from +2.8%, primarily in reflection of the growing trade dispute between the U.S. and China. At the time of this writing, financial markets are growing more optimistic regarding U.S. /China trade talks and the President has canceled the added tariff hike increase that was scheduled to take effect on March 2nd. Both sides have indicated "progress" in the negotiations, but we remain skeptical of China's commitment to long-established rules of fair trade and nondiscriminatory trade behavior.

In 2020, we believe growth should further decelerate, primarily due to a scheduled drop in federal government spending. Real GDP growth could be relatively weak, but we believe consumer and corporate activity should remain sound, thus offering support for corporate earnings prospects.

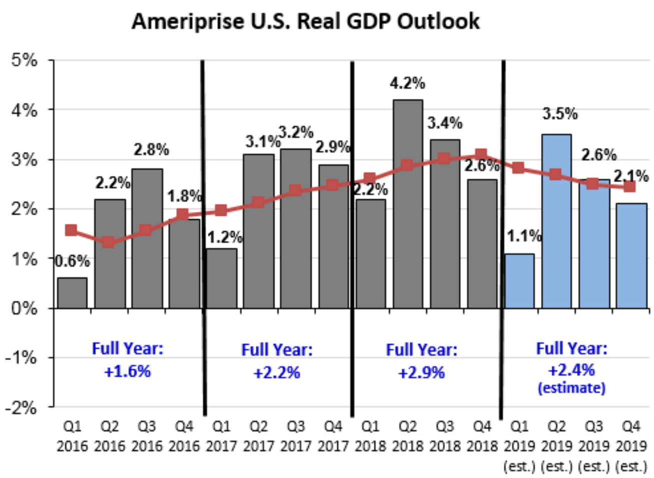


Source: Actuals via U.S. Commerce Department, estimates via American Enterprise Investment Services Inc.

A NEAR-TERM "SOFT PATCH?"

Economic growth was somewhat stronger than expected in the fourth quarter (2018) with real GDP coming-in at +2.6%. Growth in the current quarter (Q1-2019) however, is likely to be somewhat soft given a need to reduce business inventory levels and some other temporary factors. We estimate January's government shutdown could shave approximately 0.2 percentage points (pp) from GDP growth in Q1 while delayed and potentially smaller tax refunds could shift some consumer spending into Q2. These are temporary issues, however, and do not alter our overall view of economic conditions which in our view remain quite sound.

U.S. economic outlook on a quarterly basis: (Note: the **red line** in the chart below represents year-over-year growth.)



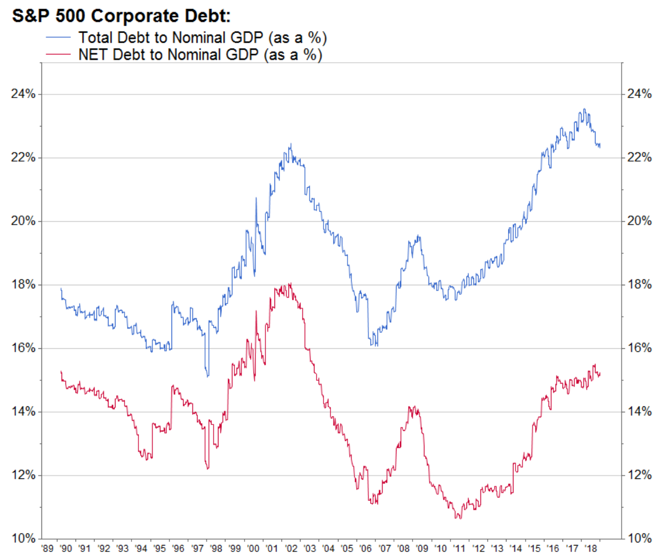
Source: Actuals via U.S. Commerce Department, estimates via American Enterprise Investment Services Inc.

Most importantly, we believe consumer finances remain in good shape. Incomes are growing at a solid pace amid strong employment growth and wage gains. Consumer debts also remain in very manageable position in our view, as we will examine in greater detail beginning on the next page.

