Economic Perspectives

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GLOBAL GROWTH DENTED, BUT NOT DERAILED.

Financial markets have been in turmoil recently, primarily due to concerns regarding the pace of growth in China. The Chinese economy has indeed faced some added challenges this year (some self-inflicted), but with most developed economies around the world experiencing reasonably solid economic conditions, the added "drag" from China and major commodity exporting nations should be manageable, in our view.

Over the last year, China's economic expansion has been tested by lackluster demand from its two largest export markets: the U.S. and Europe. Foreign demand for Chinese goods has also encountered a significant headwind from a seemingly unlikely source: the strong U.S. dollar. China unofficially pegs its currency to the U.S. dollar, so as the dollar rose rather sharply over the last year, the Chinese Yuan did as well making Chinese goods more expensive to potential foreign customers.

Despite its challenges, China is still growing at solid, albeit slower pace by most indications. Recent actions taken by the People's Bank of China (PBoC) and the Chinese central government should help stabilize near-term conditions, although these are by no means cure-all actions.

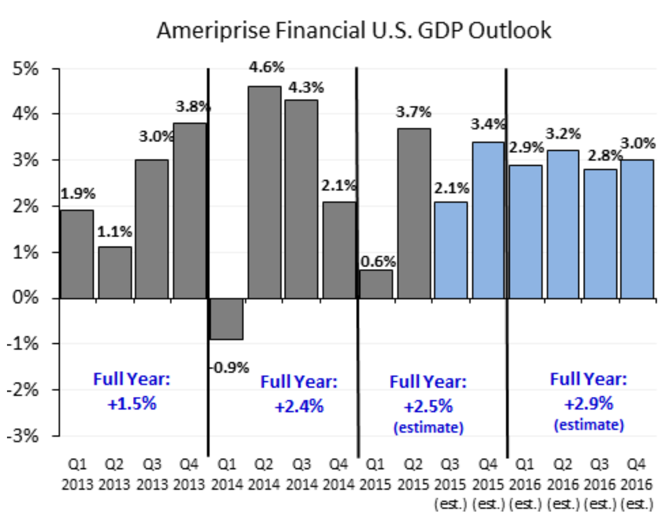
Overall, global economic prospects have likely been dented by recent developments, but not materially damaged, in our view. Most of the world's commodity-oriented economies, including such major markets as Brazil, Australia and Canada, are seeing substantial pressure from the combination of lower commodity prices and weaker demand. Over-time, however, lower commodity prices should be a benefit to consumer buying power in the world's major commodity importing regions, such as the U.S., Europe, Japan, China and India.

Adding to recent market volatility has been the prospect of a pending Federal Reserve interest rate hike. At this time, we believe Fed officials are likely to raise their short-term interest rate target at their December meeting. Historically, such moves have corresponded to heightened market volatility, but the impact on the economy is likely to be minimal.

Markets are likely to remain susceptible to instability until there is sound evidence that China has stabilized. Washington could also add to investor concerns over the near-term as elected officials must come to an agreement on a federal budget and once again lift the statutory debt ceiling. The surprise resignation of House Speaker John Boehner (effective October 30th) appears to improve the odds of a budget agreement (beyond just a short-term continuing resolution). However, the greater risk could be the debt ceiling if no deal is reached before Speaker Boehner leaves. The federal debt limit was reached in March and the Treasury Department has since been using "extraordinary measures" to keep operations funded.

Grinding the gears: The U.S. economy still finds it difficult to shift into a higher gear. Though frustrating, we believe underlying economic fundamentals are in good position to provide support amid periodic headwinds.

For the full-year, we now forecast U.S. Real Gross Domestic Product (GDP) growth of +2.5%. This would be generally in-line with last year's Real GDP pace of +2.4%, but shy of our outlook at the start of the year for U.S. Real GDP growth of +3.0%.

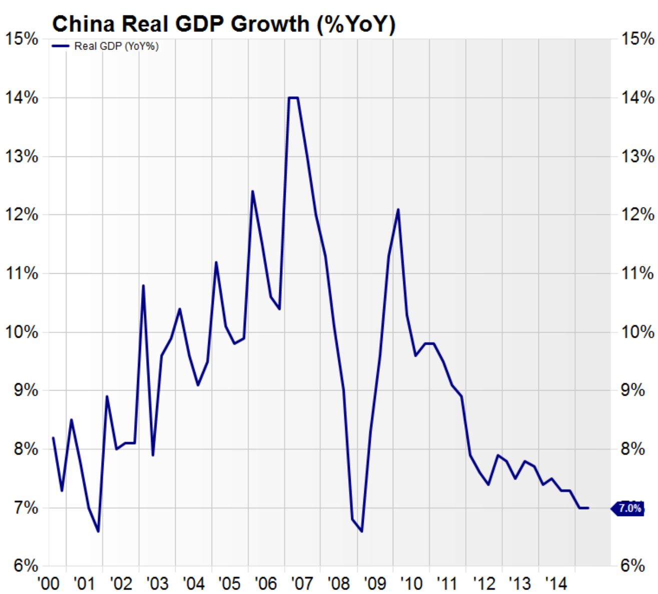


Source: Commerce Department, Ameriprise Financial Services, Inc.

A CLOSER LOOK AT CHINA.

