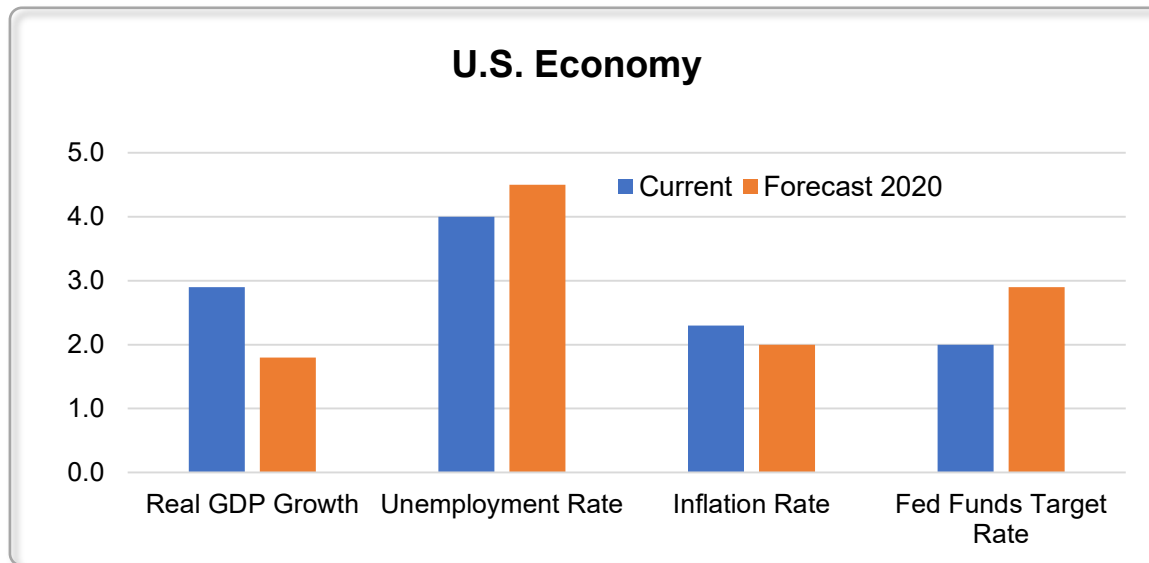


Our *Playbook* is designed to share our quarterly views in a visual presentation with comments providing context to what we believe are the pertinent issues of the most recent quarter and what we see moving forward.

## U.S. – Solid Foundation, but Risks Appear

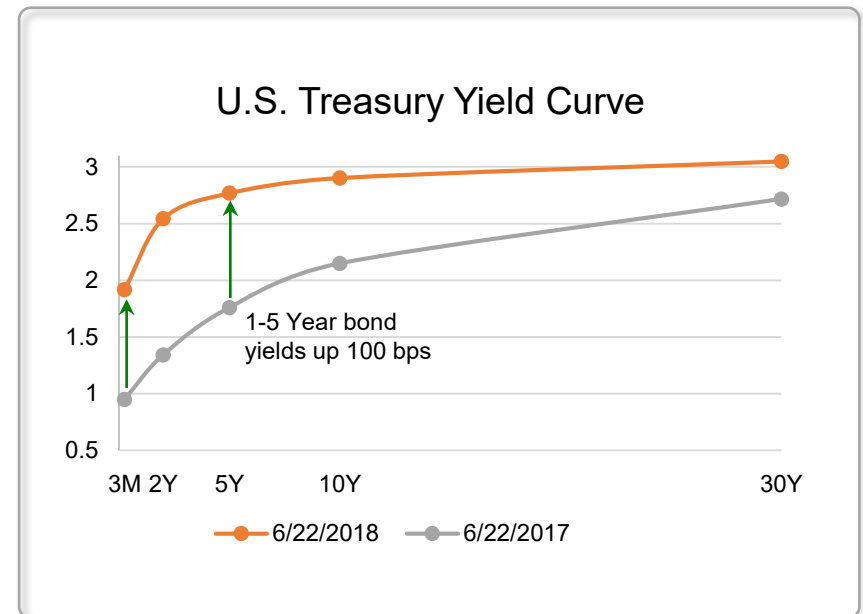
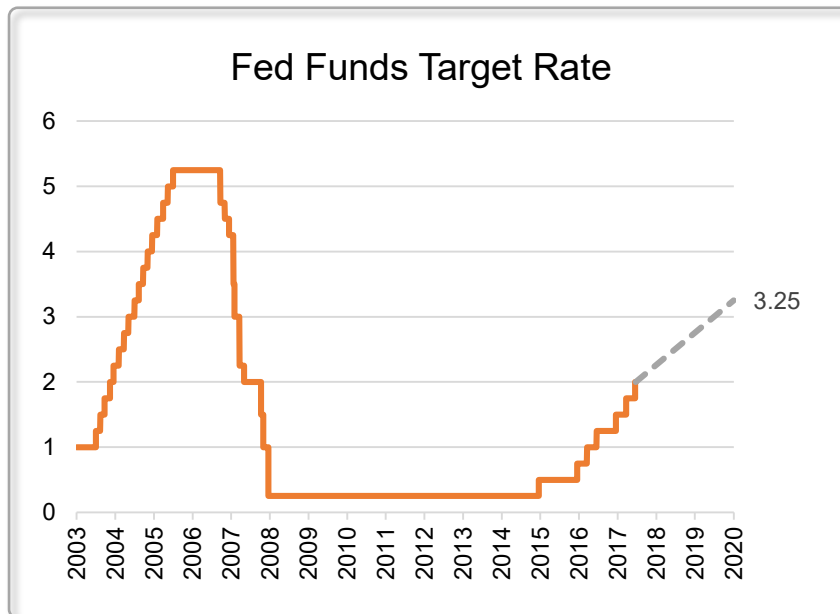
- U.S. economy has continued to show healthy GDP growth, low unemployment rates and modest inflation.
- GDP growth may slow from current levels as short-term interest rates rise and unemployment rebounds from very low current levels.
- Inflation is the main risk to the outlook with unexpected increases possible due to wage inflation in a tight labor market, trade tariffs, and/or higher energy prices.