Corporate debt levels, however, have come under some scrutiny. A broad examination of the issue however, eases our concern as to its risk to economic momentum.

The dollar value of corporate debt, and the percentage of corporate debt relative to GDP (a commonly cited measure used to determine overall leverage) are both high. However, dollar values are almost always going to be at or near all-time highs during periods of expansion, as is the dollar value of economic activity as well. It's simply normal for the dollar value of debt for any sector to grow as the economy grows.

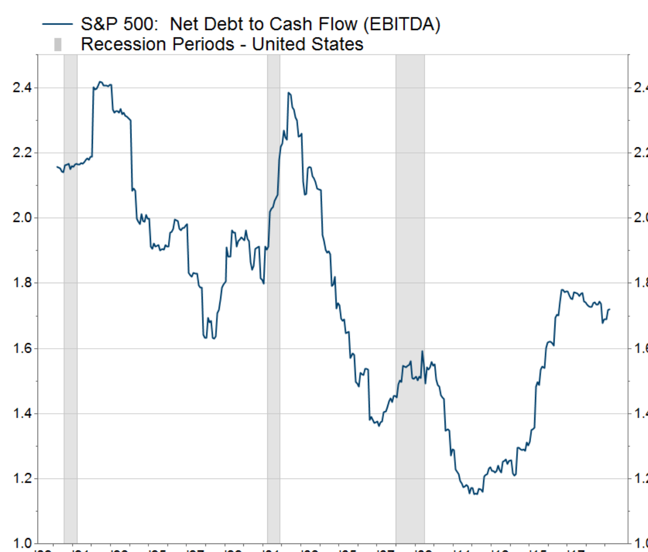
As indicated by the blue line in the chart below, total debt held by S&P 500 companies relative to U.S. GDP is currently elevated. However, companies also have elevated levels of cash on their balance sheets. The red-line represents NET-debt (debt minus cash) as a percent of GDP and shows that current levels are generally in-line with their historical norms.



Source: FactSet.

We also note that an ever-growing percentage of U.S. corporate sales come from outside the U.S. As such, comparing company debt levels to the U.S. economy alone seems to be an outdated notion.

Additionally, net debt relative to corporate cash flow generation has rebounded from post-recession lows, but it is at reasonable levels relative to historical norms.



Source: FactSet.

There are, of course, some companies and industries where debt levels are too high, but such segments are generally in the minority, in our view.

INTERNATIONAL PROSPECTS

International relations still pose the greatest risk to near-term prospects, in our view. While the U.S. and China appear to be making progress towards resolving their dispute, geopolitical risk is likely to remain elevated.

In January, the International Monetary Fund (IMF) lowered its global GDP growth forecast. As seen in the table below, the organization reduced its global growth estimates for 2019 and 2020, with reductions that were similar to the cuts it implemented in its previous quarterly update in October.

IMF Global Economic Projections

	Actual		Est.	Projections		*Difference from October projections.*		
	2016	2017	2018	2019	2020	2018	2019	2020
World	3.3	3.8	3.7	3.5	3.6	0.0	-0.2	-0.1
United States	1.6	2.2	2.9	2.5	1.8	0.0	0.0	0.0
Euro Region	1.9	2.4	1.8	1.6	1.7	-0.2	-0.3	0.0
Japan	1.0	1.9	0.9	1.1	0.9	-0.2	0.2	0.2
Developing Asia	6.5	6.5	6.5	6.3	6.4	0.0	0.0	0.0
China	6.7	6.9	6.6	6.2	6.2	0.0	0.0	0.0
India	7.1	6.7	7.3	7.5	7.7	0.0	0.1	0.0
Russia	-0.2	1.5	1.7	1.6	1.7	0.0	-0.2	-0.1
Brazil	-3.5	1.1	1.3	2.5	2.2	-0.1	0.1	-0.1
Mexico	2.9	2.1	2.1	2.1	2.2	0.1	-0.4	-0.5

Source: IMF World Economic Outlook Update, January 2019

Europe could remain an area of economic weakness in 2019. Economic activity across Europe slowed notably in the second half of 2018. Conditions are unlikely to get much better over the near-term, although lowered growth forecasts seem to incorporate much of the risk, in our view. The IMF lowered its 2019 real GDP growth estimate for the Euro Zone to +1.6% in January. The European Commission went lower-still in early February with a forecast of +1.3%. These estimates compare to a 4-year average (2014-2018) for the region of +2.1%.

