

March 6, 2017

GDP Revision Underscores Challenges Facing New Administration

Real gross domestic product for 4Q16 increased 1.9%, according to the preliminary report issued on the final day of February, a number in line with the 1.9% gain indicated in the advance report issued late in January. Consumer spending was a little stronger in the advance report, while government spending and corporate capital spending were a shade weaker.

The puny low-single-digit growth rates expressed throughout the 4Q16 GDP report underscore the difficulty in lifting a large and complex economy to sustainable 3.0% growth. By some indications, the economy should be growing faster: U6 unemployment is low with many jobs unfilled, inflation is tame, and companies have invested in technology to improve efficiency and inform business decisions.

You could equally make a counter-argument that even 2% growth is a stretch. While a record number of Americans are working, high-quality jobs are scarce with many people living paycheck to paycheck. Too many citizens are financially unprepared for retirement or a family healthcare crisis. Generally tepid overseas economies result in limited demand for U.S. exports, particularly in the current strong-dollar phase.

While the 4Q16 GDP report contained few surprises, it is worth breaking down the individual components. Economists and political pundits will be analyzing the report to determine which areas are most likely to improve or deteriorate as the new Administration moves from vague pronouncements to concrete policy.

4Q16 GDP BY THE NUMBERS

Real GDP increased at an annual rate of 1.9% in 4Q16, according to the preliminary (second) estimate released by the Bureau of Economic Analysis within the Department of Commerce. That was down from 3.5% final GDP growth in

3Q16. The preliminary 1.9% gain lines up with the 1.9% gain reported in the advance (first) estimate. There are differences in the numbers in the preliminary report compared with the advance report, but few significant revisions and no major swings.

The BEA report summarizes the drivers of absolute growth as well as causes for relative decline from the higher 3Q16 reading. Real GDP increased in 4Q16 based on positive contributions from personal consumption expenditures, private inventory investment, residential and non-residential fixed investment, and state and local government spending. Real GDP in 4Q decelerated from the 3Q level primarily because of lower exports & higher imports along with lower federal government spending. Key indicators of the consumer and business economy, such as PCE and nonresidential fixed investment, were also down in 4Q from the summer quarter.

The fourth quarter also marked a step-up in pricing pressure, as the price index for gross domestic purchases increased 1.9% in 4Q16 versus 1.5% in 3Q16. Similarly, the consumer (PCE) prices index was up 1.9% in 4Q16 versus 1.5% in 3Q16. A key driver of this apparent inflation was higher fuel costs; excluding food & energy prices, the PCE price index was up 1.2% in 4Q16 versus 1.7% in 3Q16.

In 4Q16, personal consumption expenditures (PCE) were up 3.0%, better than the 2.5% growth shown in the advance report. This metric on consumer spending captures about 70% of all spending in any quarter. Breaking down PCE further, consumer spending on goods was up 5.7%; this includes autos and home furnishings. Spending on services, ranging from haircuts to legal services to dining out and everything in between, was up just 1.8%.

(continued on next page)

ECONOMIC & MARKET COMMENTARY (CONT.)

Gross private domestic investment, which captures consumer and business spending on structures, equipment and intellectual property, was up a healthy 9.2%. Almost all of that came from 9.6% growth in residential investment, which principally is driven by housing. Residential investment was likely inflated by pent-up demand, having bounced back from negative readings (-7.7% in 2Q16 and -4.1% in 3Q16) that were largely weather-related.

Investors fixate on non-residential fixed investment because this metric is regarded as a proxy for corporate capital spending. Non-residential fixed investment disappointed with just 1.3% growth; this had previously been reported up 2.0%. This metric was dragged down by a 4.5% decline in spending on non-residential structures, as commercial construction slowed in the October through December period.

The export-import balance in the preliminary report was better than in the advance report but meaningfully worse than in 3Q16. Exports declined by 4% in 4Q after growing by 10% in the third quarter. Imports, which are subtractive to GDP, reflected 8% growth in 4Q, not the originally reported 11% surge. Still, imports were up sharply in 4Q after growing less than 1% in 3Q16.

Total federal government spending declined by 1.2% in 4Q16, pulled down by a 3.6% reduction in defense spending. State & local government spending increased 1.3% in 4Q16, better than the previously reported 1.0% gain.