Source: Current Real Annual GDP Growth as of 4Q17 – Bureau of Economic Analysis; current unemployment rate as of June 30, 2018 – Bureau of Labor Statistics; current inflation is Headline PCE year-over-year as of May 2018 – Bureau of Labor Statistics. All long term projections – Federal Reserve Bank projections.

## U.S. Short-term Rates Moving Up

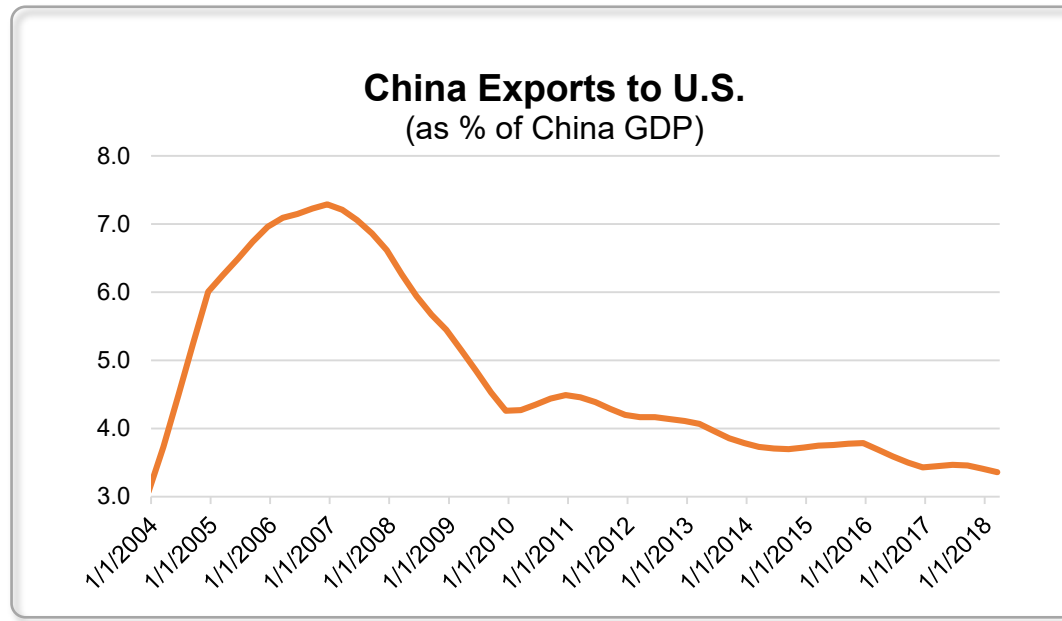
- Seven Fed Funds interest rate increases since December 2015.
- Fed voting members forecast Fed Funds rate to peak at 3.25% in 2020 before decreasing back to 2.75% beyond 2020.
- U.S. yield curve has shifted up substantially in the past year, 5-year and shorter bond yields have increased the most, with longer maturities moving much less.
- 10- and 30-year yields in the 3% range have underpinned stable mortgage rates.