Germany, the largest economy in the region, experienced a sharp deceleration in export demand in the second half of 2018 as its two largest customers, the U.S. and China, fought over trade issues. European business investment has also been put on hold amid the considerable uncertainty related to post-Brexit economic conditions. The United Kingdom is scheduled to leave the European Union (Brexit) on March 29th, but with no post-exit agreement yet at hand, an extension of the deadline seems likely.

Meanwhile, Italy and France are also struggling to implement pro-growth economic policies amid popular backlash to such policies.

A change in leadership at the European Central Bank (ECB) could also heighten regional financial market anxiety this year. The 8-year term of the central bank's current President, Mario Draghi, comes to an end in October. A decision on the next leader will not be made until after European Parliament elections in late May but some of the leading candidates for the job appear more concerned about inflation threats and fiscal restraint than Mr. Draghi has been. This is an important consideration as Mr. Draghi's expansive stimulative actions are widely viewed as having been key to the region's relatively positive outcomes over his term.

U.S. FUNDAMENTALS

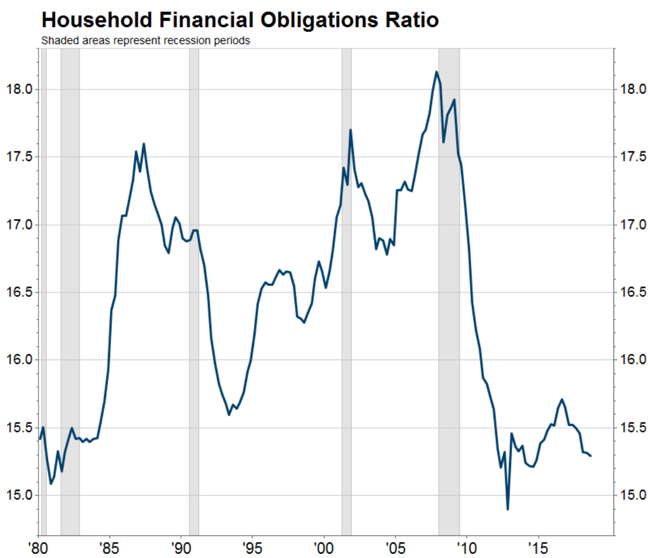
When considering the U.S. economy's intermediate-term prospects, we believe it's always best to start with an examination of consumer financial health. Consumers account for 70% of U.S. economic activity, thus their financial health is critical to the broader outlook. Additionally, in the modern era, economic cycles have become increasingly linked to consumer debt cycles.

Fortunately, from both income and balance sheet perspectives, we believe consumers are in sound condition. Spending prospects remain supported by a strong job market, rising wages, appreciating asset values (home and financial asset prices, primarily) and high confidence levels. In 2018, total wages and salaries in the private sector expanded by a solid +4.9%, while total after-tax personal income was up +5.0%. Such income gains fueled a +4.7% rise in personal consumption and left a healthy savings rate of 6.7%.

The conservative consumer financial attitudes that have prevailed since the recession also remain evident in relatively low debt burdens. After nearly ten full years of economic expansion, consumer debts are still very manageable relative to historical standards.

The Federal Reserve's Financial Obligation Ratio (FOR) has long been our favorite measure of consumer indebtedness, as it measures necessary consumer payments against disposable income, a very logical and rational manner of evaluation, in our view. Rather than just looking at the dollar amount of debt, the ratio looks at whether consumers can afford it. Required payments include: mortgage or rent, property taxes, auto payments, homeowners' insurance, required consumer debt payments (largely credit cards), and student loans.