The Chinese economy has been in the midst of a long-term deceleration trend for the last several years. This year, however, a number of incremental problems emerged to further challenge the country's pace of growth. A stronger currency has reduced export demand, misguided government policies strongly contributed to a stock market boom and bust, a crackdown on corruption has impacted consumption in some areas, and efforts to shift the economy away from a reliance on infrastructure spending and exports, to one more driven by domestic consumption, have all contributed to a shaky economic picture.

Official government data portray the country's year-over-year growth to have been near 7.0% in the first half of the year, thus in-line with central government's targets. Such reports, however, are viewed skeptically by most outside observers. There seems to be little doubt that China is still growing at a solid pace, but the 7% quote seems difficult to validate.



Source: FactSet

Likely the most significant "wrench" thrown into the China equation this past year has been the aforementioned rise in the value of the Chinese currency, the Yuan (also referred to as the renminbi, or people's currency). Through July, the U.S. dollar and the Chinese Yuan were both about 18% higher year-over-year (yr/yr) versus the Euro and Japanese Yen – making Chinese made goods that much more expensive to potential buyers in these foreign markets. It comes as little surprise then that Chinese exports to Europe (China's largest customer market) were down 15% yr/yr in July while its exports to Japan were also down 15%.

Government led efforts to reduce the country's reliance on infrastructure investment and exports also left the Chinese economy in somewhat of a fragile position this year. Over time, a greater reliance on domestic consumers should offer greater economic stability. Over the near-term, however, the downshift in infrastructure spending has weighed heavily on growth. The reduced need for mined commodities for such infrastructure as roads, bridges, residential housing and industrial complexes, has also had a significant negative impact on global commodity demand, pushing prices sharply lower and pressuring the world's commodity exporters.

Consumer spending, meanwhile, has been expanding at a solid, yet decelerating pace. Retail sales were up 10.8% yr/yr in August, but since the sector only accounts for approximately 36% of the total economy (in 2013, via World Bank) it is not large enough to fully offset the temperance of contributions from investment spending and exports. By comparison, consumer spending accounts for nearly 70% of economic activity in the U.S.

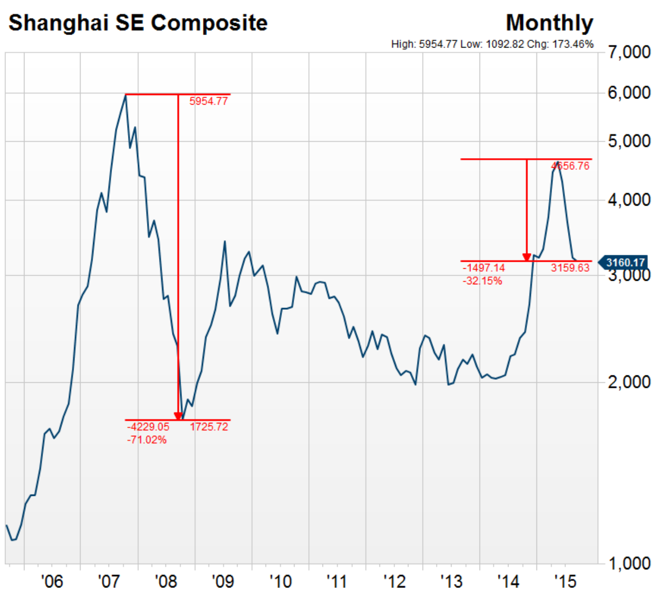
Source: FactSet

External implications: Currencies and commodities are key. China has grown to become the second largest economy in the world behind that of only the United States. Based on data from the International Monetary Fund (IMF), China accounted for 13% of global economic activity in 2014, as compared to the U.S.'s 23%. The European Union as a whole comprised 24%.

The slow-down in China will thus have an impact on the overall pace of global expansion, but most prominently on conditions in commodity-oriented economies. Although even if China were to grow by just 5% this year, it would still be the equivalent of adding another economy the size of Norway, Taiwan or Belgium.

Direct financial market "spill-over" threats, meanwhile, should be limited, in our view. China restricts foreign asset ownership, thus foreign entities own relatively little Chinese debt, equities or fixed assets. We note that financial asset ownership was the primary linkage for U.S. housing market problems to spread globally during the financial crisis.

China also contributed to its own problems over the last year by encouraging more of its citizens to invest in its domestic stock market. Unlike most developed financial markets, China's stock market has, in recent decades, shown little correlation with the country's actual underlying economic activity. Additionally, foreign investors are highly restricted in their access to the country's main domestic bourses, leaving markets to be dominated by Chinese citizens, the vast majority of whom have very little experience in asset ownership, let alone stock market investing.



