

# Perspective

## ECONOMIC OVERVIEW

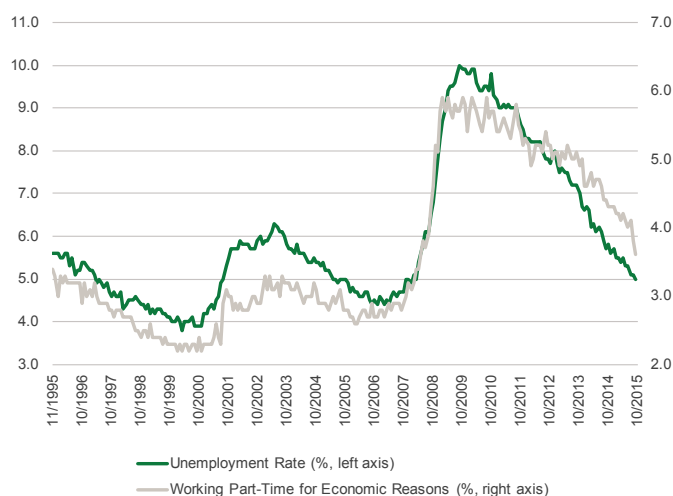
Unless otherwise noted, all figures are based in USD.

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### The U.S. Economy

The latest report on U.S. nonfarm payrolls showed they surged in October by the most this year. The addition of 271,000 jobs made up for weaker figures in August and September and pushed the three-month average for new jobs to about 190,000. The unemployment rate fell to 5.0%, and the rate of involuntary part-time workers fell to a seven-year low of 3.6%. With the top-line unemployment rate having hit the Federal Reserve's target for full employment, the part-time figure provides additional evidence that the labor market is tightening, raising expectations that the Fed will hike interest rates at its December meeting. Also, average hourly earnings year-over-year climbed by the most since 2009, which should get the Fed's attention as it evaluates inflation and inflation expectations.

#### Unemployment and Involuntary Part-Time Workers November 1995 - October 2015



Source: Federal Reserve Economic Data

Speaking of inflation, the latest consumer price index (CPI) data showed that core services price inflation reached a six-year high in October. Declines in goods prices continue to offset a good portion of the services increase, however, and the overall core CPI figure was unchanged for October at 1.9% year-over-year. Nevertheless, the core number is something to keep an eye on should the impact of U.S. dollar strength and the drop in energy prices begin to lessen.

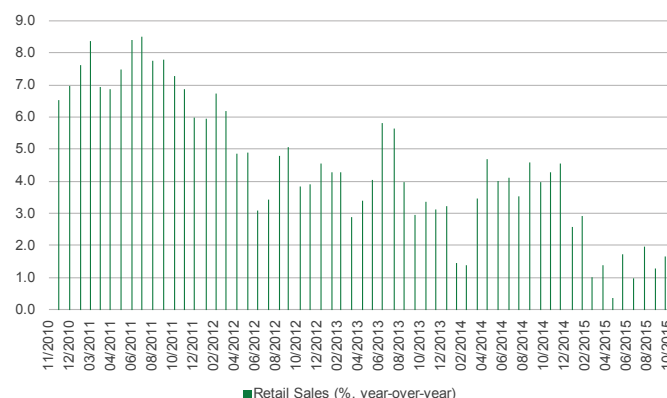
Gross domestic product (GDP) growth for the third quarter was revised up to a 2.1% annualized rate from an initial estimate of 1.5%. The change was largely the result of a revision regarding private inventories that had them only subtracting 0.6% from the overall growth figure versus a 1.4% initial decline. However, these inventories could potentially detract from fourth quarter GDP growth if they are drawn down by the end of the year. Even with the upwardly revised overall growth figure for the quarter, GDP only expanded by 2.2% year-over-year, the smallest year-over-year advance since the first quarter of 2014.

One factor perhaps contributing to the middling third-quarter figure was declining corporate profitability. The strong dollar and weak global demand continued to pressure corporate profits, factors that could also affect earnings in the coming months. Year-over-year earnings growth for S&P 500 companies was negative for the second consecutive quarter during the July through September period. A Bureau of Economic Analysis statistic that measures earnings adjusted for inventory and depreciation showed profitability for companies across the U.S. declined 4.7% year-over-year, the largest annual drop since the second quarter of 2009. This also was only the third time that profits have declined year-over-year since the end of the recession in June 2009.

Weaker growth in retail sales this year could be one factor affecting corporate earnings. Monthly retail sales data continue to have positive year-over-year growth, but the first 10 months of 2015 lagged significantly the average for the last five years. Through October, monthly retail sales have averaged 1.4% growth in 2015 versus an average of 4.4% since November 2010.