As seen in the chart below, the FOR is still quite low relative to historical averages, and it has remained low throughout this expansion - contrary to its historical pattern during expansions. In fact, since Q3-2016 the ratio has even been declining, largely due to falling mortgage obligations. Tight availability has constrained housing market activity, and a significant percentage of mortgage holders refinanced into 15-year mortgage loans versus 30-year terms during the refinancing wave of a few years ago. This is enabling people to paydown their mortgage debt much faster than historical averages.



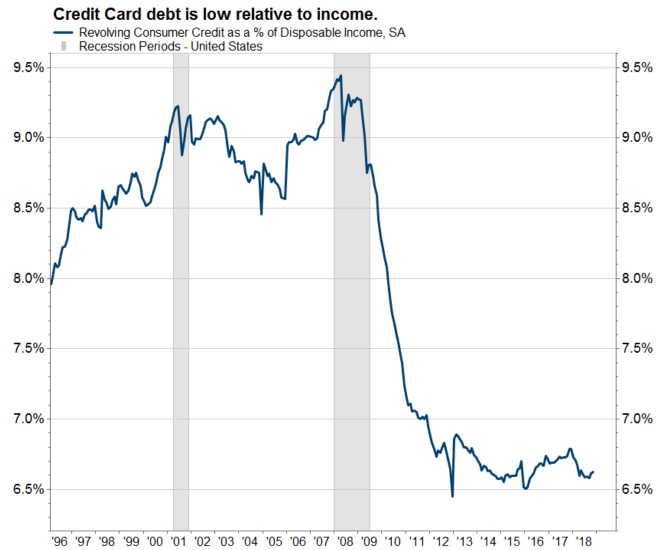
Source: FactSet

Consumers also remain quite conservative in their use of credit – despite some news reports to the contrary. Last year, it was widely touted that credit card debt had finally eclipsed the levels reached just before the financial crisis. Indeed, according to the Federal Reserve, consumer revolving credit (primarily credit card debt) ended 2018 at $1.04 trillion.

Unfortunately, news reports on such developments often emphasize their correlation with the financial crisis, suggesting that the high dollar amount of credit card debt could indicate another pending financial collapse due to financially foolish consumers. We strongly disagree.

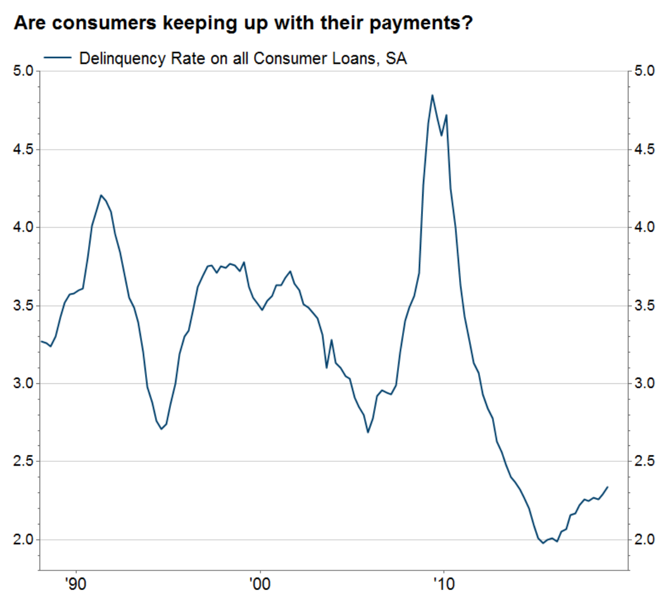
As with our previous discussion on corporate debt, the dollar amount of consumer debt is largely meaningless without context of affordability.

As seen in the chart at the top of the next column, total credit card debt as a percentage of consumer income, is currently very close to its 20-year lows. This, despite the ever-growing utilization of credit for convenience purposes and the generation of reward points.