Source: FactSet

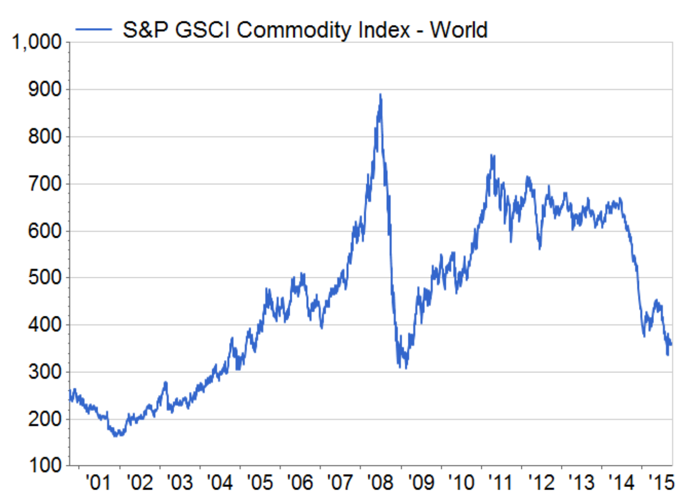
The recent boom and bust of the Shanghai SE Stock Exchange was, in fact, the second such boom and bust cycle of the past decade; and surprisingly, the lesser of the two. From late 2005 to late 2007 the Shanghai SE Composite jumped a remarkable 445% only to drop by 71% through the fall of 2008 (see chart above). By comparison, the recent 125% gain and subsequent 31% decline through the end of August seems downright tame.

How concerned should we be about China's long-term deceleration? China's near-term issues should not be confused with what we see as its natural, long-term deceleration trend. The law of large numbers, whereby percentage increases become more difficult as underlying numbers grow larger, will continue to constrain its growth rates, now and into the future.

Dissecting this concept a bit further also reminds us that weaker growth rates can, in fact, equate to stronger growth in absolute terms. For example, ten years ago (2005), the Chinese economy grew by 11.3%, from 7.5 trillion Yuan to 8.3 trillion Yuan (a nominal increase of +800 billion Yuan). Even if China were to grow by just 5% this year it would equate to an expansion of 1 trillion Yuan – a larger gain in absolute terms than that recorded in 2005 when the country's growth rate was 11.3%.

Additionally, although growth in the Chinese economy will likely prove challenged over the intermediate-term, we believe the country still has ample fuel to maintain a fairly solid pace of growth for some time. One of the primary drivers of China's rapid expansion over the last few decades has been a government encouraged migration of people from rural areas into cities where people are much more productive, require more goods and services, and have greater opportunity to attain a higher standard of living.

This has been called the greatest peacetime migration in human history and given the current rural /urban distribution, likely has many more years to run. According to *The Wall Street Journal*, approximately 20 million people a year move from the country-side to cities in China. The migration, however, does offer its risks. Previously, many migrants entering urban areas found jobs in relatively well-paying construction or manufacturing jobs – the same segments where employment is now slowing amid the heightened focus on expanding services and consumption.



Source: FactSet

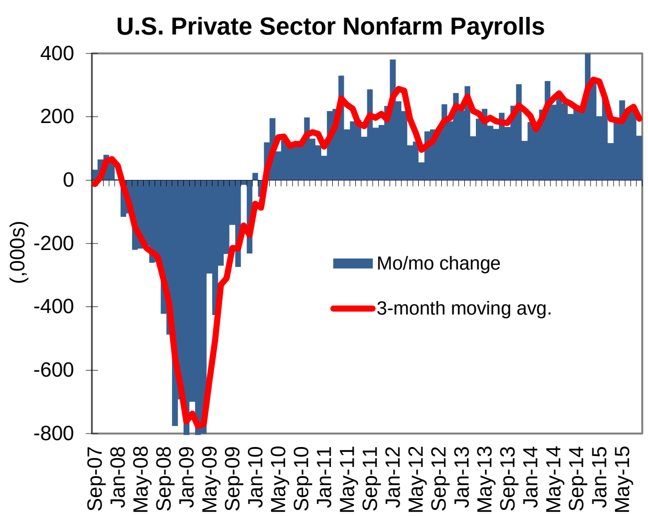
U.S. GROWTH REMAINS FAIR, BUT FAR FROM ROBUST.

Strong fundamentals provide a sound base for U.S. economic prospects, but the negative influence of the strong U.S. dollar appears to be growing.

Here in the U.S., economic activity remains solid, yet far from strong. In the second half of the year we expect activity should continue to see solid support from good consumer fundamentals and further recovery in the housing market, but headwinds from weaker export demand and the need for business inventory cuts.

As is always the case, employment is at the center of intermediate-term economic prospects in our consumer driven society. Recently, job growth has been strong and we expect labor market conditions are likely to remain fairly strong. Businesses have been keeping a tight hold on current employees, as evidenced by new claims for unemployment insurance which have been exceptionally low. Demand for labor also remains strong with the number of job openings in the economy hitting an all-time high of 5.75 million in August (the series was initiated in December 2000).

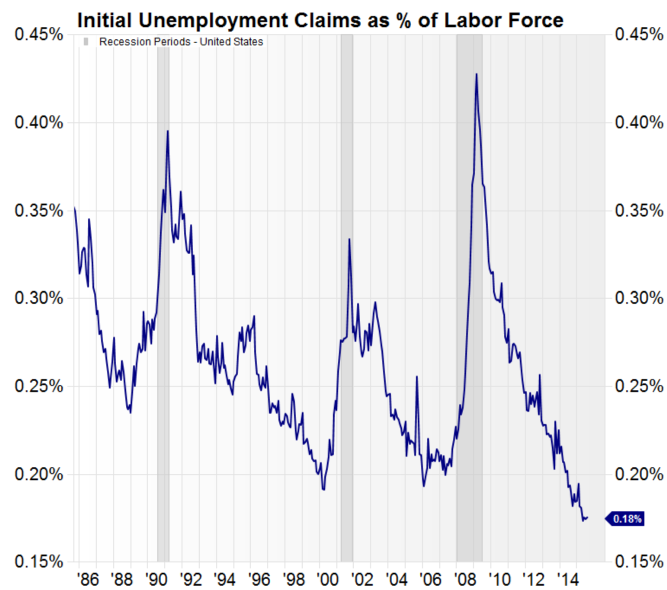
Through the first eight months of 2015, the U.S. economy added 1.7 million net new jobs for a monthly average of 212,000. This is down from the 260,000 /month average registered in 2014, but consistent with our expectations coming into the year. Some moderation of job growth was to be expected, in our view, as the economic recovery matures and labor slack is reduced. We still expect the economy to generate approximately 2.7 million net new jobs for the full year and for wage inflation to gain further traction as additional slack is removed from the market.