Source: Bloomberg. 3.25% Fed Funds Target Rate by December 2020 reflects median of FOMC members' projections.

## U.S. – China Trade

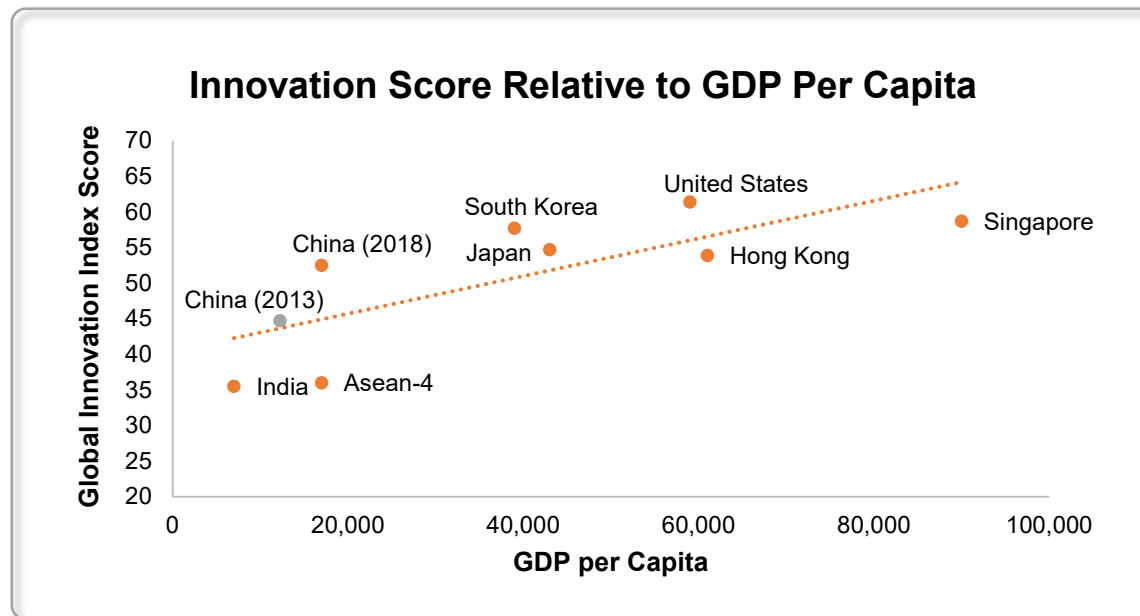
- *The Trump administration announced 25% tariffs on \$50 billion of Chinese exports to the U.S., \$34 billion went into effect on July 6 and \$16 billion, thereafter. China announced retaliatory tariffs on U.S. goods in the agriculture and energy industries. In response, the U.S. announced intentions to levy 10% tariffs on another \$200 billion of goods. China did not take any immediate retaliatory action.*
- *Exports to the U.S. have become a lower percentage of China GDP over the past ten years. The greatest impact is to global growth – meaningfully Southeast Asia (Taiwan, Malaysia, Korea, and Singapore) economies that supply intermediate goods to China for subsequent U.S. export could be hurt significantly by China tariffs.*
- *If the U.S. imposes tariffs on \$250 billion of imported goods, higher prices could mean that U.S. inflation might increase 0.5 percentage points over 3 years.<sup>1</sup>*



Notes: (1) Estimates by Stephen Roach, Yale economics professor and former chairman of Morgan Stanley Asia.