Those looking for silver linings in the GDP report pointed to the 5% gain in gross domestic income (GDI), which was the best growth since 3Q14. The average of current dollar GDP (not inflation-adjusted) and GDI was 4.3% in 4Q16, also the highest since 3Q14. Additionally, gross national product (GNP), which is the sum of GNP plus net income from foreign investments, was up 3.4%, its best growth since 3Q14. This number signals the importance of U.S. participation in the global economy and the risk that border tariffs could trigger a trade war.

CONCLUSION

As of the end of 2016, U.S. GDP was \$18.9 trillion, a mind-boggling number that unfortunately about matches the national debt. Consistent with the advance report, the prelimi-

nary 4Q16 report confirmed that GDP increased 1.6% for all of 2016, which was down from 2.6% for 2016. Last year was also the eleventh consecutive year in which GDP failed to reach 3.0% or more for the full year. While few voters likely read the BEA's full GDP report, the sense that "something's not right" likely explains the November election outcome that caught so many professional pollsters by surprise.

The 4Q16 GDP report will be the final report identified with the former administration. The new administration will be associated with 1Q17 GDP, for better or worse. The new team and its fiery leader President Trump have promised a transformative agenda. But as we and others have pointed out, the chief elements of economic transformation – new tax policy, new healthcare policy, and infrastructure spending – are interconnected in ways that make it difficult to move forward on any one issue without presenting an integrated solution that encompasses all elements in a single master plan.

Delivering on real change in spending priorities will be a complex, daunting, and mainly slow process. For example, the administration has promised a 10% hike in military expenditures for the October 2018 fiscal year. But Congress is not going to blithely approve unfunded hikes in defense spending knowing that affected constituencies (backed by their own members) will fight against cuts in every non-defense expenditure. Making a promise is not the same as making it happen. Actually growing the Navy from 276 ships to more than 300 ships will take a decade or more.

The key elements in any GDP report are consumer spending, non-residential fixed investment, and the import-export balance. A positive message from Washington will keep consumers confident and spending and will give companies the confidence to invest, while clarity on trade will prompt corporations to maintain the global investment required to drive export growth.

Playing to the base with diatribes against foes risks exacerbating Wall Street's impatience with the slow pace of change. In summary, while waiting for the President and Congress to construct policy, it is important for Wall Street that the President presents a coherent and integrated plan on tax reform, healthcare reform and infrastructure investment.