Source: Labor Department, Ameriprise Financial Services, Inc.

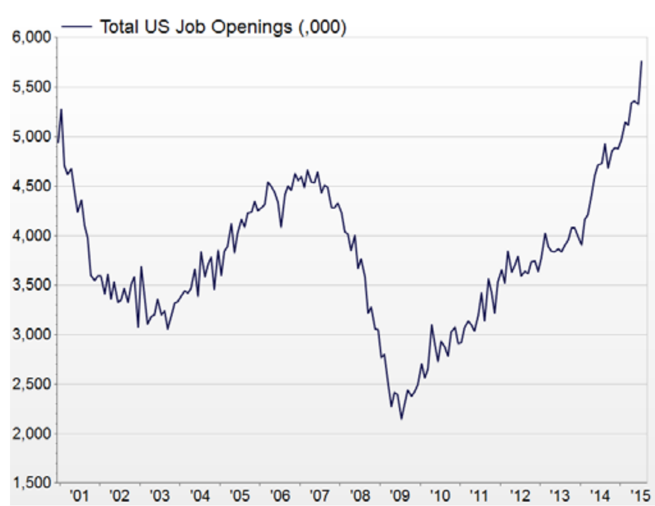
Initial unemployment claims: New claims for unemployment insurance are at 15-year lows as of this writing (on a 4-week moving average basis). In fact, the last time unemployment claim levels were this low was 2000, when the unemployment rate was 4.0%.

As seen in the chart below, new claims measured against the size of the underlying labor force are even more impressive – currently well below levels seen even during the economic boom years of the late 1990's.



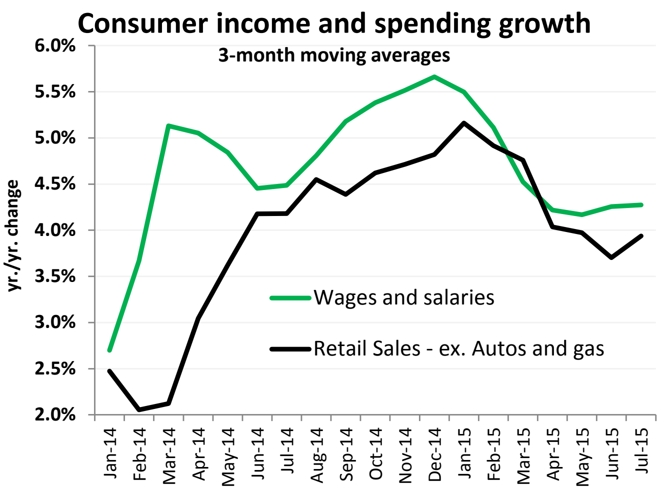
Source: FactSet

Meanwhile, the current level of job openings is also at an all-time high. Not only did the total number of openings hit a record in August but the job openings rate (i.e. the number of job openings in comparison to the underlying size of the current labor force) did as well.



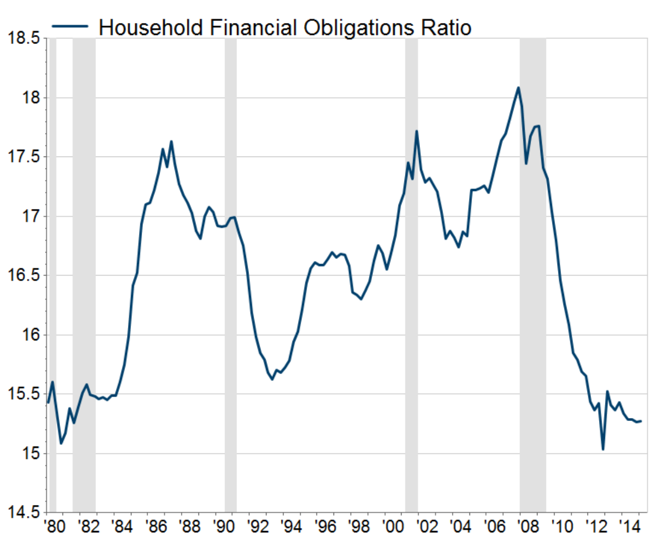
Source: FactSet

As labor markets continue to tighten, we're also seeing signs of better wage and salary growth. During the recession, businesses had little incentive to hike wages given the substantial slack in labor markets. Now, as labor availability consistently tightens on a monthly basis, companies have been compelled to hike wages in order to attract or keep desirable employees. Over the first half of the year, however, wage gains were pressured somewhat by heavy job losses in the high-wage oil and gas sector.



