Normalization in a Divergent World

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WEALTH STRATEGIES

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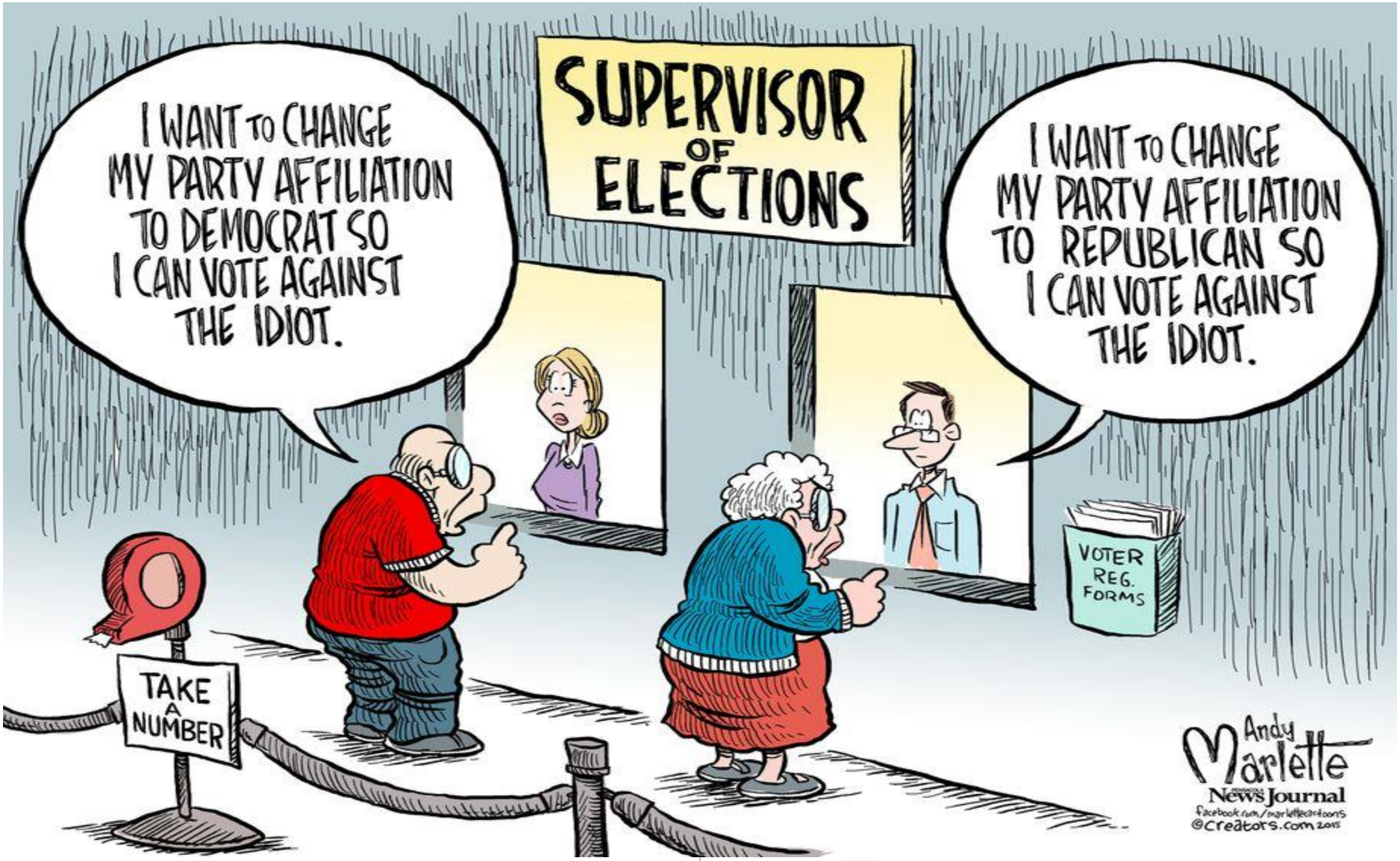
PLENTY TO TALK ABOUT

Diverge [dih-**vurj**, dahy-]

1. to differ in opinion, character, form, etc.; deviate.

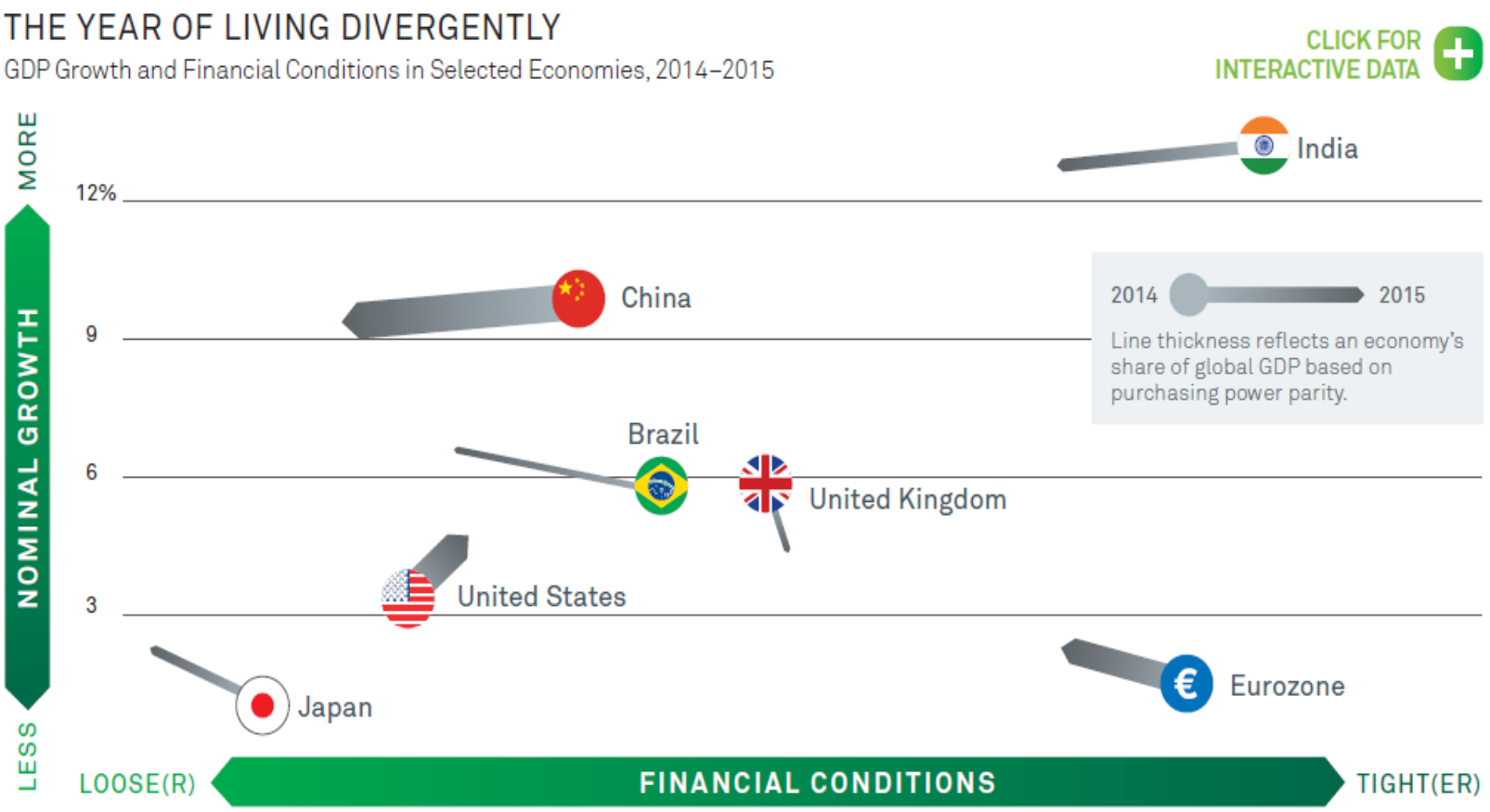
- Presidential Election
- Stock Market
- Global Macro Economy
- US Monetary / Fiscal Policy
- Regional/ Local Business Climate

