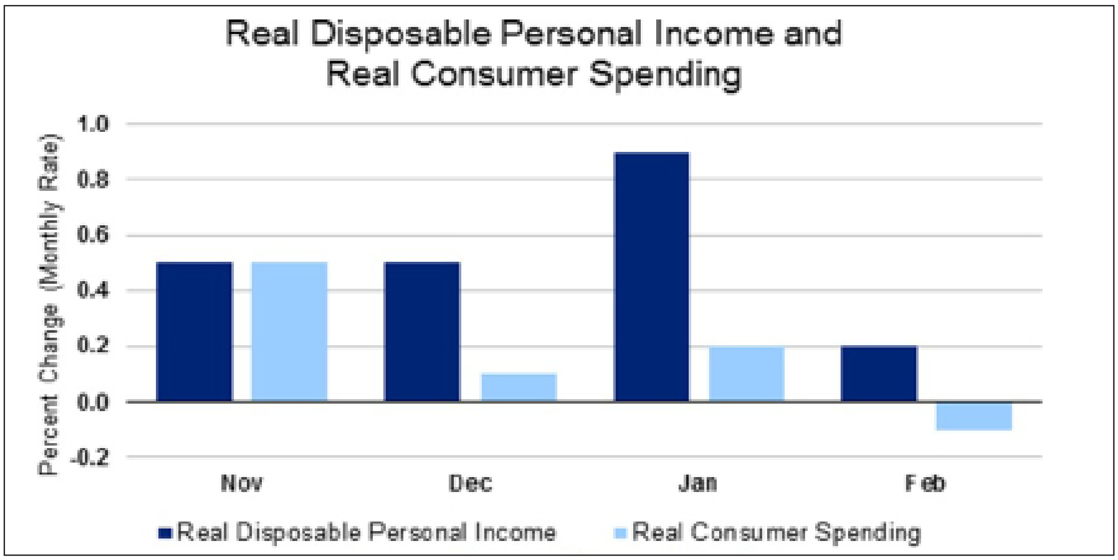
The Bryn Mawr Trust Company
WEALTH MANAGEMENT DIVISION

Economic & Market Quarterly

SPRING 2015

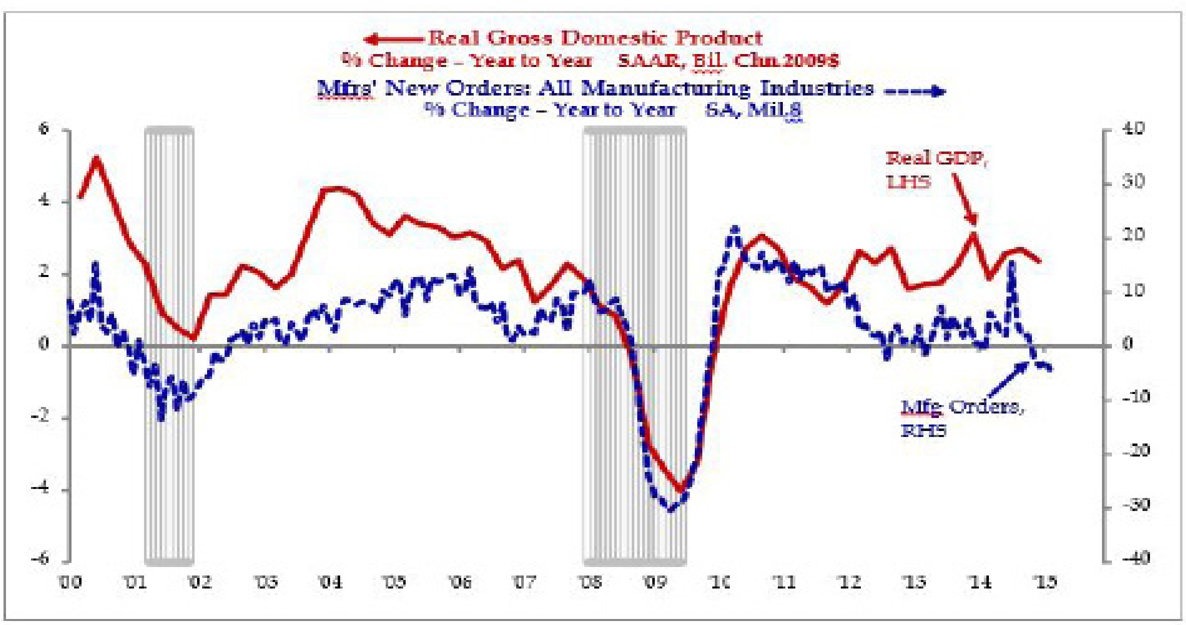
Economic Overview

First quarter 2015 data point to softness in the domestic economy, perhaps brought on by severe winter weather in much of the Northeast, as well as the lingering effects of the West Coast ports' strike (resolved in mid-February).



