STRATEGY INSIGHT

April 2018

People's United Advisors

Economic Overview

Economic Indicators	3Q'17	4Q'17	1Q'18	2Q'18	3Q'18	4Q'18
Real GDP *	3.2%	2.9%	2.3% prelim	3.1%	3.0%	2.8%
CPI (year over year)†	2.2%	2.1%	2.4%	2.7%	2.6%	2.4%
Unemployment Rate†	4.2%	4.1%	4.1%	4.0%	3.9%	3.8%

*Quarter over quarter annualized † end of period

Increase from last reported | Estimated | Decrease from last reported

The Key to Future Growth

The initial estimate of first quarter gross domestic product showed private investment increasing at a 7.3% annual rate excluding inflation. This was **good news for the economy and for investors**. Investment is the key to continued economic growth with moderate inflation.

Real growth in the economy can come from three sources. First is growth in the labor force – more people working. The second is growth in labor productivity – people producing more tomorrow than they produced yesterday. The third is from changes in the legal, regulatory, and social environments for commerce – "total factor productivity" in economics jargon –enabling commerce to be more effective and efficient. Regulatory reform may provide some room for future growth, but strong growth will depend on the first two sources.

With unemployment currently at 4.1%, there is little or no slack in the supply of labor. And with population growth running at 1% and baby-boomers retiring in large numbers, **labor force growth will not support economic growth of even 2% on its own**.

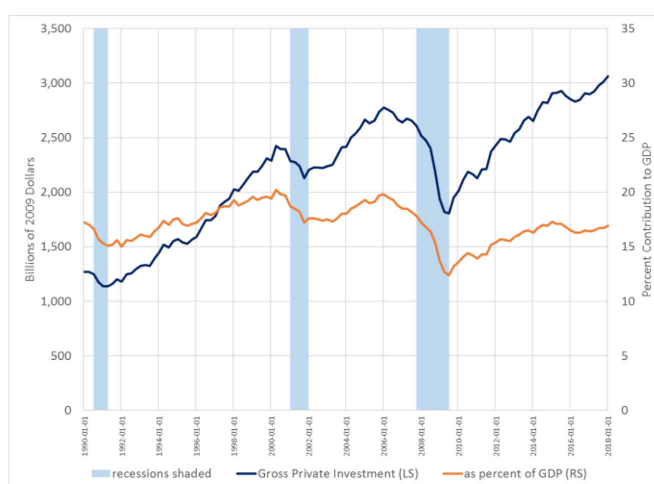
Labor needs to be more productive in order to support stronger economic growth. Increased education can boost labor productivity, but the lead time for its benefits can be long. Labor productivity can also be increased with better tools, which is where business investment is key.

Capital spending for more and better tools has been slow since the Great Recession. Gross private investment has averaged just 15.7% of GDP since mid 2009 compared to an average of 17.9% for the period from 1990 through 2007 – even including the slack periods during and following the recessions of 1991 and 2001.

Increased investment will increase labor productivity and allow the economy to expand even with low unemployment and without prompting inflationary wage and salary increases. In its absence, a tight labor market is likely to spur inflationary wage increases.

The Tax Cuts and Jobs Act provided incentives for business to invest. The preliminary first quarter GDP investment numbers provide some evidence that business is responding and increasing investment. We will be watching future investment numbers closely. **The more business invests, the more non-inflationary growth can occur, and the better the outlook for corporate earnings and stock valuations.**

Gross Private Investment



Source: Bureau of Economic Analysis

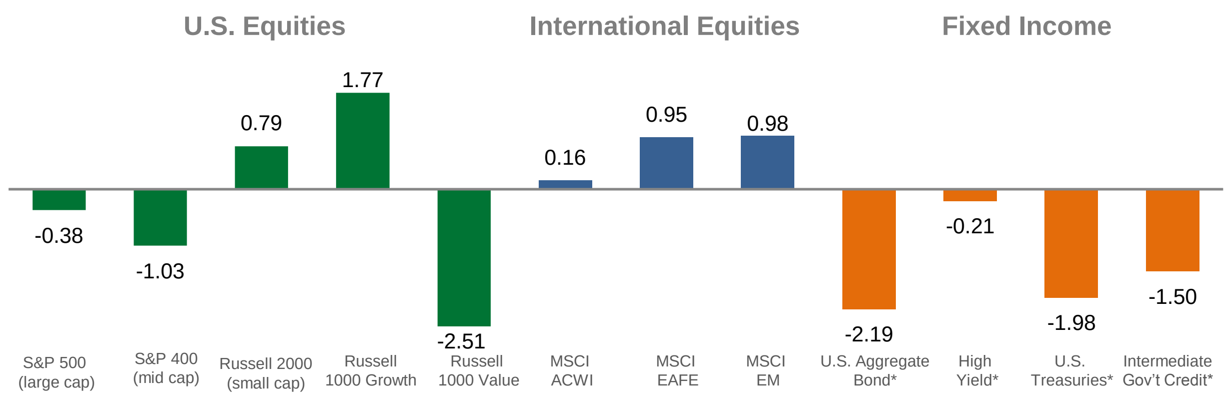
Equity: Earnings Season: Priced for Perfection?

- The beginning of earnings season appeared to draw investors' attention away from the drama in Washington and concerns over interest rates, and back to the economy. Despite continued strong earnings reports, however, the market retreated from an earlier gain and is now down year to date. The pullback appears to be a combination of wondering how the next act in earnings could possibly top this one and worries over the 10-year rate topping 3% possibly damping that second act. Although a limited number of companies have reported, 80% of those that have reported better than estimated first-quarter earnings and over 70% reported better than expected revenues. The blended earnings growth for Q1 is now at 18.3% versus 11.3% at the start of the quarter.

- Although margins are above five-year averages, companies have been mentioning wage and expense increases in their conference calls. In addition, lower tax rates have been big contributors to the margin increase. This has raised concerns that higher expenses will dampen earnings growth relative to expectations.

- We think the current market action has more to do with the increase in volatility and the market still working through its normal correction process than with any slowdown in economic or earnings growth. The uptrend from the beginning of 2016 is still intact and so is the market's 200-day moving average.

Market Returns (%) Year-to-Date As of April 30, 2018 Source: Bloomberg *Bloomberg Barclay's indices



Fixed Income: Short Rates Bear Watching, 3% is just a number

- The 10-year Treasury yield breached the psychologically important 3% threshold, the first time since 2014, and proceeded to hit its highest level since 2011. While this has received a fair amount of press, we believe that it's important to note that interest rates have moved quite significantly already – almost half a percentage points since February across maturities. Consensus is for the 10 year yield to end the year in a narrow range around 3%.

- The 3% threshold doesn't necessarily have immediate implications for markets. We are watching the significant increase in short rates much more closely, as these rates trending up is what is more likely to stress both risk assets and the economy as firms and individuals find the cost of borrowing based on floating rates moving up.

- The important dynamic we are watching for longer term is the potential for an inverted Treasury yield curve. As we've previously noted, when short-term yields go above their longer-term counterparts, banks lose much of their ability to create credit profitably, which directly impacts the level of economic activity.

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