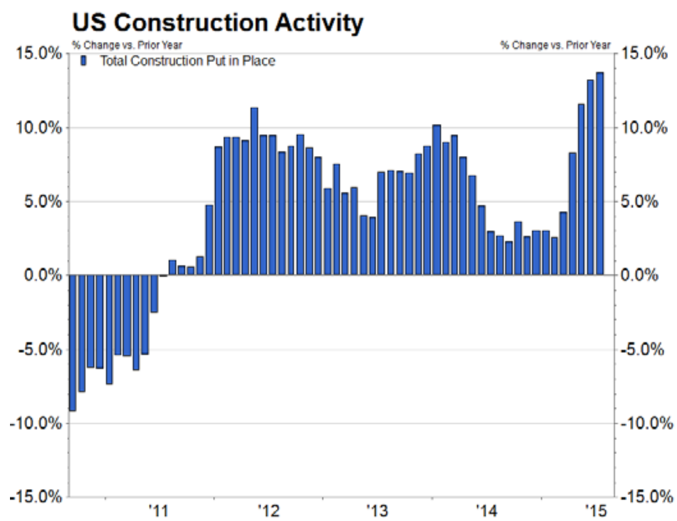
Source: Commerce Department, Ameriprise Financial Services, Inc.

Consumer balance sheets are also in very good shape. Home values continue to rise and debt levels, in comparison to disposable income levels, are in their best position in decades, according to the Federal Reserve's Financial Obligations Ratio (see chart below).



Source: FactSet

The Financial Obligations Ratio is currently near its lowest levels since the Fed initiated the metric in 1979. The ratio looks at required consumer debt payments as a percentage of aggregate disposable income. The debt payments considered include: mortgage /rent payments, property taxes, auto lease payments, homeowners' insurance and consumer debt payments. Additionally, the Fair Isaac Corporation (creators of the FICO Score) recently noted that average American credit scores are at their highest levels in at least 10 years.



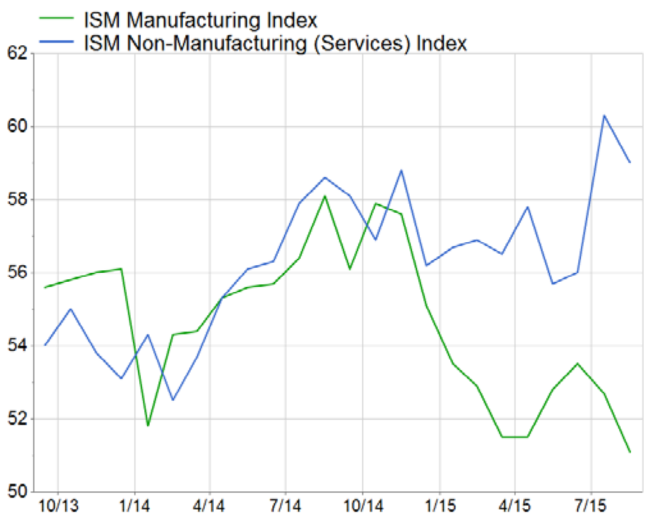
Source: FactSet

Although we believe there are considerable positives in support of current economic activity, there are clearly challenges as well. Manufacturing activity, in particular, has come under pressure from a variety of factors: lower export demand due to the strong U.S. dollar, reduced demand from the domestic oil and gas sector, and recently, the need for some trimming of business inventories.

The pressure on exports is likely to remain a headwind for the foreseeable future and could even intensify as further supply chain adjustments take effect. Inventory adjustments, meanwhile, can be abrupt but quickly addressed. Within our GDP model, we currently see business inventory reductions shaving a sharp 1.8 percentage points off of GDP in the third quarter.

A tale of two sectors: Manufacturing activity has languished but activity in the nation's vast services sector has been strong.

Business activity surveys from the Institute of Supply Management (ISM) reflect the current stress of manufacturing activity. As seen in the chart below, U.S. manufacturing activity (green line) grew at a solid pace throughout most of 2014, but momentum ebbed as the dollar strengthened and oil prices dropped.



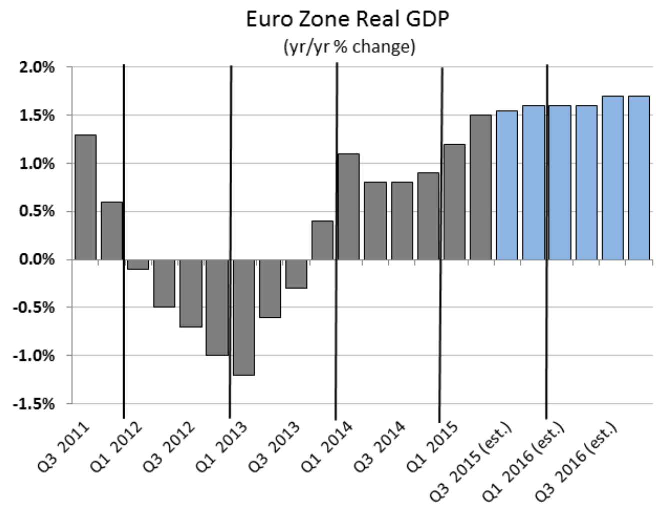
Source: FactSet, ISM

The ISM reports are diffusion indexes, meaning numbers above 50 indicate month-over-month expansion, while numbers below 50 indicate contraction. The reports thus suggest that U.S. manufacturing continues to expand on a month-over-month basis, though barely. We currently expect manufacturing to be flat to slightly lower in the second half of the year before seeing some modest improvement in 2016.