Sources: FactSet

As further evidence of consumer financial health, the chart below shows that consumers are doing very well in keeping up with their bills. Although overall delinquency rates are up off their lows, they are still very well below previous all-time lows. *A delinquent payment is any payment that is more than 30-days past due.*



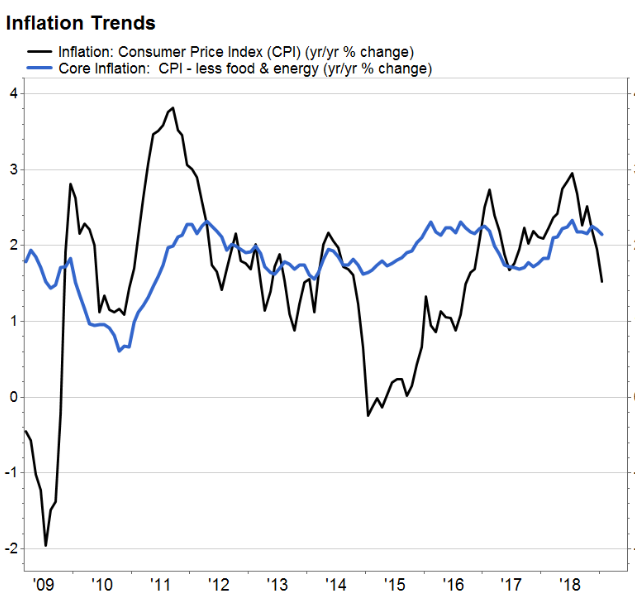
Sources: FactSet

KEY ECONOMIC FORECASTS:

Employment: We forecast the U.S. economy to generate approximately 1.9 million net new jobs in 2019, for a monthly average of approximately +158,000. This would be a deceleration from the better than expected 2.64 million net new jobs created in 2018 (220,000 /mo.). Our forecast of slower job growth is largely due to the simple fact that there are fewer people still on the sidelines and thus available to be hired into the workforce.

Unemployment rate: We forecast a 2019 year-ending unemployment rate of 3.6% as compared to the 2018 year-ending rate of 3.9%. In January, the rate ticked up to 4.0% but the increase was reflective of people re-entering the labor market and looking for work rather than job losses.

Inflation: We believe inflation is likely to remain relatively well contained over the intermediate-term. As indicated by the blue line in the chart below, core inflation (price changes for all items except food and energy) has been fairly stable for the last few years. Rising labor costs are likely to put added upward pressure on inflation, but we believe moderating costs in other areas, combined with productivity gains and the economy's steady yet modest pace of expansion, are likely to keep growth and inflation generally in balance.

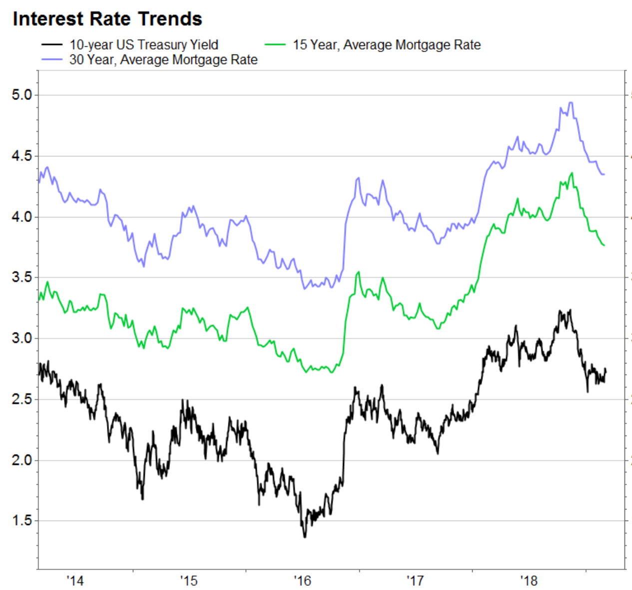


Source: FactSet

US Dollar: On a trade-weighted basis, the U.S. dollar rose by approximately 8% in 2018. In 2019, we believe the dollar's value on a trade-weighted basis could decline by about 2% to 6% as interest rate differentials are likely to remain steady.

Interest rates: Broadly speaking, we believe consumer and corporate borrowing costs are likely to drift modestly higher over the intermediate-term – especially if there is an improvement in the U.S. /China trade picture. The Ameriprise Global Asset Allocation Committee is forecasting a 2019 year-end 10-year Treasury rate of 3.5% versus its 2018 year-ending level of 2.7%.