PRESIDENTIAL ELECTION



Source: USAToday

Source: Marketwatch.com

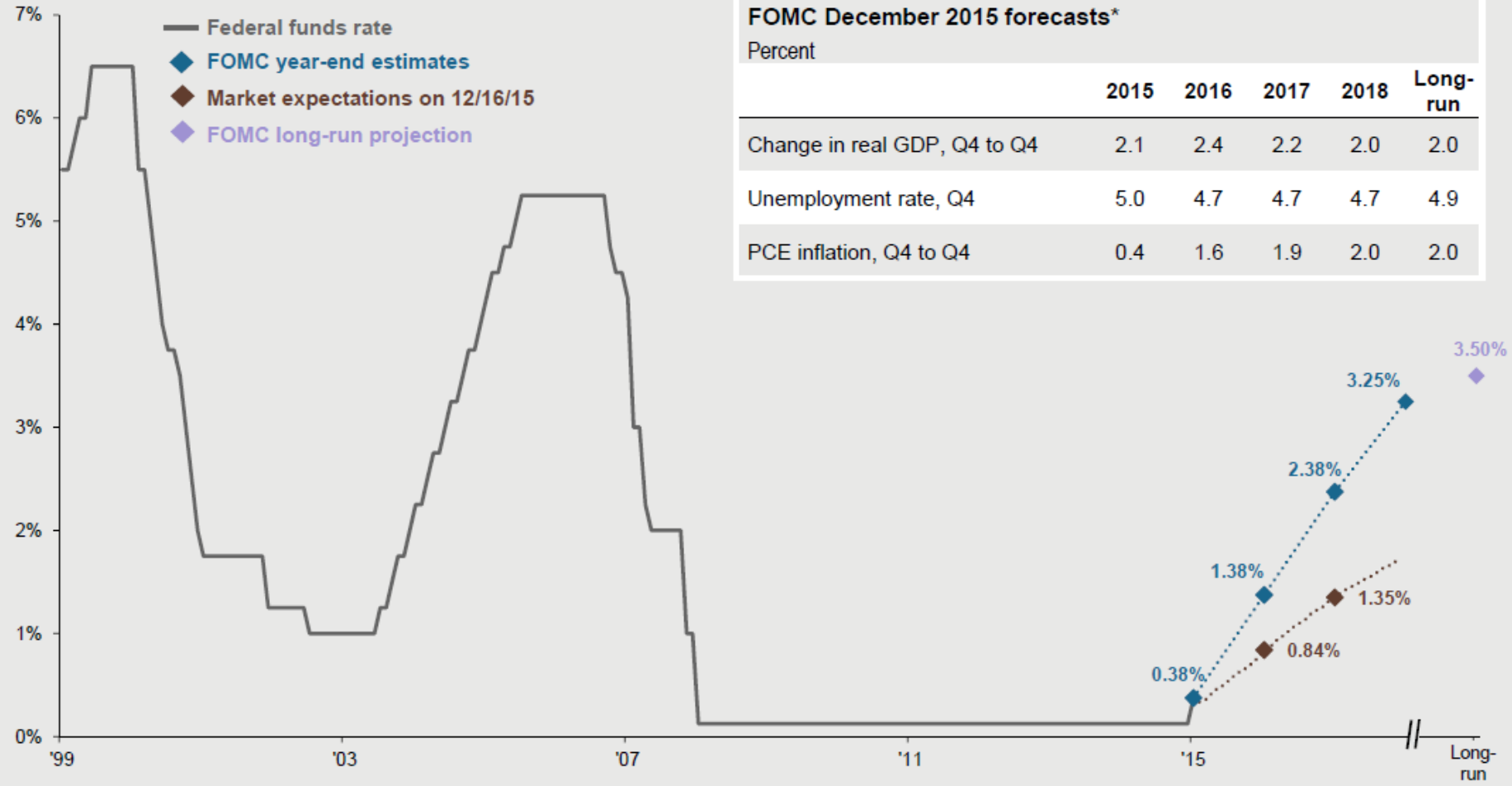


Stimulus - Interest Rates, Currency, Reserves & Oil

Likely Outcome - The Fed and Interest Rates

Federal funds rate expectations

FOMC and market expectations for the fed funds rate



FOMC December 2015 forecasts*

Percent

	2015	2016	2017	2018	Long-run
Change in real GDP, Q4 to Q4	2.1	2.4	2.2	2.0	2.0
Unemployment rate, Q4	5.0	4.7	4.7	4.7	4.9
PCE inflation, Q4 to Q4	0.4	1.6	1.9	2.0	2.0

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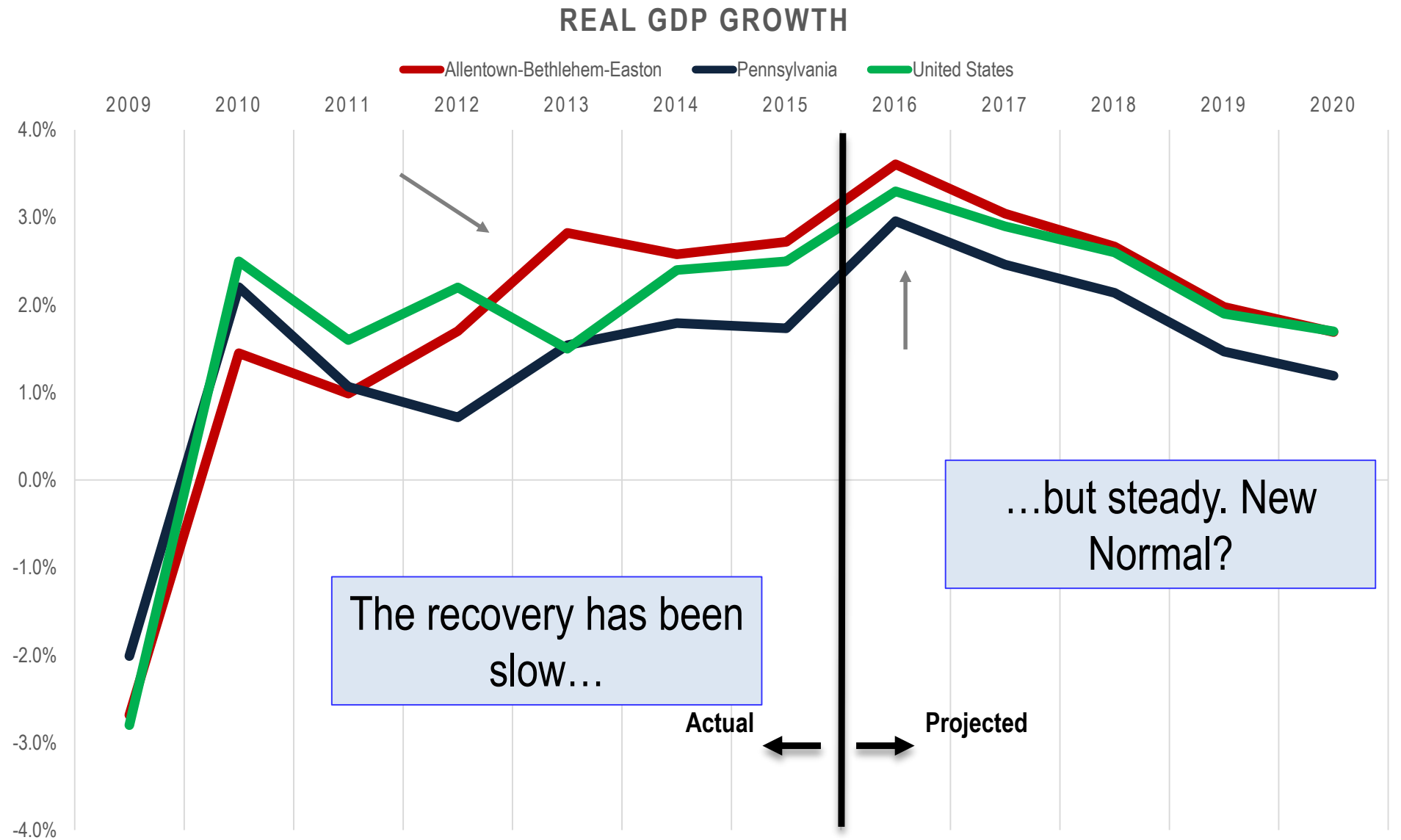
Source: JPMorgan Asset Management, FFA Investment Management

Risk of Raising Rates Too Slowly

- Economy Healthy Enough to Withstand Rate Hike and May Begin to Overheat
- Zero Policy No Longer Effective
- Inflation Picks Up and Overshoots the Fed's 2% Target
- Misallocation of Capital In Risk Assets