Jim Kelleher,
Director of Research

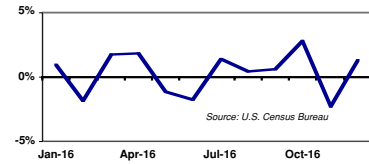
U.S. MACROECONOMIC DATA SHEET

	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17
Consumer Confidence, Conference Board	94	94.1	94.7	92.4	97.4	96.7	101.8	103.5	100.8	109.4	113.3	111.8	N/A
Consumer Expectations, U Michigan	81.9	81.5	77.6	84.9	82.4	77.8	78.7	82.7	76.8	85.2	89.5	90.3	86.5
Consumer Sentiment Index, U Michigan	91.7	91	89	94.7	93.5	90	89.8	91.2	87.2	93.8	98.2	98.5	96.3
Leading Economic Indicators	0.0%	0.0%	0.0%	-0.2%	0.5%	-0.1%	0.2%	0.2%	0.5%	0.2%	0.5%	0.6%	N/A
CRB Futures Index	163.22	170.52	184.61	186.15	192.57	181.01	180.21	186.32	186.28	189.31	192.51	192.04	N/A
LME Copper (USD/Metric Tonne)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Crude Oil, WTI	\$33.75	\$38.34	\$45.92	\$49.10	\$48.33	\$41.60	\$44.70	\$48.24	\$46.86	\$49.44	\$53.72	\$52.81	N/A
Housing Starts (000)	1,213	1,113	1,155	1,128	1,195	1,218	1,164	1,052	1,320	1,149	1,279	1,246	N/A
Housing Permits (000)	1,162	1,077	1,130	1,136	1,153	1,144	1,125	1,225	1,260	1,212	1,228	1,285	N/A
New Home Sales (000)	525	537	570	566	558	622	559	568	568	575	535	555	N/A
Existing Home Sales	5,200	5,390	5,480	5,470	5,480	5,330	5,340	5,470	5,530	5,600	5,510	5,690	N/A
Construction Expenditures	1.1%	1.6%	-2.9%	0.1%	0.9%	0.5%	0.5%	-0.2%	0.8%	0.9%	-0.2%	N/A	N/A
Personal Consumption Expenditures	0.2%	0.0%	1.1%	0.3%	0.5%	0.4%	0.1%	0.7%	0.4%	0.2%	0.5%	N/A	N/A
Retail Sales	0.5%	-0.3%	1.2%	0.2%	0.7%	0.1%	0.0%	1.0%	0.7%	0.2%	1.0%	0.4%	N/A
Automotive & Lt. Truck Sales, Mins (SAAR)	17.54	16.73	17.46	17.22	16.69	17.77	16.91	17.65	17.91	17.75	18.29	17.48	N/A
Consumer Credit	6.4%	6.3%	6.4%	6.4%	6.0%	6.0%	6.3%	6.0%	6.0%	6.2%	6.4%	N/A	N/A
Industrial Production	-0.1%	-1.0%	0.4%	-0.1%	0.5%	0.3%	-0.1%	-0.3%	0.3%	-0.2%	0.6%	-0.3%	N/A
Capacity Utilization	75.6%	74.9%	75.2%	75.1%	75.4%	75.6%	75.5%	75.3%	75.5%	75.2%	75.6%	75.3%	N/A
ISM - Purchasing Managers Index	49.7	50.7	51	51	52.8	52.3	49.4	51.7	52	53.5	54.5	56	N/A
ISM - Production Index	52.9	55.7	54.6	52.7	54.8	54.8	49.3	53.3	54.4	55.6	59.4	61.4	N/A
ISM - Non-Manufacturing Index	58.3	59.7	58.8	56	58.8	58.9	52.4	59.8	58.1	60.3	60.9	60.3	N/A
Chicago-Area Purchasing Managers Index	49.3	53.1	50.7	50.3	55.5	54.6	51.6	54	51.8	57.2	53.9	50.3	N/A
Durable Goods Orders	-3.3%	2.0%	3.2%	-2.9%	-4.3%	3.6%	0.2%	0.3%	5.0%	-4.7%	-0.5%	N/A	N/A
Factory Orders	-1.9%	-1.7%	1.8%	-1.2%	-1.8%	1.4%	0.4%	0.6%	2.8%	-2.3%	1.3%	N/A	N/A
