The Bryn Mawr Trust Company
Wealth Management Division

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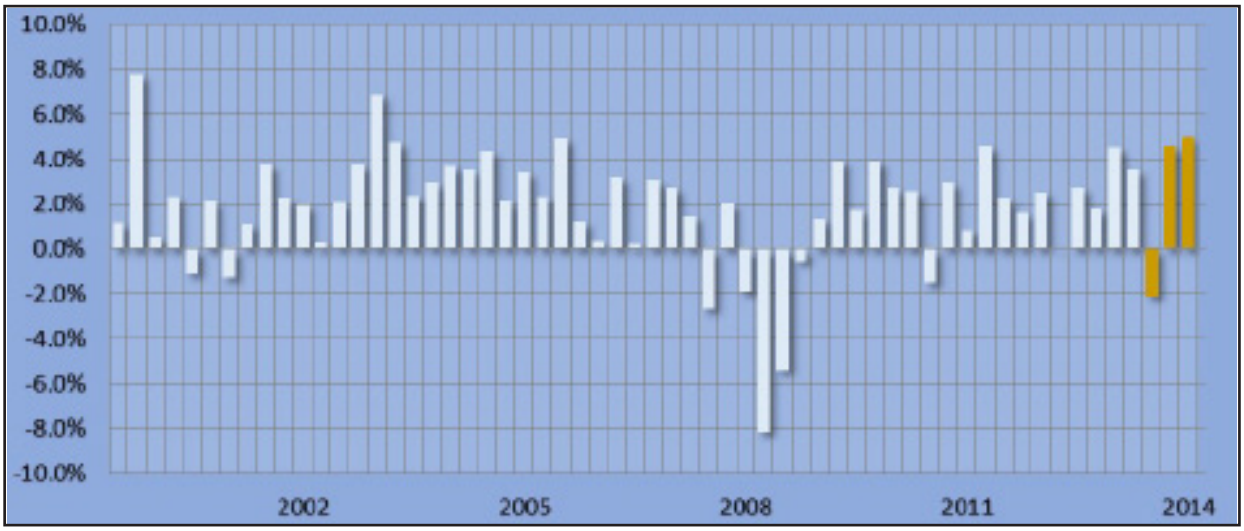
Economic Overview

The U.S. has been the bastion of both economic growth, currency strength and stability on the global stage for 2014 and thus far in 2015. Real GDP growth came in at a very robust 5% in the third calendar quarter, after registering strong growth of 4.6% in the second quarter. The resilience of the U.S. economy is very notable, given that the first quarter came in at a negative (2.1%) rate due to the unusually severe winter weather.

Graph I: Real GDP Growth



Sources: BEA, Vining Sparks

Preliminary real GDP growth came in at a disappointing 2.6% in the fourth calendar quarter of 2014. Growth was adversely affected by an upturn in imports, while personal consumer expenditures were a strong positive contribution.

Consumer spending, which represents about two-thirds of domestic GDP has been aided by a better jobs picture. The civilian unemployment rate dropped to 5.7% by January of this year from 7.0% over the course of 2014. Non-farm payroll employment growth accelerated through the course of 2014, registering an average gain of 246,000 new jobs per month in the fourth calendar quarter. According to the Bureau of Labor Statistics (BLS) data, average hourly earnings remain subdued, but some acceleration is expected in 2015.

Graph II: Employment

Source: BLS, Vining Sparks

Consumer spending has also been aided by the dramatic decline in energy prices, primarily crude oil, since June 2014. The decline in crude has led to the drop in the price of refined products, such as gasoline, jet fuel and heating oil. As of February 12, the national average for regular unleaded gasoline stood at $2.24/gallon, according to the AAA (Automobile Association of America). We believe that the majority of savings from lower gas prices will be spent by households, which should further enhance the consumer-based U.S. economy.

Events in Europe have taken center stage once again. On January 15, the Swiss National Bank (SNB) ended a three year decision to hold the Swiss franc at 1.20 euro. The news was unexpected and currency and financial asset swings were volatile in the wake of the announcement, with significant weakness in the shares of Swiss franc denominated securities. It is estimated that 40% of Swiss exports go to the Eurozone. The franc surged about 40% in value against the euro and saw significant gains against virtually every other foreign currency.

The Swiss National Bank (SNB) created the pegged rate in order to curb speculation in the Swiss franc in driving up its value during the European debt crisis several years ago. In removing the cap, the goal was to discourage any new flows of funds in to the franc. The credit rating service Fitch stated that the "impact on Fitch-rated corporates will be limited. A large proportion of their costs are overseas and the currencies of their assets and liabilities tend to be well matched." Many Swiss-based companies which also are traded on the New York Stock Exchange (NYSE) in U.S. dollars by means of an American Depository Receipt (ADR), saw their prices rise significantly in the NYSE, in the immediate wake of the news.

The Eurozone was once again in the spotlight on January 22, as the European Central Bank (ECB) surprised the globe with a larger than expected buying program for its version of Quantitative Easing (QE). Expectations were for a $50 billion buying program and the announcement came in for a program of $60 billion per month and is slated to continue until September 2016. The immediate reaction in the U.S. Treasury market was toward lower yields.

The Capital Markets

Equity market volatility has spiked upward relative to the rather "tranquil" market environments of the last few years. Coupled with the volatility, the strong performance of the U.S. dollar since early July 2014 – Trade Weighted U.S. Dollar Index up 14.5% - had a significant impact on the direction of global cash flows in to domestic large cap equities. The nature of these flows also had a large impact on the dispersion of performance between large cap and smaller cap equities, as well as between sectors as observed through sector specific ETF flows.

The U.S. equity markets are trading at record highs. The Federal Reserve is in the early stages of shifting its approach regarding monetary policy having ended its extraordinary program of Quantitative Easing (QE). It can clearly be included among a number of reasons for the acceleration in volatility. The recent pick-up in volatility is moving the VIX (measure of implied market volatility) closer to its longer term average.

Based on external research sources, the S&P 500 has experienced corrections of at least 10% for a total of 93 times in the 86 years since 1928, or roughly once per year. There are periods, when the market does not experience a correction on the order of 10% (e.g. March 2003 – November 2007). Conversely, 5% price adjustments occur on average 3 ½ times per year.

Valuation levels do not appear to be overly extended. The current Price/Earnings ratio (P/E) of the S&P 500 Index is approximately 16.7 times estimated forward twelve month earnings per share, according to FactSet, Inc. Given low inflation and a ten year U.S. Treasury bond around 2%, we see the market as fairly valued.

The equity market, as measured by the S&P 500 Index is currently providing a current dividend yield of 2%. The current level of dividend payout represents less than 30% of the market index's current estimated earnings per share, and compares favorably to historical averages closer to 45%.

In our view, U.S. equity markets remain more attractive versus their global counterparts on the bases of growth and stability. However, we see selective and actively managed opportunities in certain international markets, particularly Asia.

We continue to be defensive as to the fixed income markets regarding duration and credit, and believe that the change in Fed policy (2015) and improving economic conditions will eventually exert upward pressure on short term interest rates and the configuration of the yield curve. We see the probability of the curve flattening with the front end rising at a faster pace than the longer end, as inflation expectations stay subdued and the Federal Reserve reluctant to shrink its balance sheet.

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