Lehigh Valley Area GDP Growth



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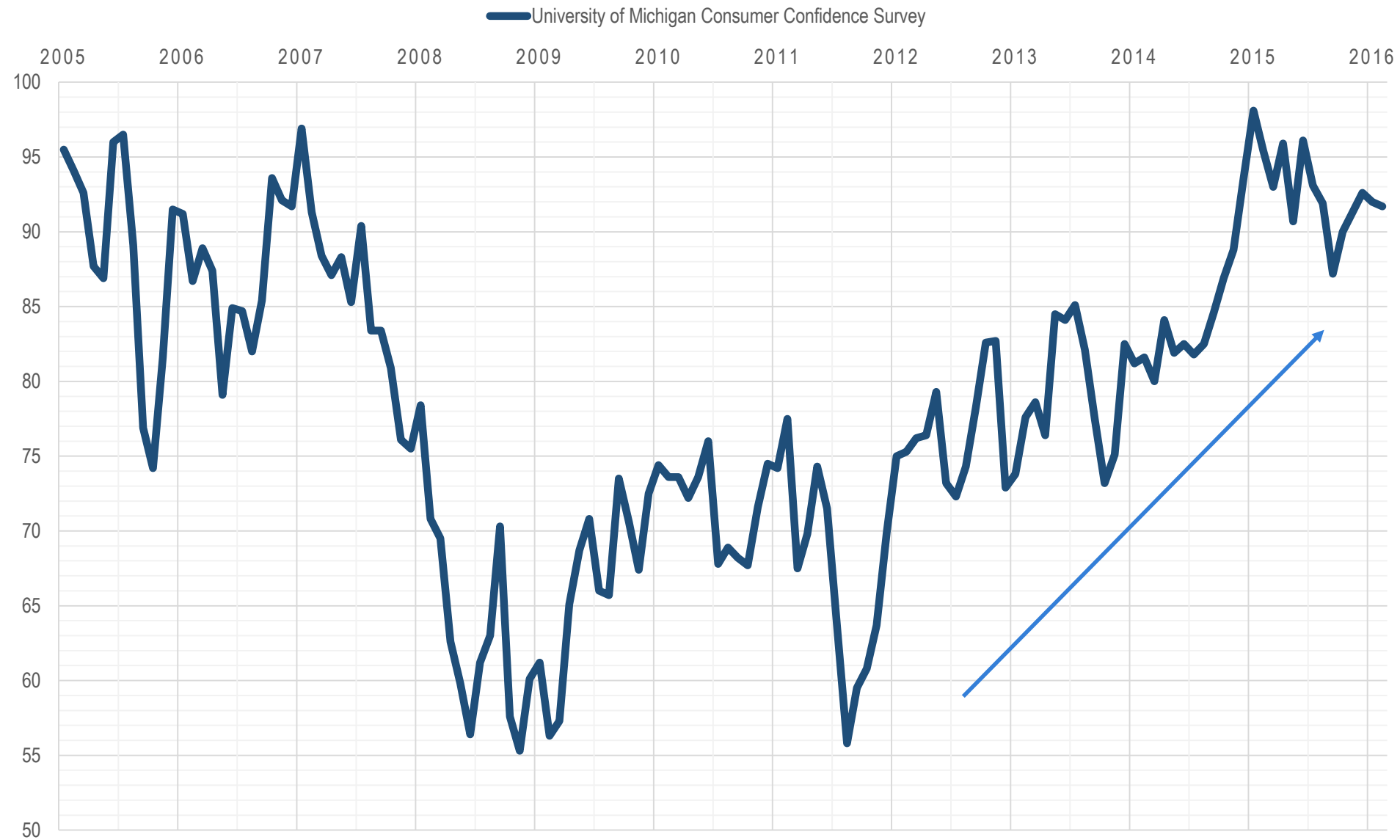
Source: Moody's Analytics, FFA Investment Management

Consumer Sentiment



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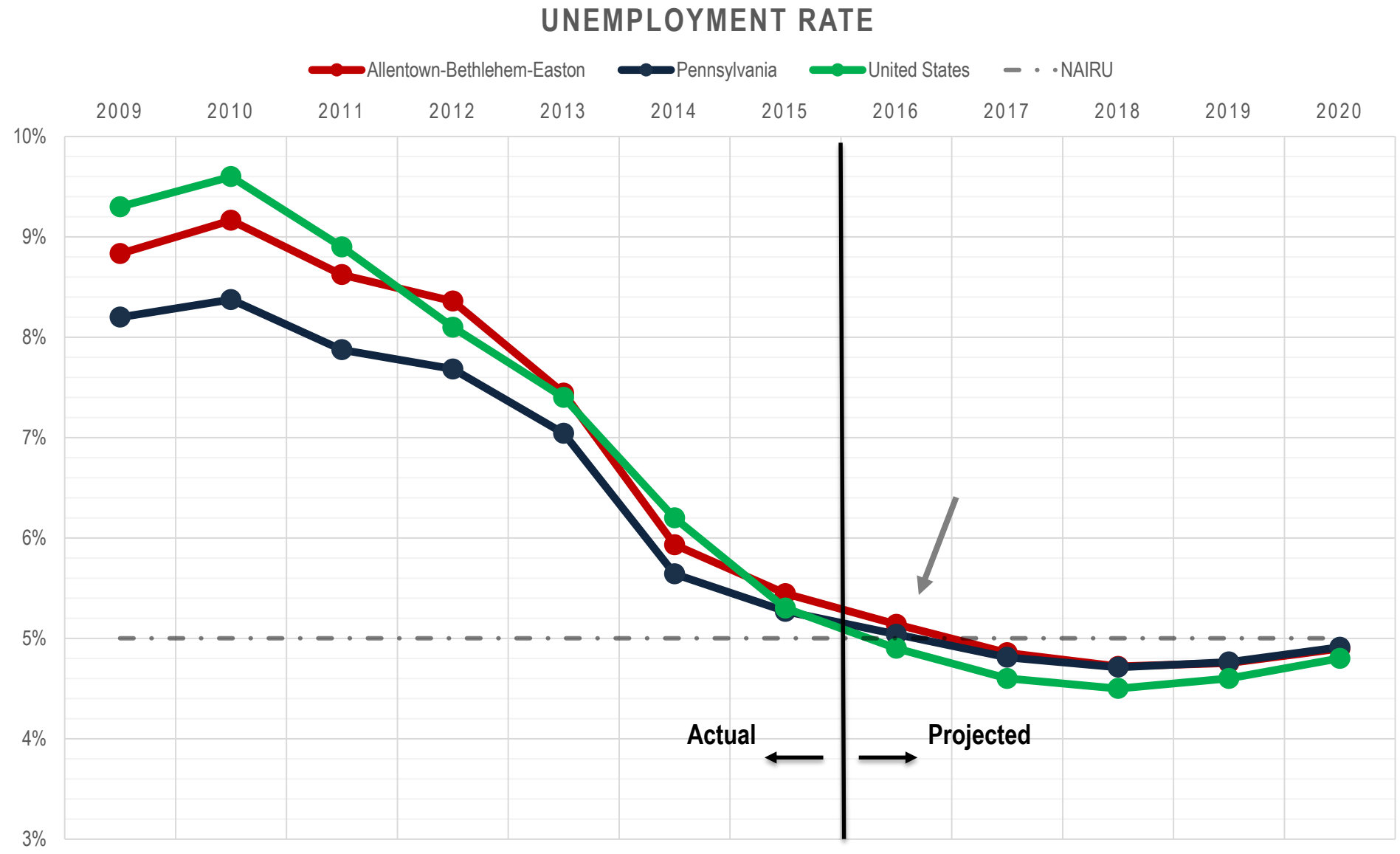
Source: Bloomberg, FFA Investment Management

UNEMPLOYMENT RATE



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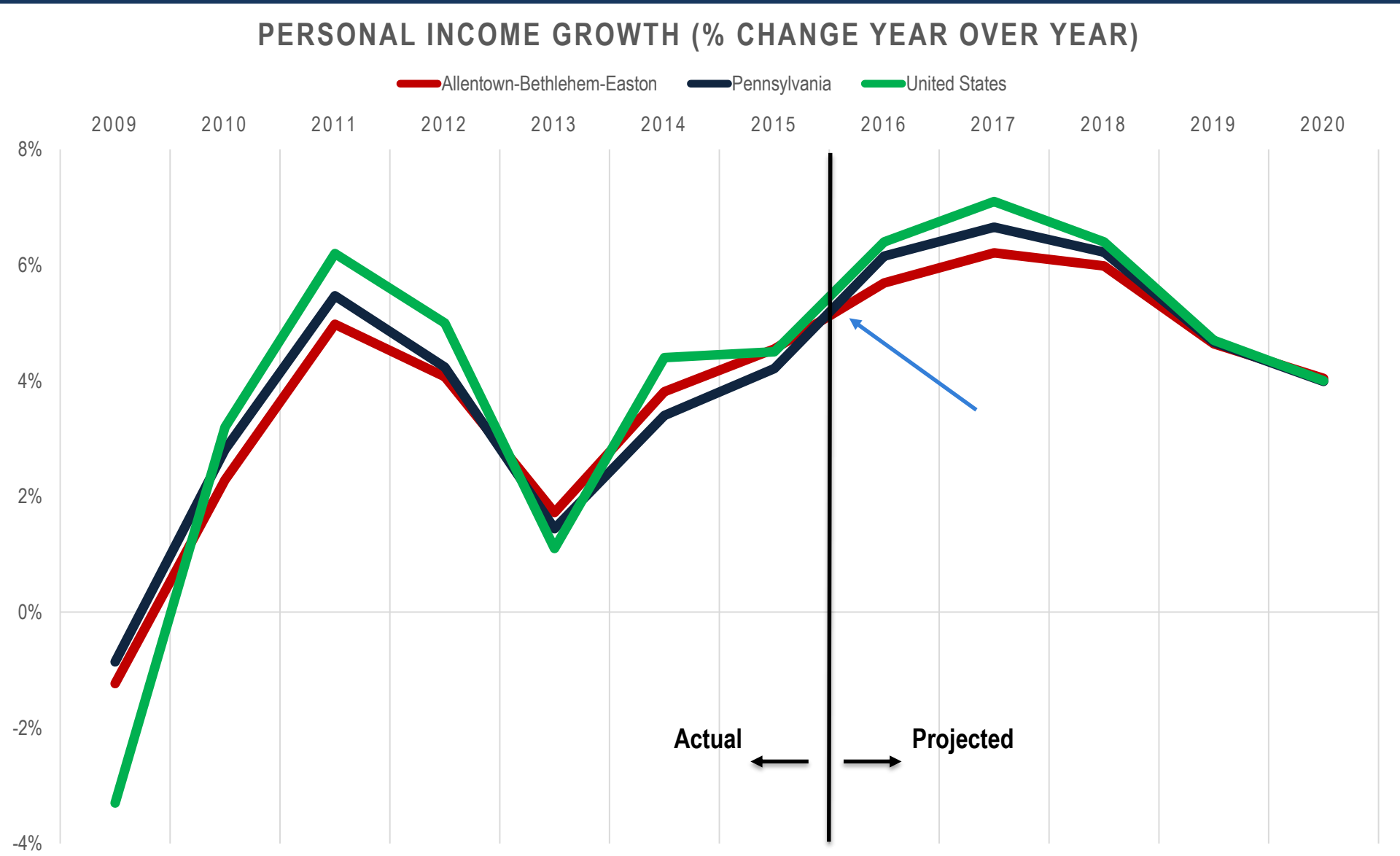
Source: Moody's Analytics, FFA Investment Management