## U.S. Policy Makers Worried about China Innovation

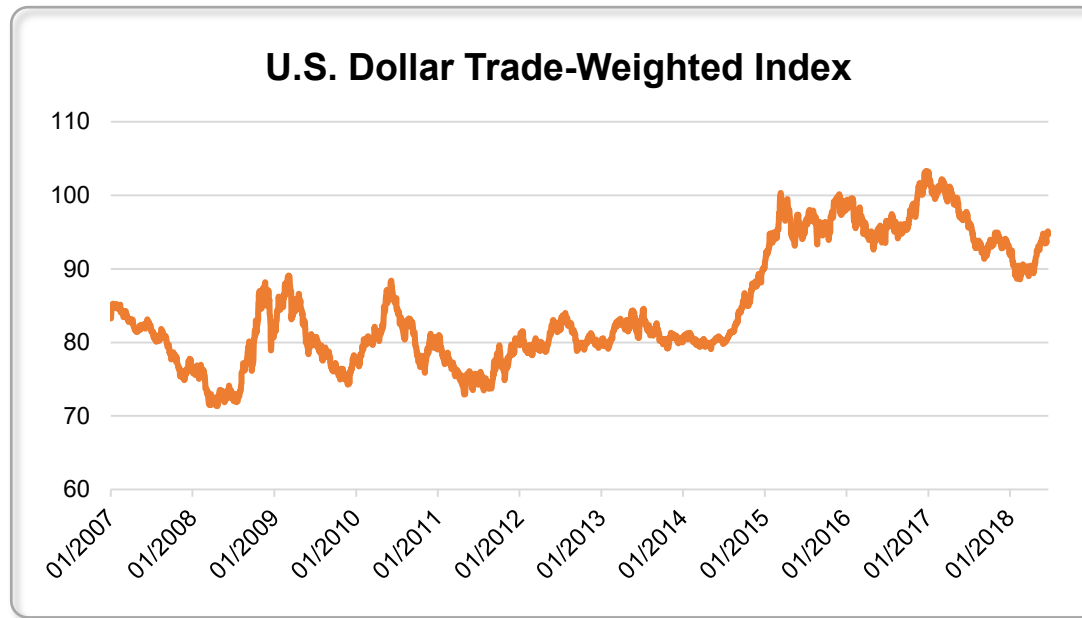
- *U.S. tariffs on China reflect concerns about jobs, theft of Intellectual Property and the Development Trajectory articulated by the China 2025 plan that seeks a larger market share of high value-added global industrial output in certain business sectors – most importantly technology.*
- *On innovation capability, China has improved rapidly and now ranks well above countries with similar per capita GDP, such as India and the Southeast Asian countries (ASEAN).*
- *The U.S. still has a technological advantage over China, but the difference has eroded in recent years and the U.S. administration seeks to square the rules, level the playing field, and make it more difficult for China to outstrip the U.S. in technological advances in the long-term.*



Source: IMF, Cornell University, INSEAD, World Intellectual Property Organization. GDP per Capita in PPP terms as of June 2018

## Higher Interest Rates Attract Attention to U.S. Dollar

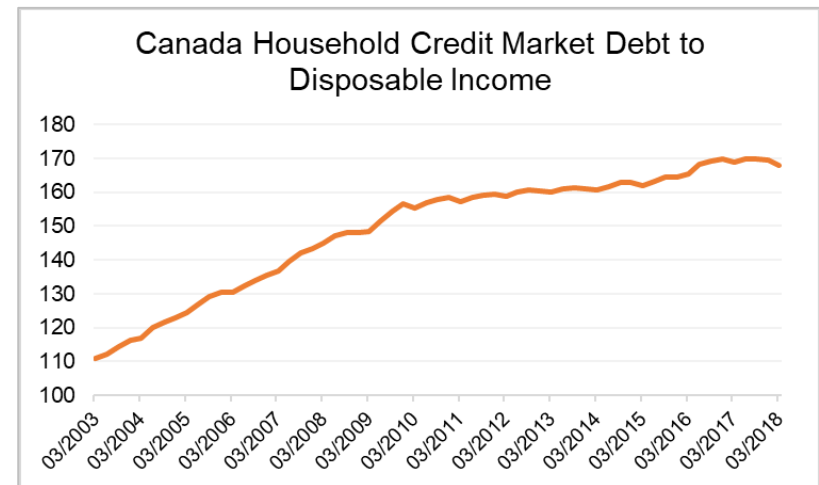
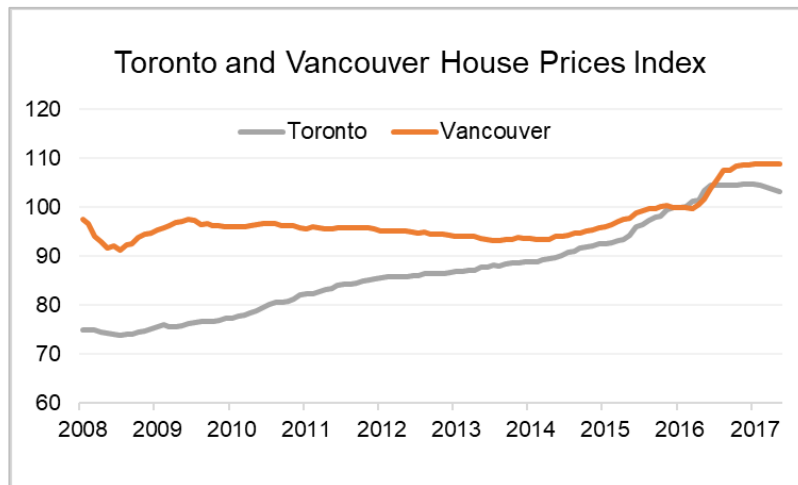
- *U.S. Dollar has strengthened against all major currencies as the short-term interest rate differentials have widened between the USD and other currencies.*
- *A stronger USD may eventually result in larger trade deficits as it benefits countries that export to the U.S. (foreign goods become cheaper for U.S. consumers), contrary to the stated goal of reducing the trade deficit.*
- *The stronger USD has impacted capital outflows from emerging markets, where local currencies have weakened adding to emerging equity and debt markets poor performance.*



