CRAWFORD
INVESTMENT COUNSEL
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Economic and Market Environment

Third Quarter 2018

The Firm's Outlook: Summary And Conclusion

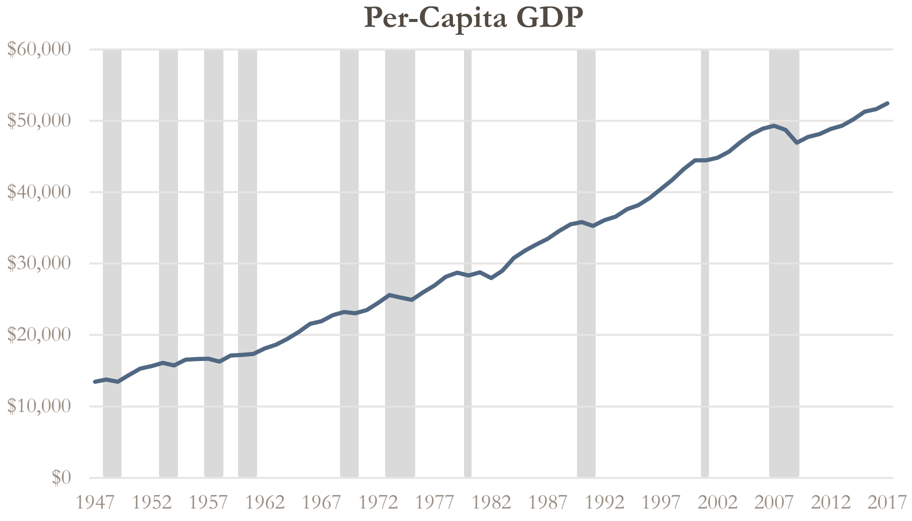
THE ECONOMY

- Broadly speaking, the U.S. economy is in very good shape. Growth is faster than it has been in years, unemployment is near record lows, and confidence is high. Interest rates and inflation are rising, but from low levels and at a gradual pace.
- The possibility of policy errors in the monetary and fiscal areas are potential risks to the economy, as are trade wars and the fact that the recovery/expansion cycle is mature. These factors bear watching over the next year.
- The Federal Reserve (Fed) considers the economy to be well-balanced currently, but continues its process of normalizing interest rates. At least two more federal funds rate increases are expected this year.

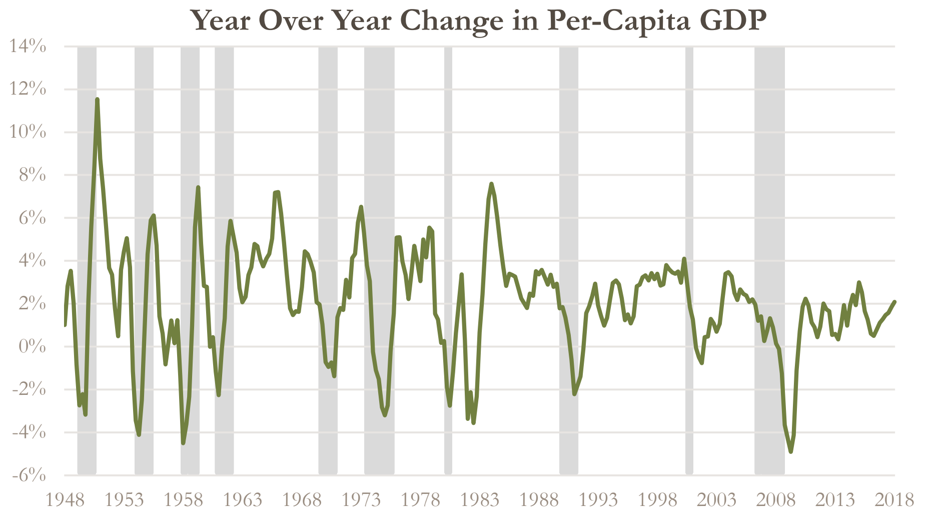
STOCKS AND BONDS

- Even though corporate earnings progress is spectacular, stock prices have been basically flat for the first half of the year. This may reflect the fact that earnings gains have already been discounted and that profits are peaking.
- Companies continue to reward shareholders with dividend increases and share buybacks.
- The 10-year U.S. Treasury note, considered the benchmark interest rate, has increased in yield this year, but currently trades at a yield of less than 3%. Well-contained inflation expectations appear to be limiting further increases in yield.
- Geopolitical risks are always present. Currently, there appears to be progress with North Korea, but tensions with Iran and China are on the rise. Trade wars may be considered geopolitical, and investors are expressing concerns about their potential impact on economic growth. We suggest a strong emphasis on quality as the best means of controlling risk.