Personal Income Growth



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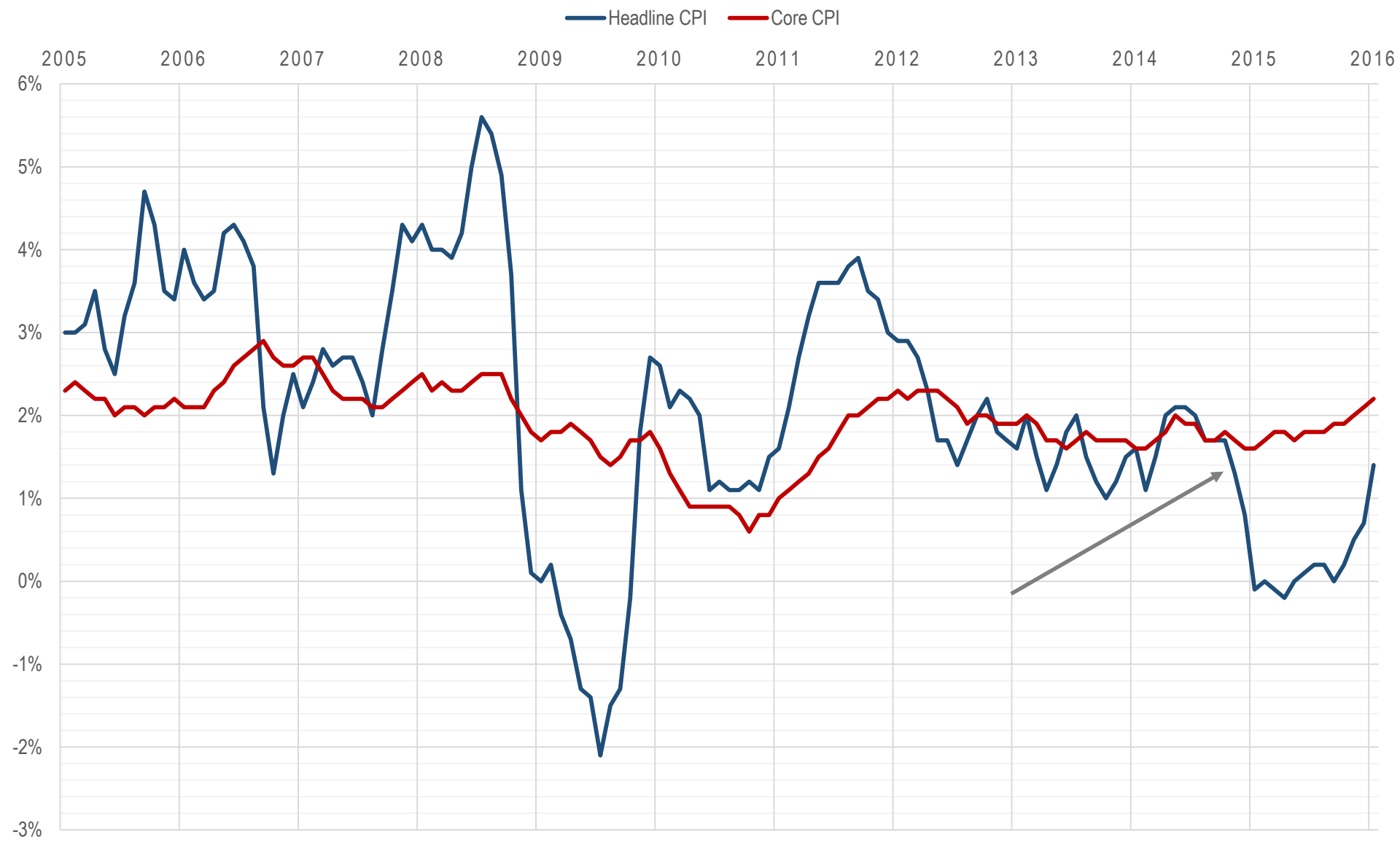
Source: Moody's Analytics, FFA Investment Management

Consumer Inflation



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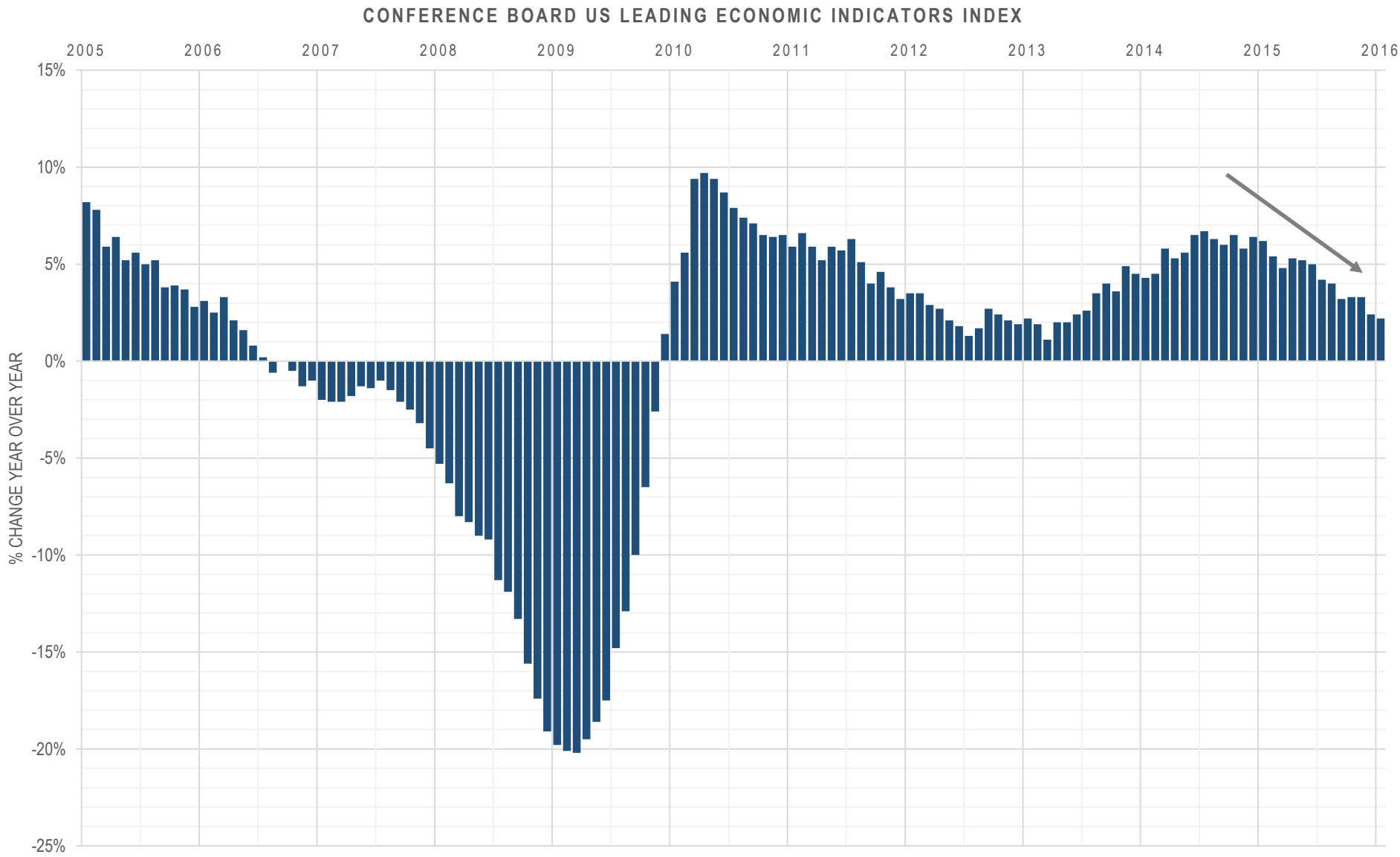
Source: Bloomberg, FFA Investment Management

Risk of Raising Rates Too Quickly

- Weakness in China and Other Emerging Markets Pulls US into Recession
- Other Major Central Banks Still In Easing Cycle (Negative Rates)
- Inflation Remains Well Below Target
- Lack of Liquidity in Risk Assets