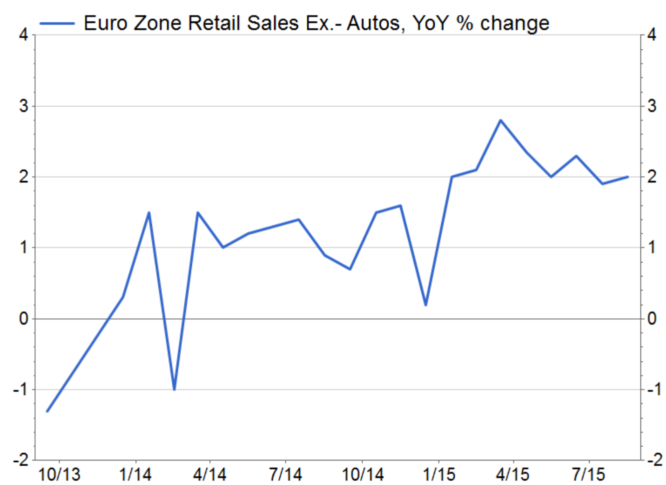
Services, meanwhile, (the blue line in the chart above) are much more reliant on domestic conditions and thus less susceptible to dollar related issues. As such, the sector, which accounts for approximately 80% of U.S. economic activity, has been fairly resilient, if not encouraging over recent months.

EUROPE CONTINUES TO SEE SLOW IMPROVEMENT.

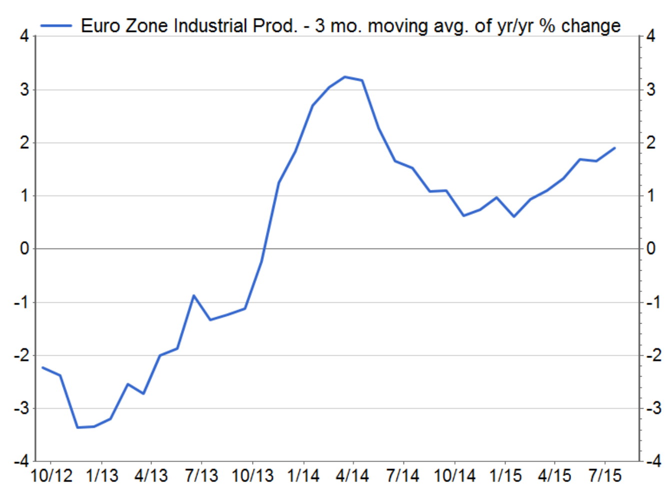
Lost amid the focus on China, economic activity in the world's largest economic region, Europe, continues to improve. While the stronger dollar has been an impediment to growth here in the U.S., the opposite has been true in Europe. A weaker Euro (down 11% yr/yr versus the U.S. dollar through September 25th) has bolstered demand for Euro Zone made goods and stimulated a strong summer tourist season.



Source: Euro Stat, consensus estimates from Bloomberg



Source: FactSet



Source: FactSet

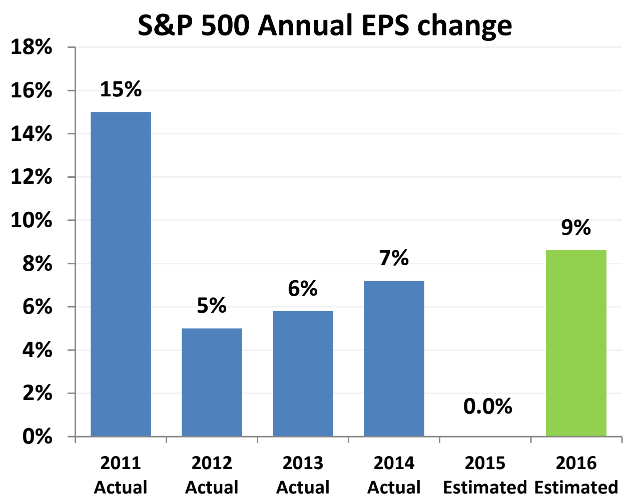
CORPORATE PROFITS: THE BRIDGE BETWEEN THE ECONOMY AND EQUITY MARKETS.

S&P 500 earnings per share (EPS) were basically flat over the first half of the year. Sharply lower earnings in the energy sector (where profit results were down 57% yr/yr on average) accounted for much of the pressure on overall results. According to Bloomberg, S&P 500 EPS would have been a fair 6.3% higher over the first half if the energy sector alone is excluded from results.

Notably, energy sector comparisons become easier after the current quarter (Q3-2015); and the sector could become a tailwind for aggregate earnings in 2016.

The strong U.S. dollar has also weighed on the results of U.S. multinationals over the last few quarters as foreign earned income translates into fewer U.S. dollars at the time of financial reporting. Weaker commodity prices, meanwhile, have also been a detriment to profitability in the materials sector.

Corporate earnings will see further pressure from these factors in the third quarter, but beyond that the strong headwinds from each of these factors should begin to abate. In 2016, we believe these factors could even act as a solid tailwind for corporate results, as reflected in current consensus estimates for 2016 S&P 500 EPS growth of +8.6%.