Philadelphia Fed BOS	-3.8	10.6	-1.2	-1.5	4.1	-0.9	4.3	11.6	11.1	8.7	19.7	23.6	43.3
Richmond Fed Manufacturing, Shipments	-9	22	13	-3	-8	7	-14	-4	2	1	12	13	N/A
Business Inventories	-0.1%	0.3%	0.1%	0.2%	0.2%	0.0%	0.2%	0.0%	-0.1%	0.8%	0.4%	N/A	N/A
PCE Deflator (YOY%)	0.9%	0.8%	1.0%	1.0%	0.9%	0.9%	1.0%	1.2%	1.4%	1.4%	1.6%	N/A	N/A
Core PCE Deflator (YOY%)	1.7%	1.6%	1.6%	1.6%	1.6%	1.7%	1.7%	1.7%	1.8%	1.7%	1.7%	N/A	N/A
Consumer Price Index %change	-0.1%	0.1%	0.3%	0.2%	0.2%	0.0%	0.2%	0.3%	0.3%	0.2%	0.3%	0.6%	N/A
Producer Price Index	-0.6%	0.0%	0.4%	0.5%	0.6%	-0.2%	-0.2%	0.5%	0.3%	0.2%	0.6%	1.1%	N/A
Import Price Index	-0.5%	0.4%	0.7%	1.2%	0.7%	0.1%	-0.2%	0.1%	0.5%	-0.1%	0.5%	0.4%	N/A
Export Price Index	96	95.9	96.4	97.5	98.2	98.4	97.5	97.9	98	98.1	98.5	98.6	N/A
Spot Gold, London PM Fixing	\$1,234.90	\$1,237.00	\$1,285.65	\$1,212.10	\$1,320.75	\$1,342.00	\$1,309.25	\$1,322.50	\$1,272.00	\$1,178.10	\$1,145.90	\$1,212.80	N/A
Nonfarm Payrolls, Monthly Change	237,000	225,000	153,000	43,000	297,000	291,000	176,000	249,000	124,000	164,000	157,000	227,000	N/A
Manufacturing Payrolls, Monthly Change	-12,000	-20,000	1,000	-21,000	12,000	12,000	-17,000	-12,000	-5,000	0	11,000	5,000	N/A
Challenger, Gray & Christmas Job Cuts	61,599	48,207	64,141	30,157	38,536	45,346	32,188	44,324	30,740	26,936	33,627	45,934	N/A
Unemployment Rate	4.9%	5.0%	5.0%	4.7%	4.9%	4.9%	4.9%	4.9%	4.8%	4.6%	4.7%	4.8%	N/A
Average Hourly Earnings	\$21.33	\$21.40	\$21.46	\$21.48	\$21.53	\$21.59	\$21.62	\$21.68	\$21.72	\$21.74	\$21.80	\$21.84	N/A
Personal Income	-0.1%	0.3%	0.7%	0.4%	0.4%	0.4%	0.2%	0.4%	0.5%	0.1%	0.3%	N/A	N/A
M-1 % Change (MOM%)	6.6%	15.9%	17.1%	18.5%	0.3%	-1.4%	32.7%	1.0%	4.0%	3.5%	-5.0%	26.4%	N/A
M-2 % Change (MOM%)	6.8%	7.1%	8.5%	7.2%	6.7%	5.9%	8.0%	5.7%	5.2%	7.3%	3.4%	7.8%	N/A
M-2, seasonally adjusted (yoY%)	5.7%	6.1%	6.5%	6.8%	6.9%	7.0%	7.2%	7.2%	7.6%	7.3%	7.1%	6.6%	N/A
U.S. \$ -- Trade Weighted Index (Broad)	123.8474	121.3586	119.4249	120.6839	121.1283	121.9666	120.8472	121.7757	122.9086	125.8049	127.7405	127.618	N/A
USD/Yen	112.69	112.57	106.5	110.73	103.2	102.06	103.43	101.35	104.82	114.46	116.96	112.8	N/A
USD/EUR	1.0873	1.138	1.1451	1.1132	1.1106	1.1174	1.1158	1.1235	1.0981	1.0589	1.0517	1.0798	N/A
U.S. Trade Deficit (blns\$)	-\$45.610	-\$37.281	-\$38.541	-\$42.186	-\$45.070	-\$39.977	-\$40.991	-\$36.516	-\$42.710	-\$45.730	-\$44.262	N/A	N/A