As seen in the chart below, the yield on the U.S. 10-year Treasury hit multi-year highs of approximately +3.2% in last year's fourth quarter, before falling along with stock prices and rising economic concerns.



Source: FactSet

Simply put, interest rates reflect inflation expectations, combined with the supply and demand for credit. As noted previously, we believe inflation is likely to remain fairly steady. An acceleration of economic activity however, could cause some upward pressure on prices (i.e., inflation) which would likely boost interest rates by a similar amount. This is the normal give-and-take between economic growth and inflation /interest rates and one that portrays a good balance between growth and inflation.

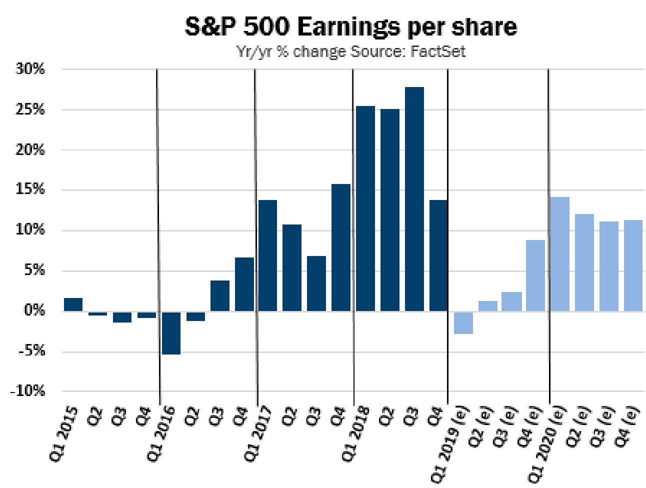
Government demand for borrowing remains exceptionally strong relative to historical standards given high fiscal deficits and the Federal Reserve's ongoing balance sheet reduction efforts. Although consumer and corporate credit demand remains relatively subdued.

The Federal Reserve, meanwhile, has indicated that it will likely remain on "hold" this year, absent any tangible signs of growing inflation pressures.

CORPORATE PROFITS: the bridge between the economy and equity markets.

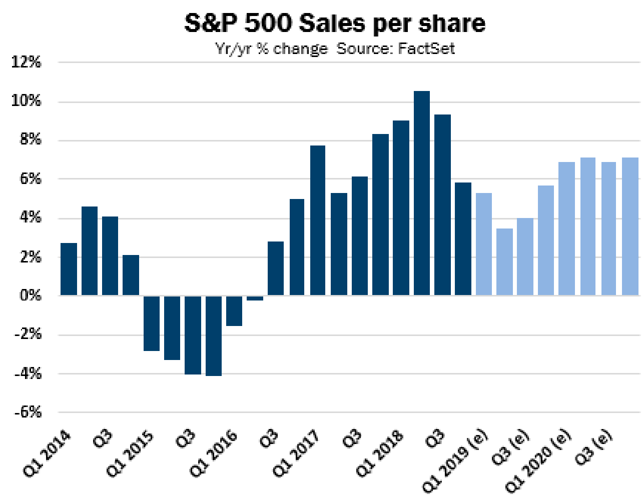
Companies of the S&P 500 generated exceptional earnings per share (EPS) growth in 2018 of approximately 23%, according to FactSet. We estimate approximately half the expansion was due to lower tax rates. Sales, which are unaffected by changes in tax rates, were also strong (at +8.3% for the year) indicating that business results were more than just a tax cut story.

Outlook: Earnings growth is expected to decelerate sharply in 2019. FactSet consensus EPS estimates currently show an expected growth rate of just +3% on sales growth of about +5%. The earnings weakness is largely due to 2018's very difficult comparisons. A strong U.S. dollar could be a modest headwind as well.



Source: FactSet

Analysts estimates for 2019 declined steadily in the second half of 2018, largely due to rising expectations of a more difficult business climate in China and lower aggregate commodity prices. These issues could reverse should China and the U.S. come to an amicable resolution to their trade dispute and the outlook for sales and earnings could improve noticeably.