US Leading Indicators



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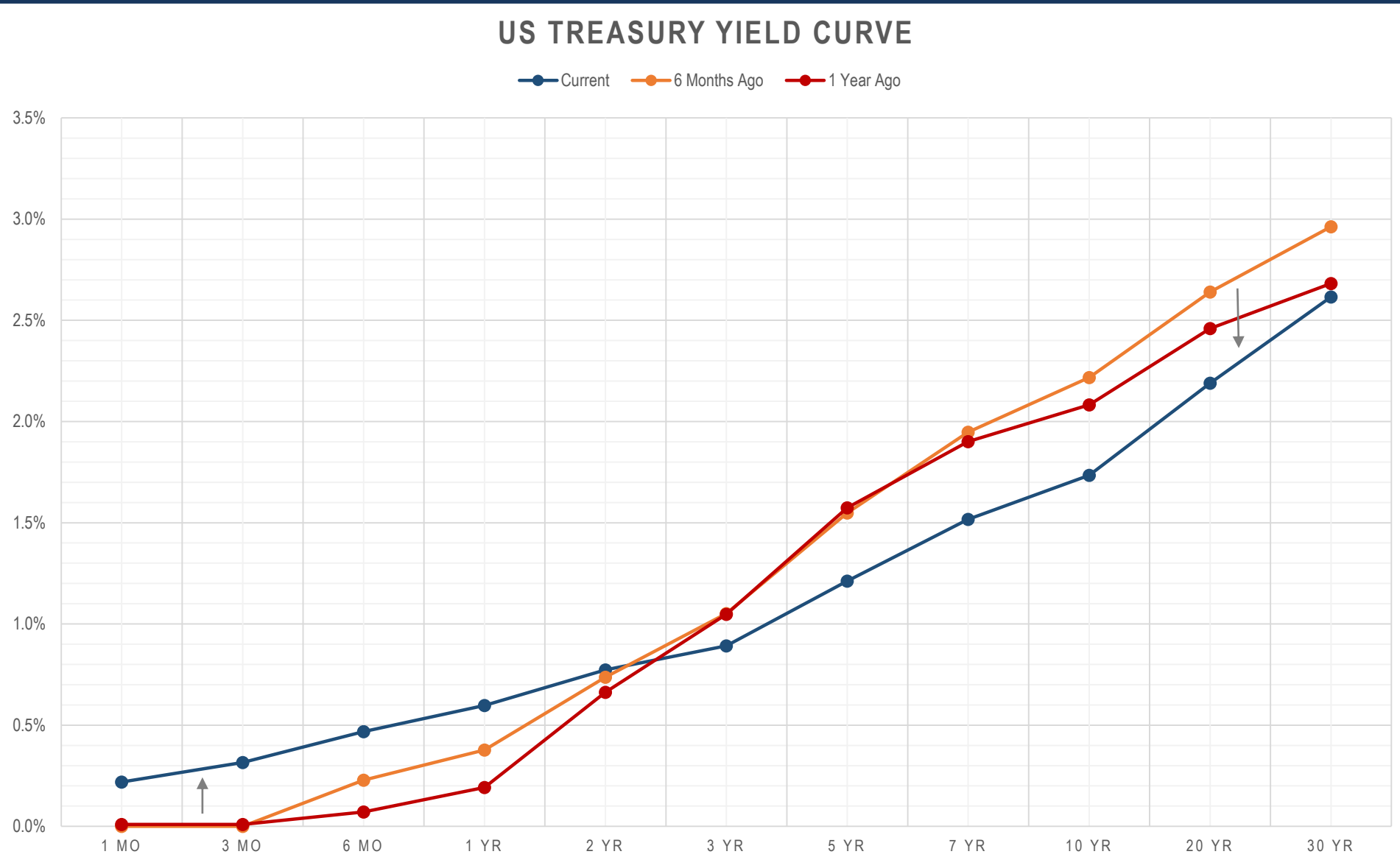
Source: Bloomberg, FFA Investment Management

Yield Curve Starting to Flatten



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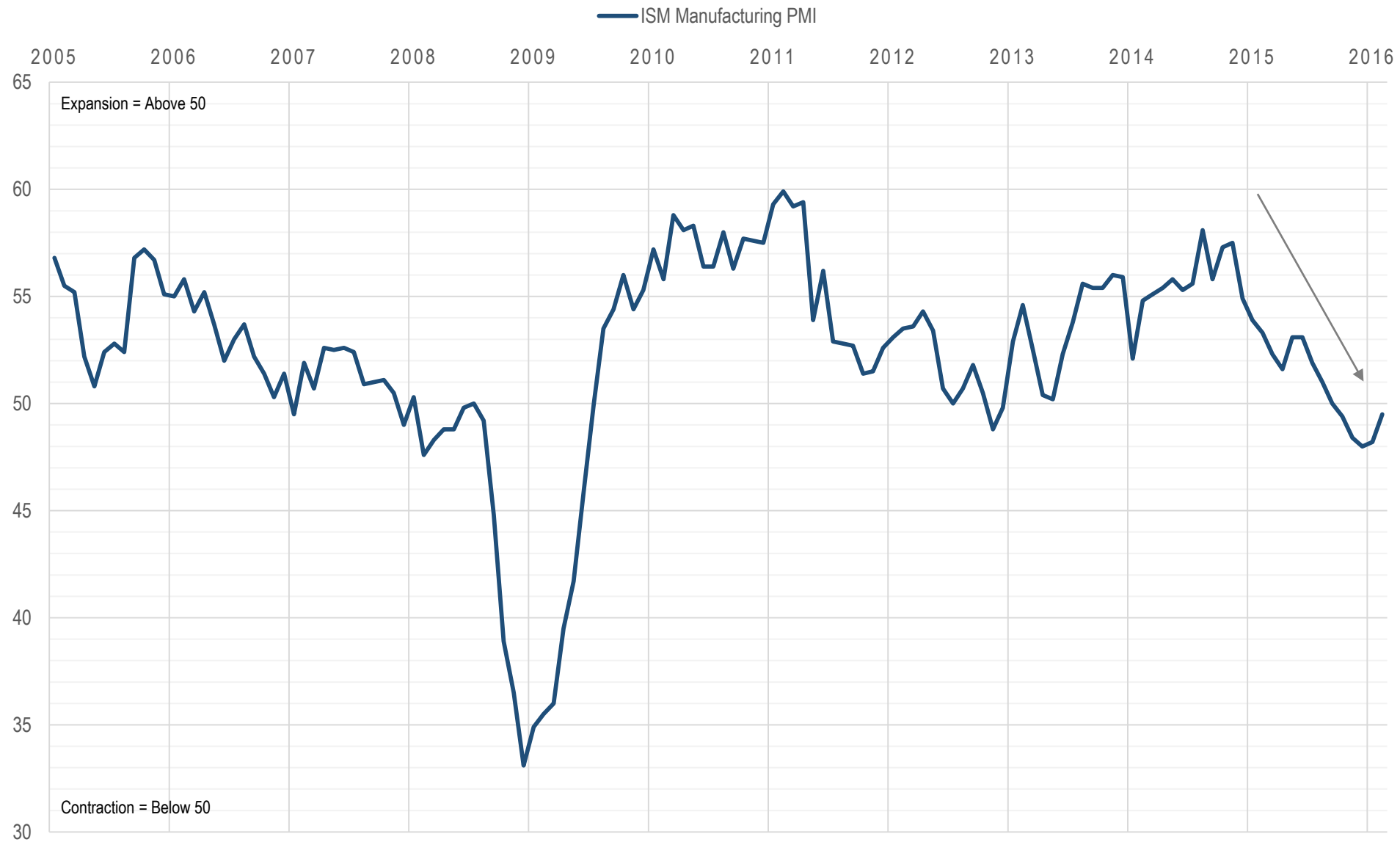
Data as of 2/29/16

Source: US Treasury Department, FFA Investment Management

Manufacturing Slump



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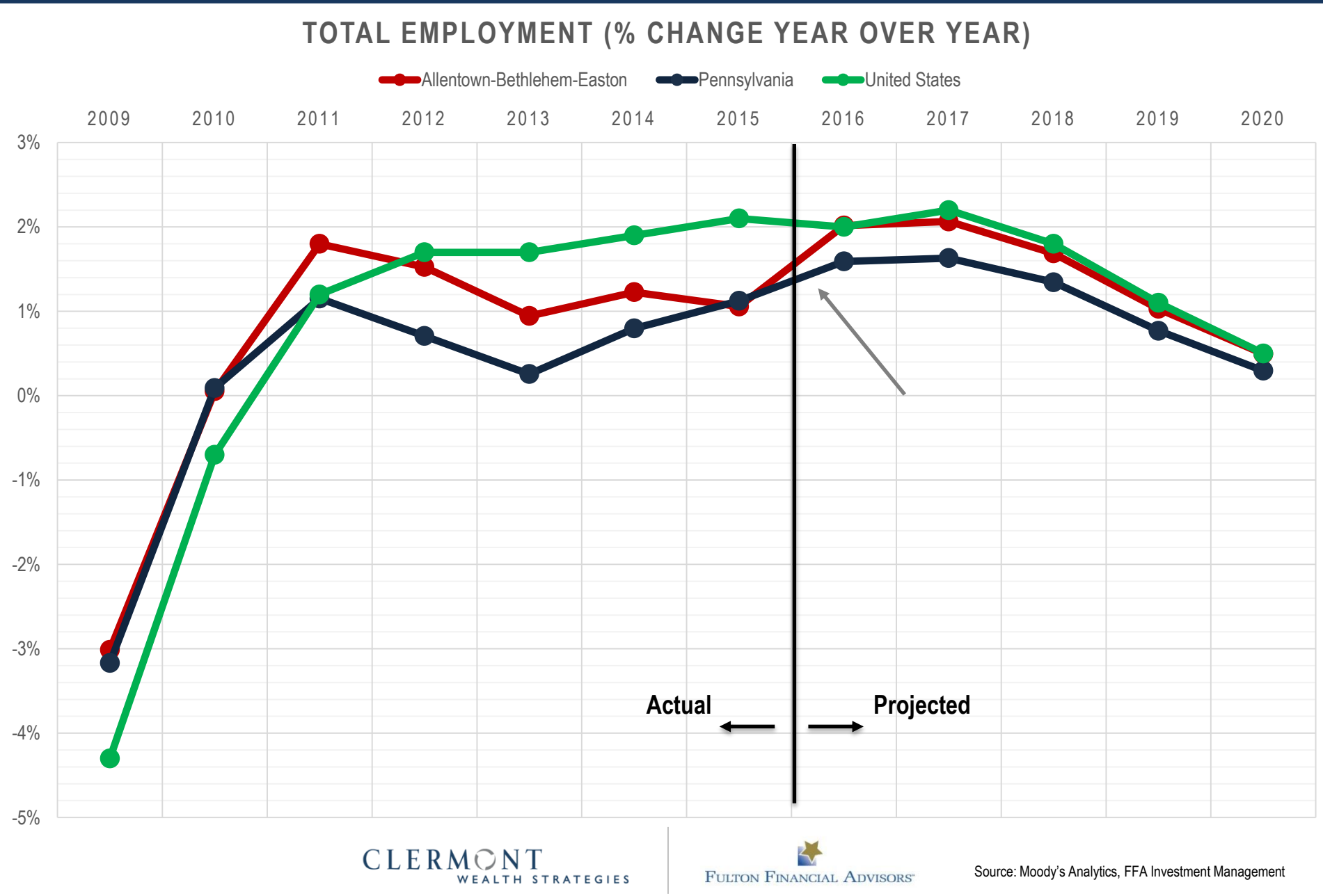
Source: Bloomberg, FFA Investment Management