Source: FactSet

Year-over-year Operating EPS growth: Actuals and Estimates:

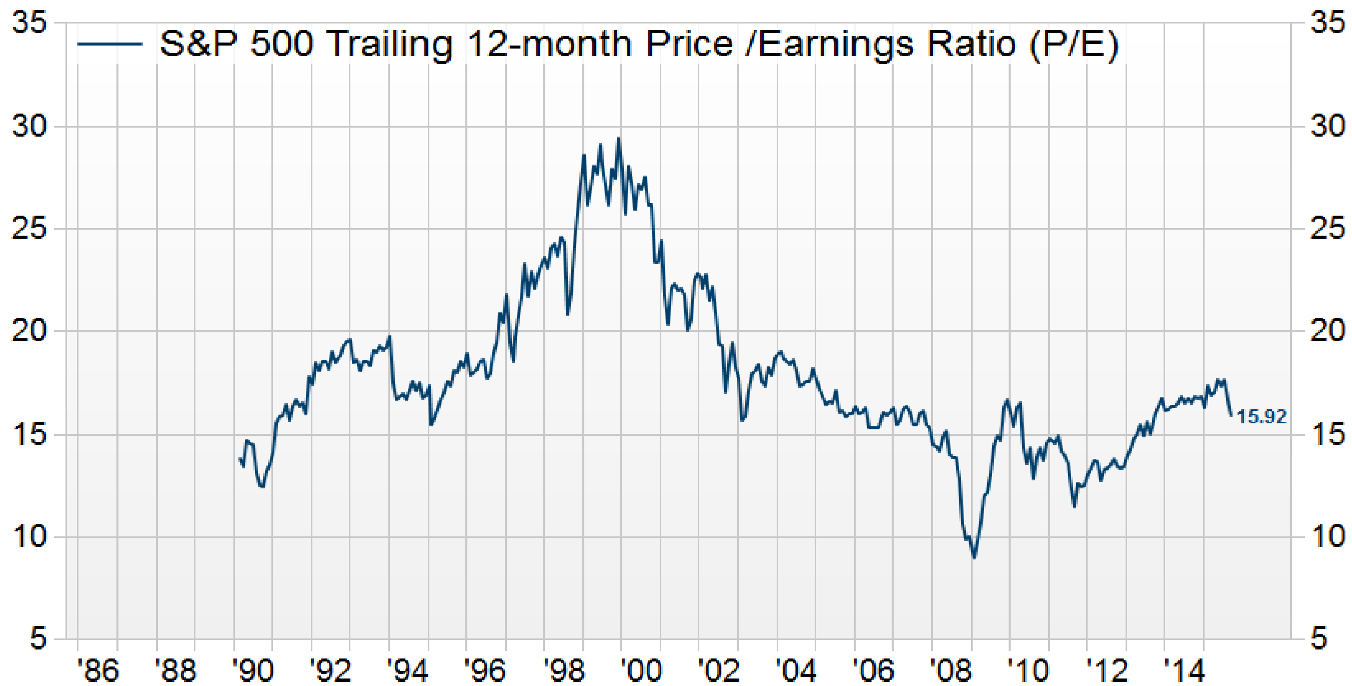
	Q1-2014 ACTUAL	Q2-2014 ACTUAL	Q3-2014 ACTUAL	Q4-2014 ACTUAL	Q1-2015 ACTUAL	Q2-2015 ACTUAL	Q3-2015 Estimate	Q4-2015 Estimate	Calendar 2014 ACTUAL	Calendar 2015 Estimate	Calendar 2016 Estimate	Forward P/E
Consumer Cyclical	7%	12%	8%	5%	9%	11%	12%	13%	10%	10%	15%	17.8
Consumer Staples	6%	8%	7%	-4%	2%	3%	-5%	1%	5%	-1%	7%	18.9
Energy	0%	18%	10%	-19%	-58%	-56%	-65%	-60%	1%	-60%	10%	27.1
Financials	4%	6%	11%	-15%	9%	0%	-3%	16%	3%	5%	9%	12.8
Health Care	7%	18%	17%	21%	21%	15%	7%	8%	17%	12%	10%	15.2
Industrials	5%	13%	11%	12%	9%	1%	1%	3%	11%	4%	8%	14.2
Materials	0%	12%	20%	1%	2%	9%	-13%	3%	8%	0%	16%	13.8
Technology	3%	9%	5%	14%	10%	10%	3%	2%	8%	6%	8%	15.1
Telecom	40%	39%	7%	9%	5%	10%	12%	17%	22%	10%	4%	11.6
Utilities	22%	3%	4%	2%	6%	6%	0%	-3%	8%	2%	4%	15.9
S&P 500 Total	**6%**	**12%**	**10%**	**3%**	**2%**	**-1%**	**-5%**	**4%**	**7%**	**0%**	**9%**	**16.1**
S&P 500 Trailing 12-month Operating EPS	$112.14	$115.29	$118.04	$118.67	$119.20	$119.02	$117.35	$118.54	$118.67	$118.54	$128.79	

Source: Thomson Reuters Baseline, Ameriprise Financial Services, Inc.