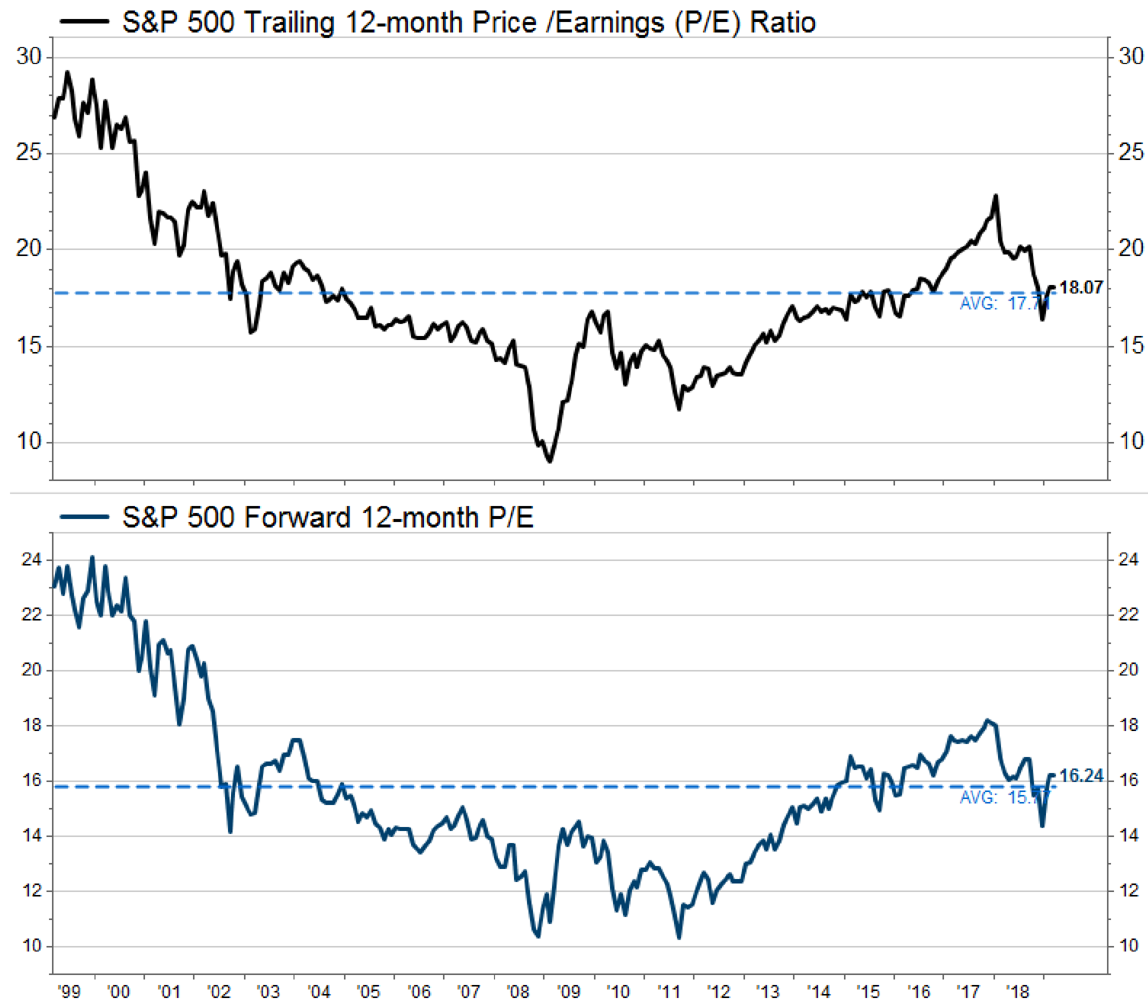


Source: FactSet

S&P 500 Earnings Estimates	2014	2015	2016	2017				2018				2019				2020
3/4/2019	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Est.	Est.	Est.	Est.	Est.
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Quarterly $$ amount				$30.87	$32.80	$33.54	$36.29	$38.71	$41.03	$42.85	$41.29	$37.59	$41.52	$43.86	$44.96	
yr/yr				13.9%	10.7%	6.7%	15.9%	25.4%	25.1%	27.8%	13.8%	-2.9%	1.2%	2.4%	8.9%	
qtr/qtr				-1%	6%	2%	8%	7%	6%	4%	-4%	-9%	10%	6%	3%	
Trailing 4 quarters $$	$119.02	$118.67	$119.64	$123.25	$126.42	$128.53	$133.50	$141.34	$149.57	$158.88	$163.88	$162.76	$163.25	$164.26	$167.93	$188.19
yr/yr	6.8%	-0.3%	0.8%				11.6%				22.8%				2.5%	12.1%
Implied P/E based on a S&P 500 level c **2804**											17.1	17.2	17.2	17.1	16.7	14.9

Source: FactSet

Valuation metrics improved considerably over the last few months, primarily due to the downdraft equity markets suffered in late 2018. Today, market valuation levels are in-line with their twenty-year averages but still slightly above their longer-term averages. Given today's lower interest rate environment, we believe U.S. equity markets are generally reasonably valued.



Source: FactSet

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SUMMARY

Last year's recession fears were misplaced, in our view. The current expansion will eventually come to an end and we will see our next recession. But economic downturns do not come and go based on the calendar, nor are they likely to be caused by stock market corrections, temporary declines in consumer or business confidence, or even inverted yield curves. Most of these factors are coincident indicators of an economic downturn, not factors that cause a downturn in and of themselves.

In today's era, recessions are most commonly caused by the consumer debt cycle, i.e. too much leverage. By this measure, we believe the odds of a recession remain low.

Overall, we believe the U.S. economic outlook remains solid and the current period of expansion could continue for a few more years – absent negative developments on key risk factors, particularly the broad relationship between the U.S. and China.

However, conditions may be too good. The job market in particular, is close to being about as good as it can get, and labor constraints are likely to weigh on the pace of growth going forward. Higher labor productivity (i.e., an increase in output per hour worked) can overcome labor constraints but this would require a material improvement in productivity trends.