Employment Growth



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Source: Moody's Analytics, FFA Investment Management

Bottom Line on Normalization

US

- Normalizing Rates in mid December
- Slow to raise rate in future
- US economy does not slip into recession

Northeast

- Net Hiring in Northeast Region strongest in 15 yrs. in Q4 2015
- Foreclosure are abating in Northeast setting up price stability
- Demographics / Aging workforce are a negative factor
- Volatility in Retail and Financial sectors denting spending

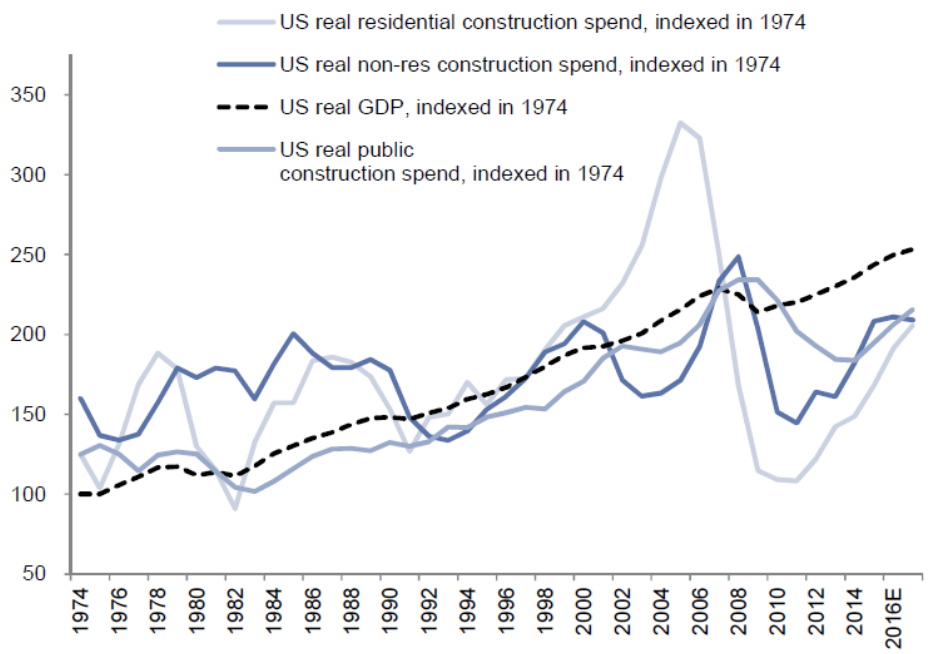
Lehigh Valley

- High Incomes and residential inflow positive
- Transportation and warehousing important driver
- Downtown Investments spurring new investment

US Construction Forecast

Total US construction growth should remain robust over the next few years, largely driven by residential and public spending; commercial growth is expected to decelerate for the strong growth experienced in 2015. Existing home inventories remain tight (at the lowest levels since March 2005), which should spur future growth. While commercial real estate pricing remains robust, pockets of lower occupancy rates have begun to develop.

Categories/Sub-sectors	2015	2016E	2017E	% total construction capex	Growth 2015	Growth 2016E	Growth 2017E
Private non-residential construction	**$418**	**$428**	**$433**	**32%**	**12%**	**2%**	**1%**
Office	$57	$59	$59	4%	28%	5%	0%
Healthcare	$35	$36	$37	3%	8%	3%	3%
Retail	$42	$42	$42	3%	12%	0%	0%
Warehouses	$15	$15	$15	1%	12%	0%	-5%
Manufacturing	$83	$83	$83	6%	48%	-1%	0%
Chemicals	$35	$37	$37	3%	561%	6%	0%
Other manufacturing	$48	$46	$46	4%	-5%	-5%	0%
Communication	$20	$21	$21	2%	18%	3%	0%
Power	$79	$79	$82	6%	-12%	0%	4%
LNG	$7	$11	$14	1%	88%	53%	27%
Power ex-LNG	$72	$68	$68	5%	-16%	-5%	0%
Mining	$7	$6	$5	1%	-36%	-21%	-10%
Lodging	$26	$31	$32	2%	32%	20%	3%
Other	$55	$57	$58	4%	3%	3%	3%
Residential construction	**$611**	**$702**	**$773**	**46%**	**13%**	**15%**	**10%**
Public construction	**$285**	**$305**	**$327**	**22%**	**6%**	**7%**	**7%**
Total Construction	**$1,314**	**$1,435**	**$1,532**		**11%**	**9%**	**7%**