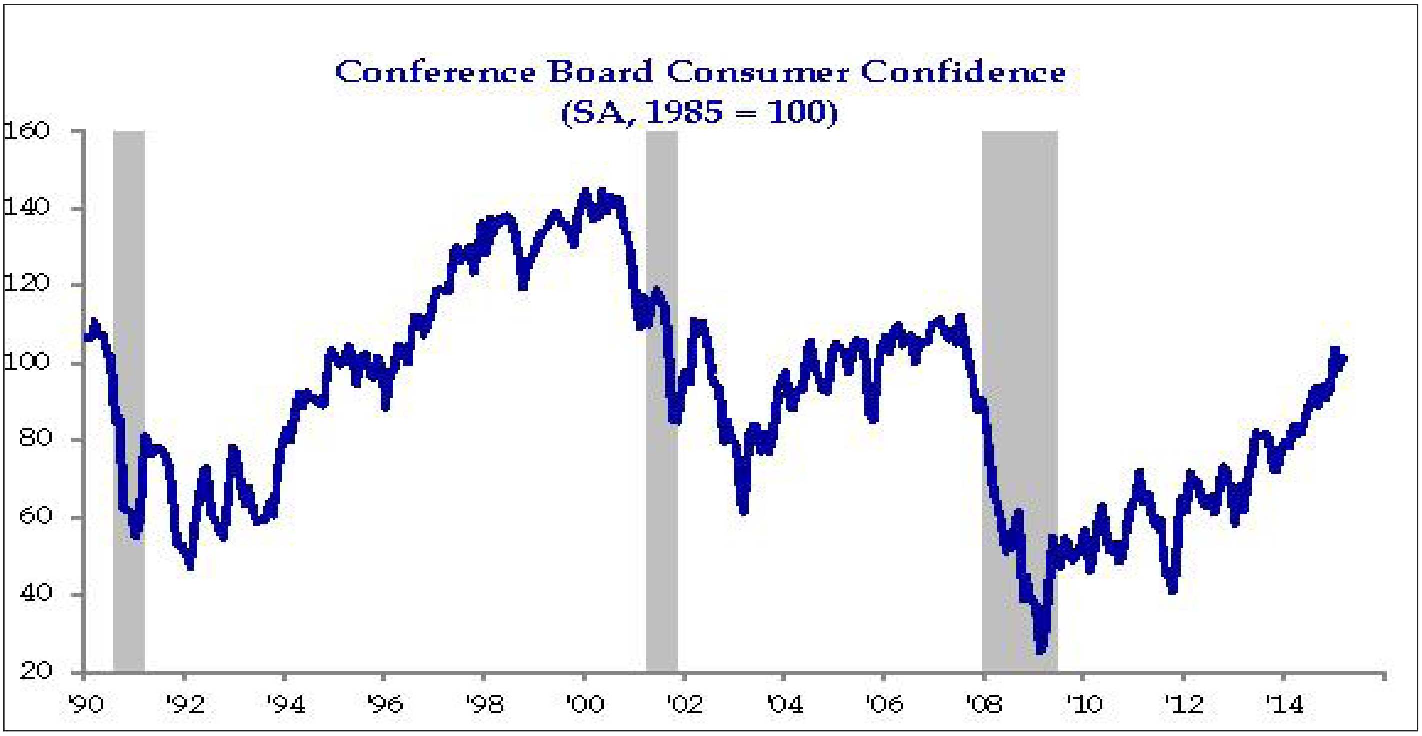
Source:Bureau of Economic Analysis

The fourth quarter 2014 release of GDP was disappointing at 2.2%. Growth was paced by an increase in personal consumption expenditures, along with gains in nonresidential fixed investment and exports.



Source:Bureau of Economic Analysis, Census Bureau, Strategas Research

Consumer spending, which represents approximately two-thirds of U.S. GDP, remains strong and was aided by the dramatic decline in energy prices since June of last year. The decline in crude has led to the drop in refined product prices, such as gasoline, jet fuel and heating oil and will aid discretionary spending by the consumer as the effects work through the system.



Source: Strategas Research

The positive effects of lower energy prices and the better employment picture have been positive catalysts for consumer confidence.