Over the long-term, we believe three fundamental factors: demographics, government debt, and China, will have an outsized influence on the path of global economic activity and financial markets. Demographics across the industrial world reveal slower population growth and aging societies; this implies slower potential economic growth than has been experienced historically. Government borrowing needs, particularly here in the U.S., are high and about to go much higher over the next few decades. This is somewhat of a new dynamic for fixed income markets and it remains to be seen at what rates markets will clear. Meanwhile, China has become a major influence in the global economy over a very short-period of time. Chinese leadership has been very strategic in wielding its expanding power and the country's policies and actions do not always adhere to established norms of fair dealing. China's path of development could someday intersect with those of presiding western powers in a messy way.

RISKS

Though we have confidence in our forecast of a slower-than-desired, yet continuing, global recovery, we recognize that a number of serious economic and financial market challenges remain. Government debt loads remain exceptionally high in most of the world's developed economies. The hard choices associated with correcting these imbalances are likely to weigh on economic performance for some time; but allowing debt levels to continue higher would ultimately be much worse. Recent volatility in foreign market capital flows, as well as wide currency swings that correspond with such, are also an economic risk that bears careful watching.

Furthermore, we are still in unchartered territory in terms of potential policy response should the economic expansion falter. Monetary and fiscal policy, the traditional levers of stimulus employed to counter a downturn, are largely exhausted. Interest rates have little room to go lower and government debts are already on an unsustainable path. Should another adverse global economic shock occur over the intermediate-term, there is little government officials could do to directly counteract the results.

Geopolitical risks (e.g., N. Korea, Syria, Venezuela, relations with China and Russia, most notably) are also more difficult than they have been in a long time. The impact of these issues on economic and financial market activity has been reasonably contained thus far, but tensions could easily evolve into much more serious problems. There always have been problems for the global economy /capital markets to deal with, and there always will be.

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