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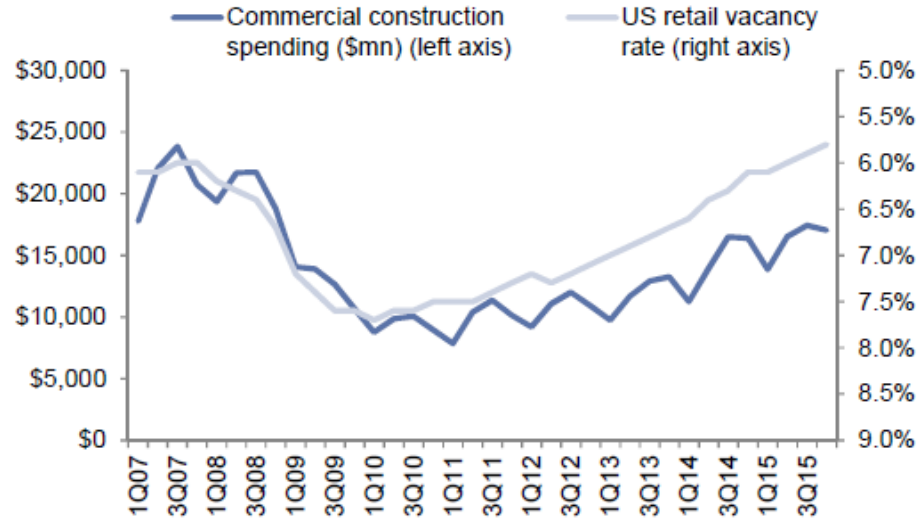
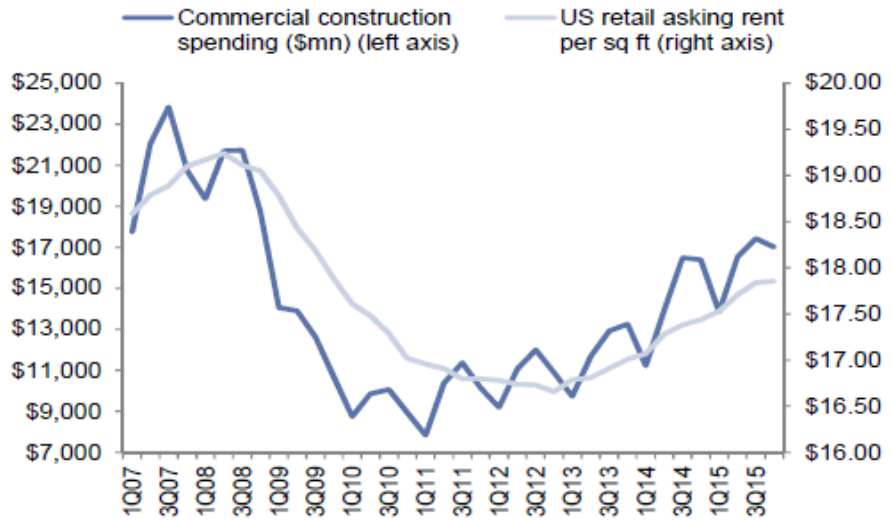
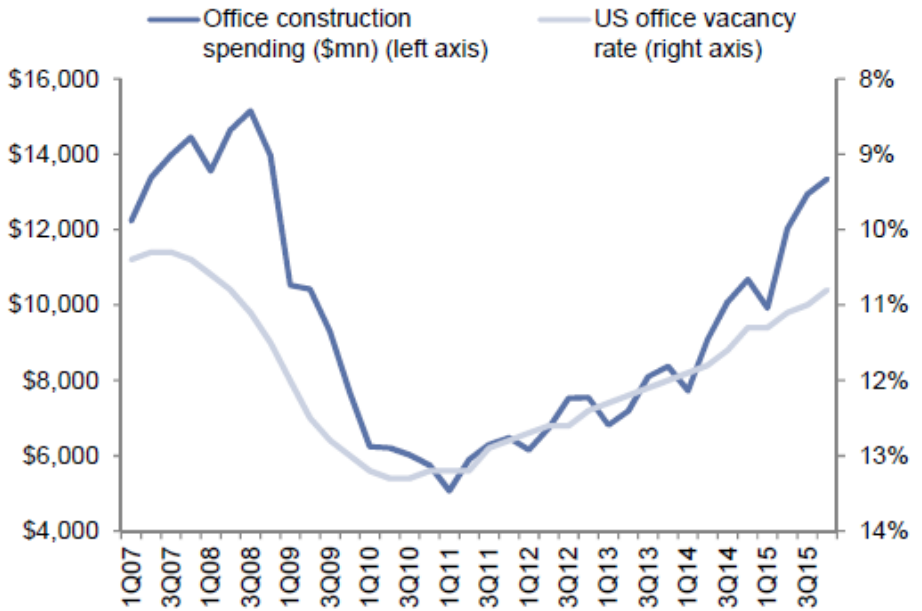
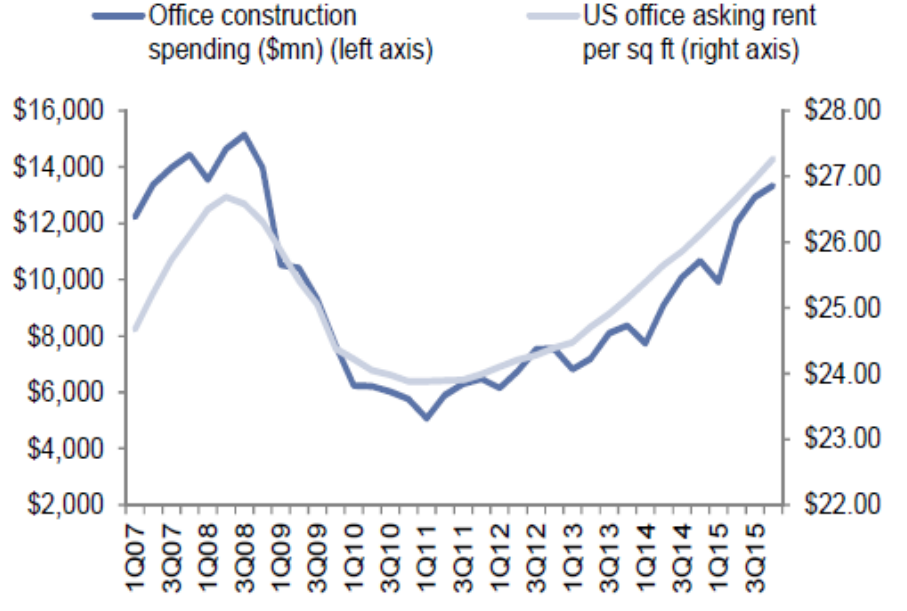
Source: Bureau of Economic Analysis, US Census Bureau, Goldman Sachs Global Investment Research, FFA Investment Management

Commercial and Office Construction









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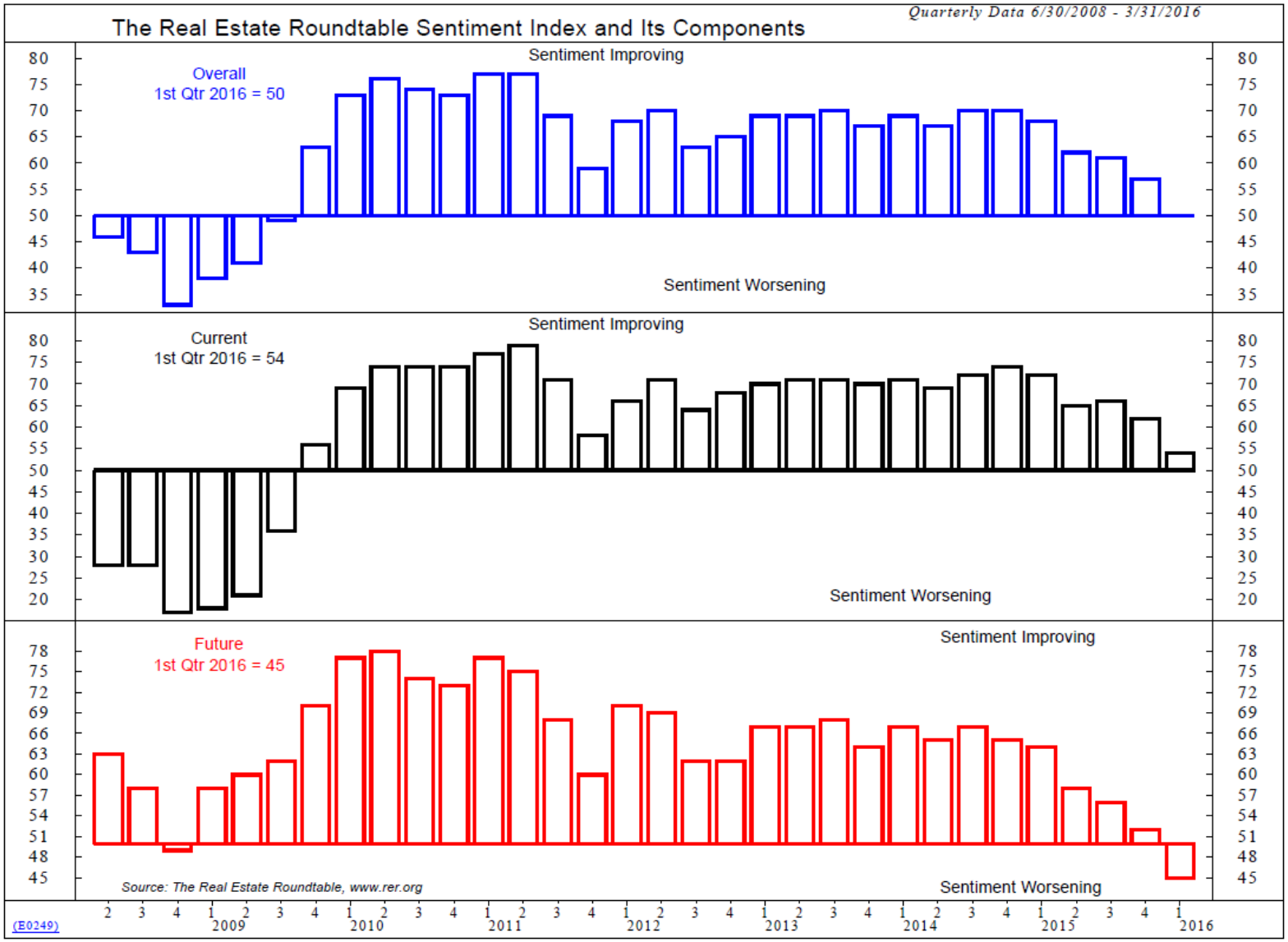
Source: CoStar, US Census Bureau, Goldman Sachs Global Investment Research, FFA Investment Management