Source: Bloomberg. Components of trade-weighted USD Index: Euro 57.6%, Japanese Yen 13.6%, British Pound Sterling 11.9%, Canadian Dollar 9.1%, Swedish Krona 4.2%, Swiss Franc 3.6%.

## Canada's Housing Market Cools Off and Borrowing Slows

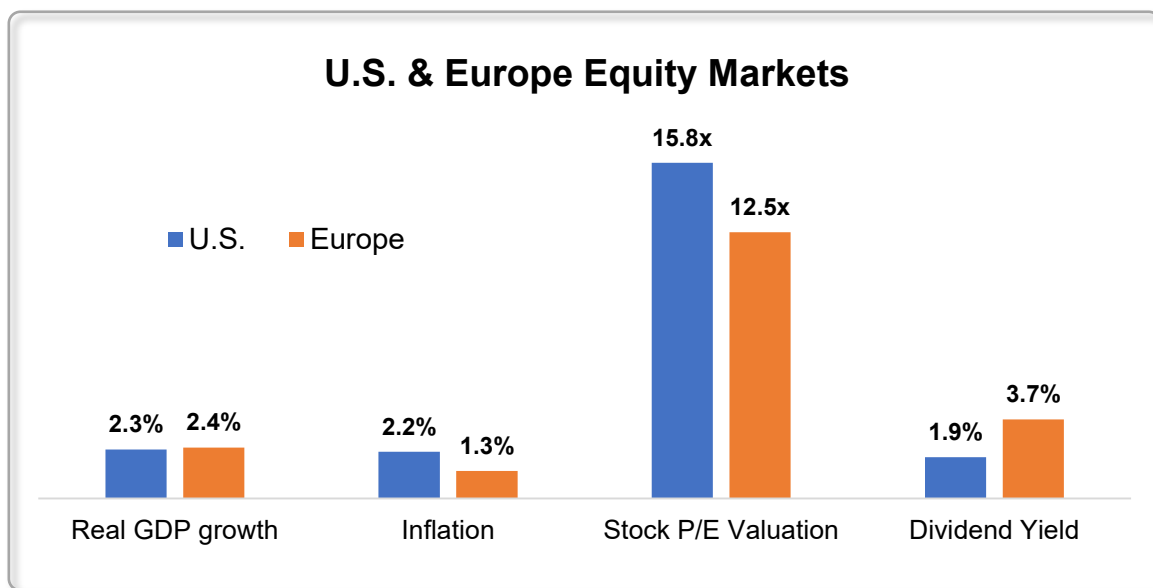
- Toronto housing prices declined in first half of 2018 for the first time in ten years, while Vancouver housing prices have been flat for the last four quarters. Borrowing for home purchases was lowest in four years.
- Canada's Household Debt to Disposable Income ratio also fell from 169.7% to 168%, representing the biggest drop since 1990. This pullback in the expansion of debt may indicate slower GDP growth moving forward.
- The cooling of the Canadian housing market and NAFTA uncertainty gives the Bank of Canada more flexibility to defer interest rate hikes.



Source: Bloomberg, STCA Toronto and Oshawa New House Price Index, and STCA Vancouver British Columbia New House Price Index. Monthly Data. The debt to income figure represents Household Debt to Disposable Income, from Canada National Balance Sheet Accounts Credit Market Debt to Disposable Income. Quarterly Data.

## Europe for Sale

- *European Central Bank (ECB) recently announced the end of its asset purchase program beginning December 2018.*
- *The ECB Deposit Rate expected to increase mid-2019.*
- *Political uncertainty in Britain, Italy, and Germany may impact ECB policy decisions as bond purchases wane and rate hikes are contemplated.*
- *European stocks trade at significantly better valuations and higher dividend yields than their U.S. counterparts.*



Source: Bloomberg. Real GDP Growth for 2017; Inflation as of May 31, 2018; S&P 500 and Stoxx 50 represent the respective equity markets; forward dividend yield as of June 22, 2018.





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December 10, 2018