Stock market valuations have improved considerably over the last two months amid flat earnings and lower equity prices. At 15.9 the trailing price-to-earnings multiple for the S&P 500 is currently below its long-term average of 16.5 as measured by Ibbotson's.

Although we believe current valuations are relatively attractive and open to some upside should corporate earnings growth improve, we believe stock market performance over the intermediate-term is likely to be primarily reflective of corporate profit growth.

S&P 500 Price to Earnings (P/E) valuation level:



Source: FactSet

S&P 500 earnings outlook:

S&P 500 Earnings Estimates	2013	2014				2015				2016			
9/28/2015	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Est.	Est.	Est.	Est.	Est.	Est.
	FY	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Quarterly $$ amount		**$28.15**	**$30.20**	**$30.69**	**$29.63**	**$28.68**	**$30.02**	**$29.02**	**$30.82**	**$29.85**	**$31.68**	**$32.73**	**$34.53**
change over last week		na	na	na	na	na	na	-$0.22	-$0.22	-$0.78	-$0.69	-$0.73	-$0.71
yr/yr		**6%**	**12%**	**10%**	**2%**	**1.9%**	**-0.6%**	**-5%**	**4%**	**4%**	**6%**	**13%**	**12%**
qtr/qtr		-3%	7%	2%	-3%	-3%	5%	-3%	6%	-3%	6%	3%	5%
Trailing 4 quarters $$	**$110.66**	**$112.14**	**$115.29**	**$118.04**	**$118.67**	**$119.20**	**$119.02**	**$117.35**	**$118.54**	**$119.71**	**$121.37**	**$125.08**	**$128.79**
yr/yr	**5.8%**				**7.2%**				**-0.1%**				**8.6%**
Implied P/E based on													
a S&P 500 level of: **1882**							15.8	16.0	15.9	15.7	15.5	15.0	14.6

Source: FactSet

SUMMARY.

China's rapid pace of economic expansion has contributed more to global growth than any other nation over the last decade, according to the IMF. As such, it should come as little surprise that its difficulties this year have created concern. But this is certainly not just a China story. The double impact of slower Chinese exports and reduced Chinese infrastructure investment have had a strong negative impact on China's raw material needs – a development that is hitting many commodity-oriented economies around the world rather hard.

Rapid growth in Chinese demand for commodities helped fuel strong growth in many countries over the last two decades. The somewhat sudden decline in demand and prices therefore is likely to strain global growth over the intermediate-term. Commodity-exporting countries and areas such as Australia, Canada, Africa, Russia, Latin America and OPEC producers, are already seeing such burdens.

Eventually, however, lower commodity prices should be added fuel for the ongoing expansion in many of the world's major economic regions that are net commodity importers; areas such as: the U.S., Europe, Japan, India and China. Combined, these areas accounted for 69% of world GDP in 2014, according to IMF data.

Overall, we believe global economic growth prospects have likely been dented as a result of recent turmoil with commodity producers suffering much of the damage. Companies that sell into these markets are also likely to face a continuing headwind.

In conclusion, we would be much more worried about recent market volatility and implications out of China, if it were not for what we see as strong underlying economic fundamentals, here in the U.S. After several years of deleveraging, consumer debt levels are arguably in their best position in more than three decades. Corporate balance sheets are also in strong condition, and earnings should become more attractive as pressures from energy, commodity prices, and the dollar, fade.

Our long-term view has not changed. We continue to believe the U.S. economy is well positioned for stronger growth when headwinds fade. This is not to say that we expect U.S. economic growth to be particularly "robust" anytime soon. We believe GDP growth is capable of reaching a potential average growth rate close to 3.0% over the next few quarters, and could be capable of maintaining a growth rate of 2.5% to 3.0% over the next few years. Such rates may be slower than many of us are used to seeing, especially during historical recovery periods. However, demographic considerations (i.e. slower population growth and an aging society), combined with what we see as the likelihood of slower credit expansion given the credit-induced crisis just experienced, should result in a moderate pace of potential growth going forward.

On a positive note, such conditions should foster a continuation of today's relatively modest inflation backdrop over the long-term, as well as keeping an upward bound on credit demand, and thus interest rates. Clearly the economy is not back to where many of us would like to see it, but we continue to make steady progress.

RISKS.

Though we have confidence in our forecast of a slower-than-desired, yet continuing, global recovery, we recognize that a number of serious economic and financial market challenges remain. Government debt loads remain exceptionally high in most of the world's developed economies. The hard choices associated with correcting these imbalances is likely to weigh on economic performance for some time; but allowing debt levels to continue higher would ultimately be much worse. Recent volatility in foreign market capital flows, as well as wide currency swings that correspond with such, are also an economic risk that bears careful watching.

Additionally, we are still in unchartered territory in terms of potential policy response should the economic recovery falter. Monetary and fiscal policy, the traditional levers of stimulus employed to counter a downturn, are largely exhausted. Interest rates have very little room to go lower and government debts are already on an unsustainable path. Should another adverse global economic shock occur over the intermediate-term, there is little government officials could do to directly counteract the results.

Geopolitical risks (Ukraine, Iraq /Syria, Russia, N. Korea) have arisen that could yet present stronger headwinds, but for now the impact of these issues on broader economic activity has been reasonably contained. There always have been problems for the global economy /capital markets to deal with, and there always will be.

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