Commercial Real Estate Sentiment



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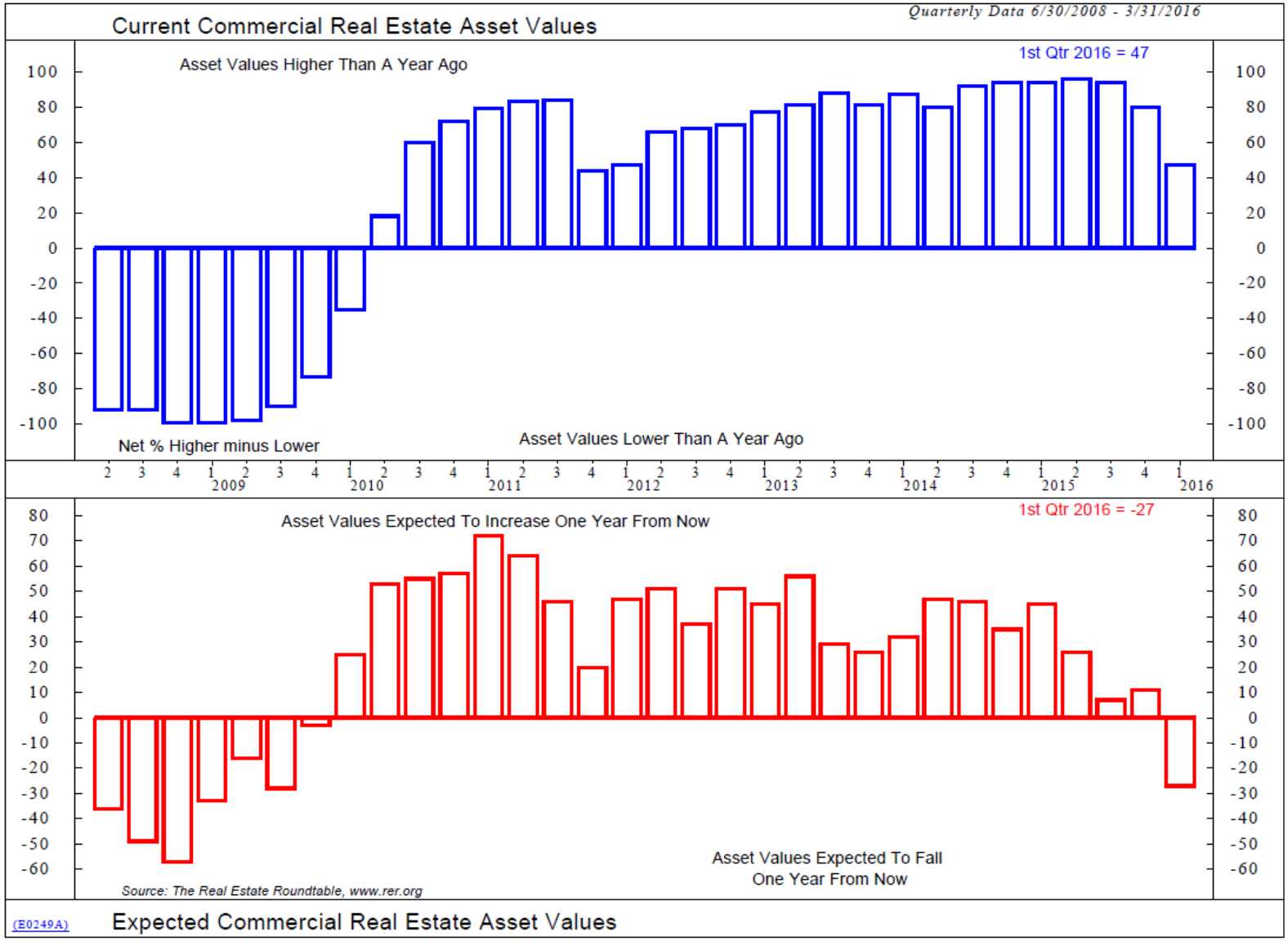
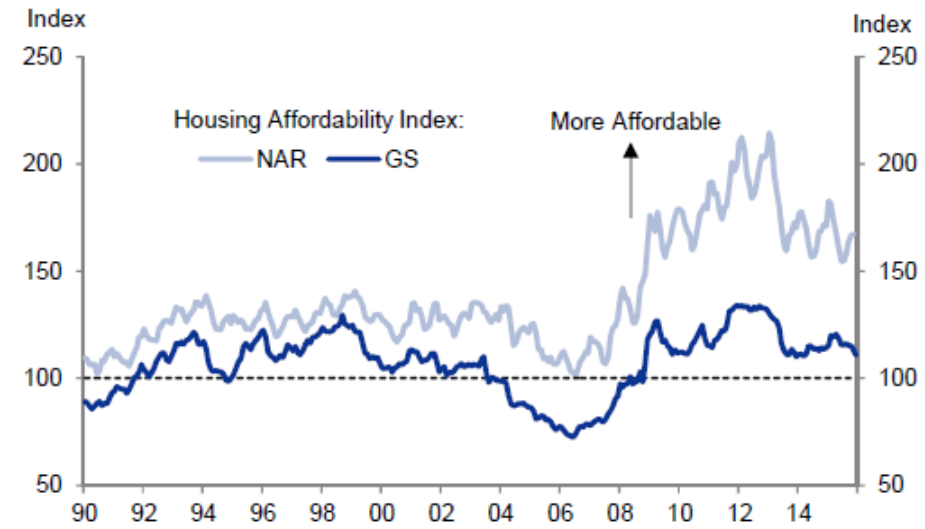
Source: Ned Davis Research, FFA Investment Management

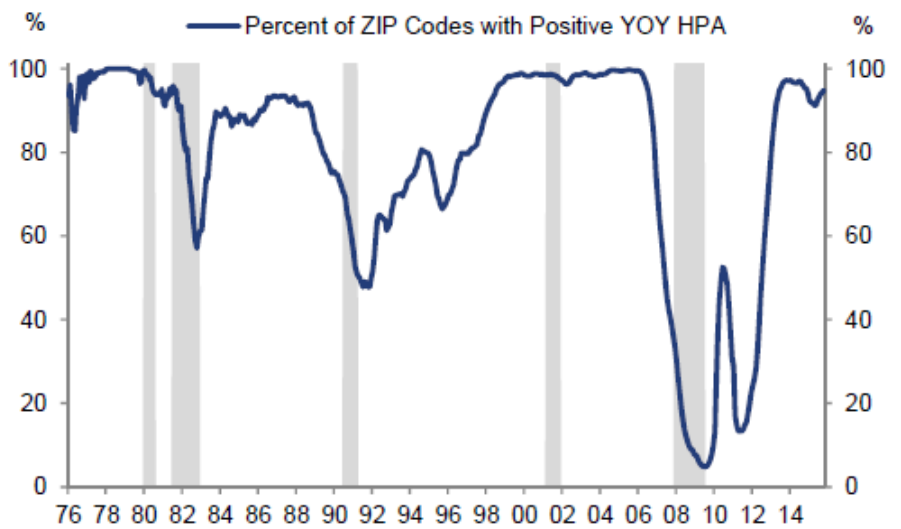
Commercial Real Estate Values

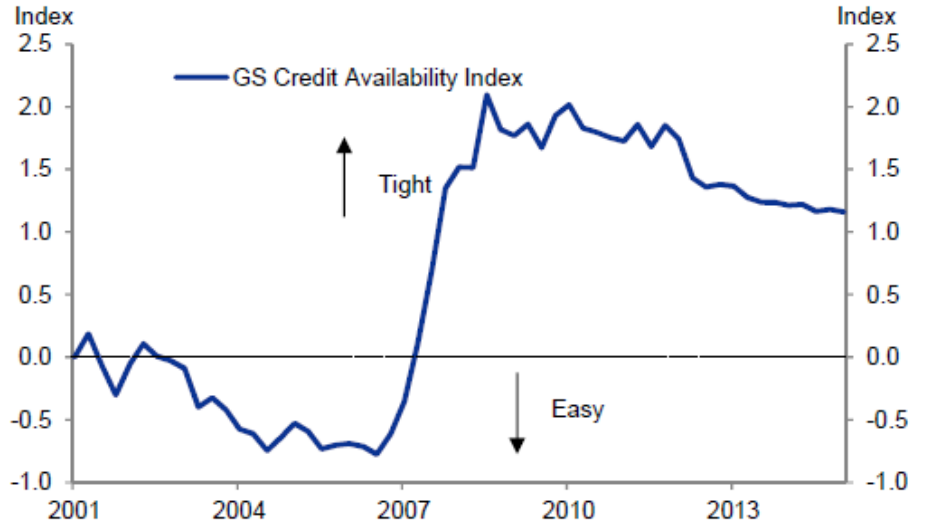


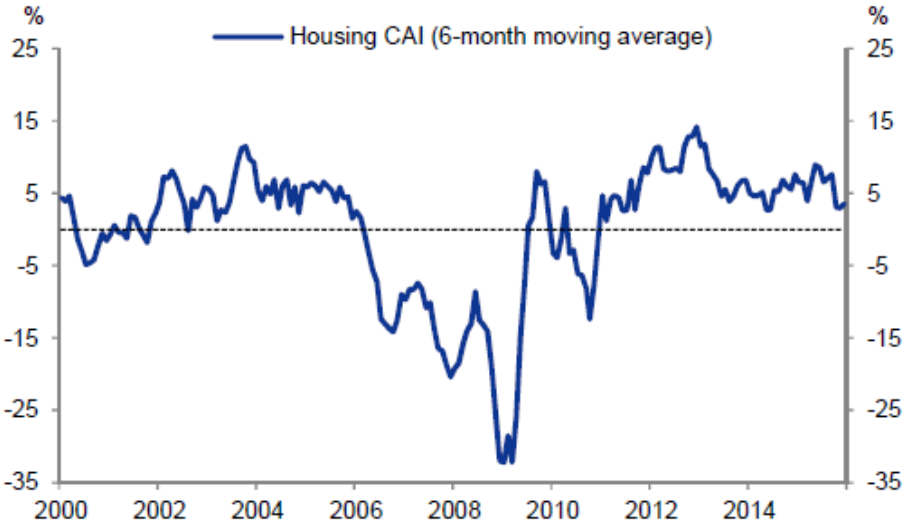
Source: Ned Davis Research, FFA Investment Management

Housing Market









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Source: Goldman Sachs Global Investment Research, FFA Investment Management

KEY BUSINESS ISSUES TO CONSIDER OVER THE NEXT 18 MONTHS

- US economy slips into recession
- Federal Reserve hikes 4 times in 2016 / Federal Reserve reverses course and lowers rates
- US Dollar continues to strengthen materially, further pressuring US manufacturing
- Projected single-family housing recovery does not materialize
- Weak economic environment causes a pause in local downtown revitalization and investment projects

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Weekly Commentary

Weekly Market Update:

February 3, 2016

February 14, 2016

February 21, 2016

February 28, 2016

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