### U.S. Retail Sales

#### November 2010 - October 2015



Source: FactSet

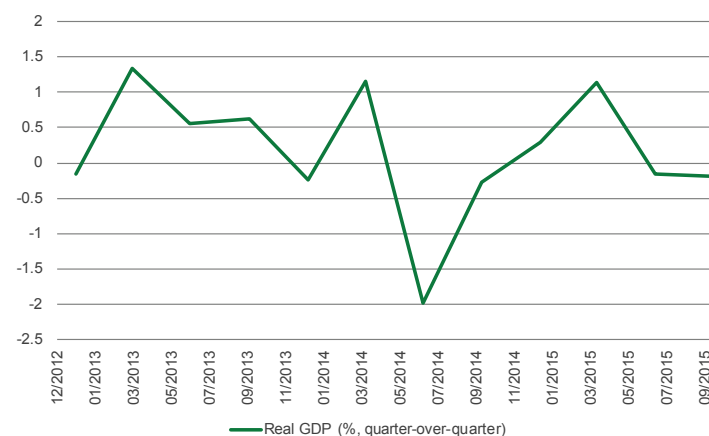
## Global Economy

In the third quarter, Japan fell into its second recession since Prime Minister Shinzo Abe took office in December 2012. The first recession came on the heels of an increase in the country's consumption tax in April 2014 that was hard to overcome. This past quarter, slower growth in China and a weaker global outlook led to a decline in business investment and shrinking inventories, which drove the contraction. GDP declined at a 0.8% annualized rate for the quarter, following a revised 0.7% drop in the second quarter. With two consecutive quarters of negative growth, the economy met the common definition of being in recession.

In response, Abe announced new stimulus measures, with a focus on social programs such as cash payouts to low-income groups to try to boost consumption. Abenomics—the name given to the prime minister's economic reform agenda—has been criticized for focusing mostly on big businesses, and the prime minister said the latest stimulus effort is part of the second phase of his economic plan, which centers on “inclusion.”

### Japanese Gross Domestic Product

December 2012 - September 2015



Source: FactSet

In the eurozone, GDP in the bloc's 19 countries rose at an annualized rate of 1.2% in the third quarter, the weakest performance since the third quarter of 2014. Weak growth has left the eurozone economy 0.5% smaller than it was at its largest in the first three months of 2008. This, along with persistently low inflation, led European Central Bank (ECB) President Mario Draghi to reassert during November his commitment to providing additional stimulus if necessary. Draghi stated that an expansion of the ECB's bond purchase program as well as other measures would be on the table in December. One piece of positive economic news for the eurozone was a flash reading of the composite purchasing managers' index (PMI) indicating it reached its highest level since May 2011. Both the manufacturing and services indices rose, pointing to broad-based expansion.

Finally, the International Monetary Fund (IMF) announced that next year it would add the Chinese renminbi (or yuan) to the basket of currencies—joining the dollar, pound, euro, and yen—that make up its Special Drawing Rights (SDR), which can act as an international reserve currency. China had lobbied hard to be included in the SDR, treating it as a marker of international prestige and acceptance as it continues to reform its economy. At this point discussion about what might happen with the renminbi moving forward is speculative in nature, but if the Chinese government is committed to boosting the renminbi's usage in the long-term and achieving reserve currency status, it could hesitate to devalue its currency in the future, as that would negatively impact the reserves built up by foreign central banks.

## Our Perspective

Global equity markets were essentially flat in November following strong returns during October. Valuations in the broad U.S. stock market remain generally elevated, but we continue to see little evidence of excesses in the market or economy that would need to be unwound. In this environment, discernment and flexibility are critical.

Given the slow global growth environment, in portfolios geared toward investors that need capital growth, we are targeting investments in fundamentally strong businesses that are not heavily reliant upon macroeconomic growth to drive sales and earnings. More specifically, we see value in businesses that we believe have control of their destiny and are taking share in large established markets or are creating new markets on their own. The goal is to identify companies trading at attractive valuations relative to their growth potential.

For fixed income investors and investors with a shorter time horizon or current income needs, we continue to focus on opportunities we are seeing in investment-grade corporate bonds. A selective approach to the below investment-grade corporate space is helping us find value there as well, however opportunities are becoming more scarce as investors reach for yield. With regard to government debt, we continue to favor Agencies over Treasuries. In addition, we do not believe current yields in longer-term bonds are at levels to fully compensate for the risk that is present in today's interest rate environment and, as a result, our portfolios have a generally shorter duration than the benchmark. In our view, short-term and income-oriented investors should also explore equities that display stable fundamentals and are trading at attractive valuations. We believe companies that generate strong, stable cash flows and pay an attractive dividend could be compelling options for these types of investors in the current environment.

Source: FactSet. Analysis: Manning & Napier Advisors, LLC (Manning & Napier).

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