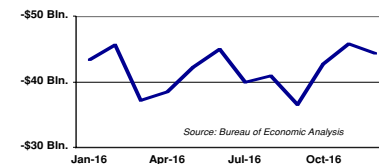
a/o February 24, 2017

ECONOMIC TRADING CALENDAR

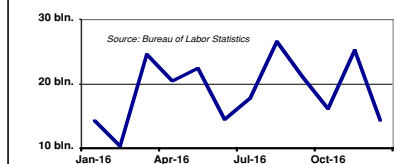
Release: **Factory Orders**
Date: 3/6/2017
Month: January
Previous Report: 1.3%
Argus Estimate: 1.4%
Street Estimate: 0.9%



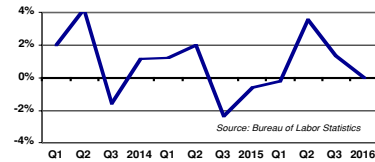
Release: **International Trade**
Date: 3/7/2017
Month: January
Previous Report: -\$44.3 Bln.
Argus Estimate: -\$43.0 Bln.
Street Estimate: -\$46.0 Bln.



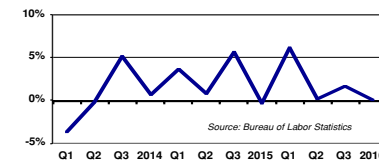
Release: **Consumer Credit**
Date: 3/7/2017
Month: January
Previous Report: \$14.2
Argus Estimate: \$14.5
Street Estimate: \$20.0



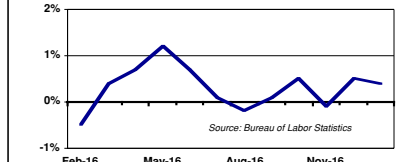
Release: **Non-farm Productivity**
Date: 3/8/2017
Month: 4Q
Previous Report: 1.3%
Argus Estimate: 1.4%
Street Estimate: 1.5%



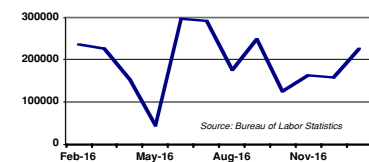
Release: **Unit Labor Costs**
Date: 3/8/2017
Month: 4Q
Previous Report: 1.7%
Argus Estimate: 2.0%
Street Estimate: 1.5%



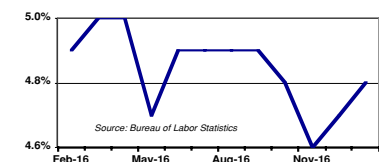
Release: **Import Prices**
Date: 3/9/2017
Month: February
Previous Report: 0.4%
Argus Estimate: 0.4%
Street Estimate: 0.1%



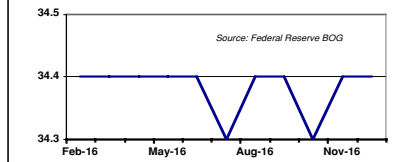
Release: **Non-farm Payrolls**
Date: 3/10/2017
Month: February
Previous Report: 227000
Argus Estimate: 200000
Street Estimate: 175000



Release: **Unemployment Rate**
Date: 3/10/2017
Month: February
Previous Report: 4.8%
Argus Estimate: 4.7%
Street Estimate: 4.7%



Release: **Average Workweek**
Date: 3/10/2017
Month: February
Previous Report: 34.4
Argus Estimate: 34.4
Street Estimate: 34.4



Previous Week's Releases and Next Week's Releases on next page.

ECONOMIC TRADING CALENDAR (CONT.)

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
27-Feb	Durable Goods Orders	January	-0.5%	0.5%	1.6%	NA
28-Feb	U.S. Gross Domestic Product	4 Q	1.9%	2.0%	2.1%	NA
	GDP Price Index	4 Q	2.1%	2.1%	2.1%	NA
	Wholesale Inventories	January	1.0%	1.2%	0.4%	NA
	Chicago PMI	February	50.30	NA	53.0	NA
1-Mar	Personal Income	January	0.3%	0.3%	0.3%	NA
	Consumer Spending	January	0.5%	0.4%	0.3%	NA
	ISM Manufacturing Index	February	56.0	55.0	56.0	NA
	Construction Spending	January	-0.2%	0.5%	0.7%	NA
	Beige Book Release	NA	NA	NA	NA	NA
2-Mar	ISM Non-Manufacturing Index	February	56.5	55.0	56.5	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
14-Mar	Producer Price Index	February	0.6%	0.5%	NA	NA
	PPI ex-Food & Energy	February	0.4%	0.4%	NA	NA
15-Mar	Empire State Manufacturing	March	18.7	NA	NA	NA
	Consumer Price Index	February	0.6%	0.4%	NA	NA
	CPI ex-Food & Energy	February	0.3%	0.3%	NA	NA
	Chicago PMI	February	50.30	51.30	NA	NA
	Retail Sales	February	0.4%	0.3%	NA	NA
	Retail Sales ex - Autos	February	0.8%	0.5%	NA	NA
	Business Inventories	January	0.4%	0.4%	NA	NA
	FOMC Rate Decision	NA	0.5-0.75%	0.5-0.75%	NA	NA
	Beige Book Release	NA	NA	NA	NA	NA
16-Mar	Housing Starts	February	1,246k	1,252k	NA	NA
17-Mar	Industrial Production	February	-0.3%	0.0%	NA	NA
	Capacity Utilization	February	75.3%	75.6%	NA	NA
	Leading Economic Indicators	February	0.6%	0.5%	NA	NA
	U. of Michigan Confidence	March	96.3	97.3	NA	NA

* Preliminary

** Advance

^Final

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