The March employment report (+126,000 nonfarm payroll jobs) was very weak relative to expectations. The unemployment rate held steady at 5.5%.

Employment gains in the healthcare sector remain very strong but the Bureau of Labor Statistics (BLS) reported that "the employment declines in the first quarter of 2015, as well as the gains in 2014, were concentrated in support activities for mining, which includes support for oil and gas extraction."

The relative impact of the energy sector on the U.S. domestic equity market is more significant than its impact on the broad U.S. economy but nevertheless, still an important economic variable. The weaker March employment numbers have caused many economic forecasters to lower their first quarter 2015 real GDP estimates down to the 1% area.

The Fed

On the monetary front, we still see the Federal Reserve raising short term interest rates later this year. The first quarter "soft patch" of economic releases pushes out the probable first stage of tightening beyond June.

In its March 18 statement, the FOMC (Federal Open Market Committee) shifted its stance on growth downward and expressed confidence in the improvement of the labor markets. Regarding inflation, the FOMC stated that "inflation is anticipated to remain near its recent low level in the near term, but the Committee expects inflation to rise gradually toward two percent over the medium term."

International

Economic growth in the Eurozone has come in well below forecasts, prompting direct intervention by the European Central Bank (ECB). The markets received a "QE-like" response from the ECB on January 22, at the rate of 60 billion Euro ($66 billion) in sovereign bond purchases per month. The program is expected to last until September of 2016.

The monetary stimulus provided by the ECB set the stage for a strong performance by international developed equity markets in the first quarter of 2015. Markets, as measured by MSCI EAFE, provided a return of 4.88% in the first quarter, outperforming most other major sub asset classes. The strong performance occurred despite the difficult discussions surrounding Greece and their willingness to agree to measures set by EU ministers as to the repayment of debt.

The U.S. Capital Markets

U.S. interest rates continue to hang in the balance, waiting for any indication from the Federal Reserve Open Market Committee to actually begin the task of raising interest rates. With lack of inflation, the dollar strengthening, central foreign banks mixed on raising and lowering their own short term lending rates, the obvious flight to quality in the U.S. Treasury market has been a major factor driving U.S. Treasury rates lower.

What would motivate a consensus in the market forecasting that the FOMC will raise rates by the end of 2015? Very simply, the Federal Reserve needs a tool back in the tool box. Janet Yellen recently stated that her preferred market tool is a change in the level of short term interest rates. The Discount Rate remains at .75% and the overnight Fed Funds target stands at 0 -.25%, certainly not a point of flexibility for the Fed to react to another significant credit event.

Given current economic and monetary circumstances, our outlook for interest rates is a gradual rise in the second half of 2015, perhaps 50 basis points, followed by another 50 bps in early 2016. This action in combination with an expected lift in the flight to quality on ten year yields (normalizing around 2.30% -2.60%) later this year, should produce a flattened yield curve - a non-parallel shift. Fixed income purchases in the 7-10 year area should benefit from "roll down" as interest rates rise.

Taxable municipal bonds have been heavy in new issuance, offering yields 10-20 basis points (+0.10 – 0.20%) higher than the "AA" corporate curve. Lower rated "single-A" general obligation bonds and essential service revenue bonds continue to offer competitive taxable equivalent yields and, in some cases, absolute yields greater than government securities. "Crossover" buyers (taxable accounts with the ability to buy municipal securities) should continue to be the benefactors of tax exempt and taxable issuers competing for the same investment dollars.

With low inflation (< 2%); a ten year Treasury bond trading around/under the 2% level; slow wage growth and commodity pricing pressures; moderate GDP growth (around 2.5% for the year) and unemployment falling but still above previous market peaks, we see the equity markets as fairly valued and selectivity rising to the surface as a key to performance.

In 2014, strong demand for US dollar denominated assets (flight to quality) was a significant factor in the rise of large cap US equity market indices. The old adage that, "It's a market of stocks, not a stock market," is beginning to take hold in the latter stages of the cycle and specifically in 2015, thus far.

Better quality companies (e.g. strong cash flow, efficient cost structures, etc.) are positioned well to generate profitability in a lower inflation and strong dollar environment. We also see continued M&A activity and return of cash to shareholders (share buybacks, dividend boosts, etc.) as part of the landscape.

We submit that equity market volatility heightens preceding/during Fed tightening cycles but also see at this juncture that eventual tightening by the central bank will be a function of a broadening economic expansion and not excess inflationary pressures. Equity markets can perform quite well in various stages of Fed tightening if the action is a function of rising growth prospects.

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