THE U.S. ECONOMY: ONWARD AND UPWARD!



Source: Federal Reserve Bank of St. Louis
Real gross domestic product per capita, Chained 2009 Dollars, Annual, Seasonally Adjusted Annual Rate (Data Through: 2017)
Shaded for NBER designated recessions



Source: Federal Reserve Bank of St. Louis
Real gross domestic product per capita, Percent Change from Year Ago, Quarterly, Seasonally Adjusted Annual Rate (Data Through: 1/1/2018)
Shaded for NBER designated recessions

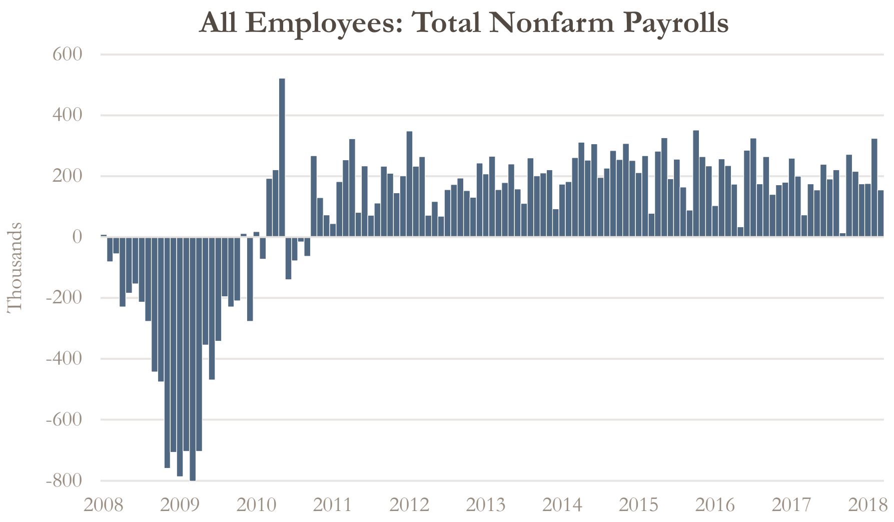
» The top chart illustrates the simple thought that economic growth in this country is the norm. Only on occasion do recessions occur that temporarily disrupt growth.

» The current recovery/expansion is the second longest in U.S. history and will become the longest in July 2019 if a recession does not occur before then.

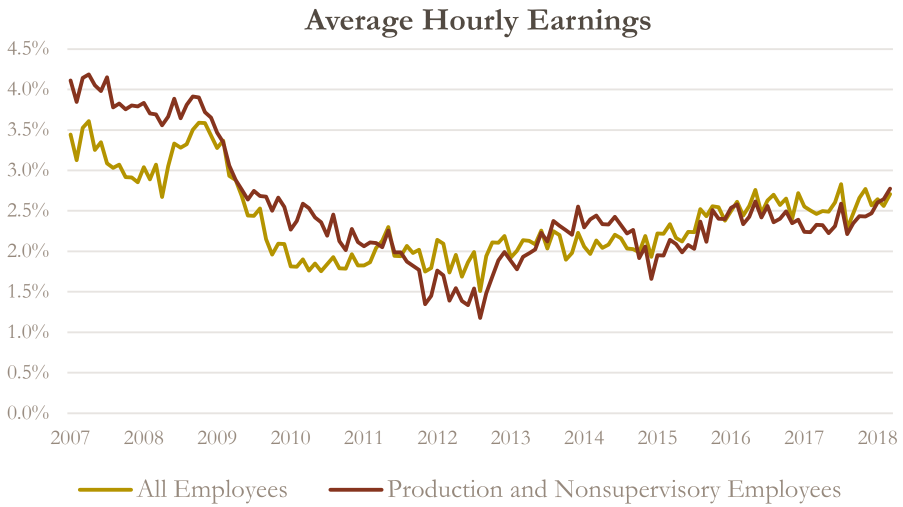
» The strong upward and consistent trend in economic growth is the best support for investment. Such an impressive trend suggests a favorable operating environment for companies.

» The consistently upward slope in the top chart is put in perspective by the volatility of year-over-year changes in growth. There are smaller cycles within the overall trend that affect investment also.

EMPLOYMENT: ANOTHER GREAT STORY



Source: Bureau of Labor Statistics
All employees, thousands, total nonfarm, seasonally adjusted, 1 month net change (Data Through: March 2018)



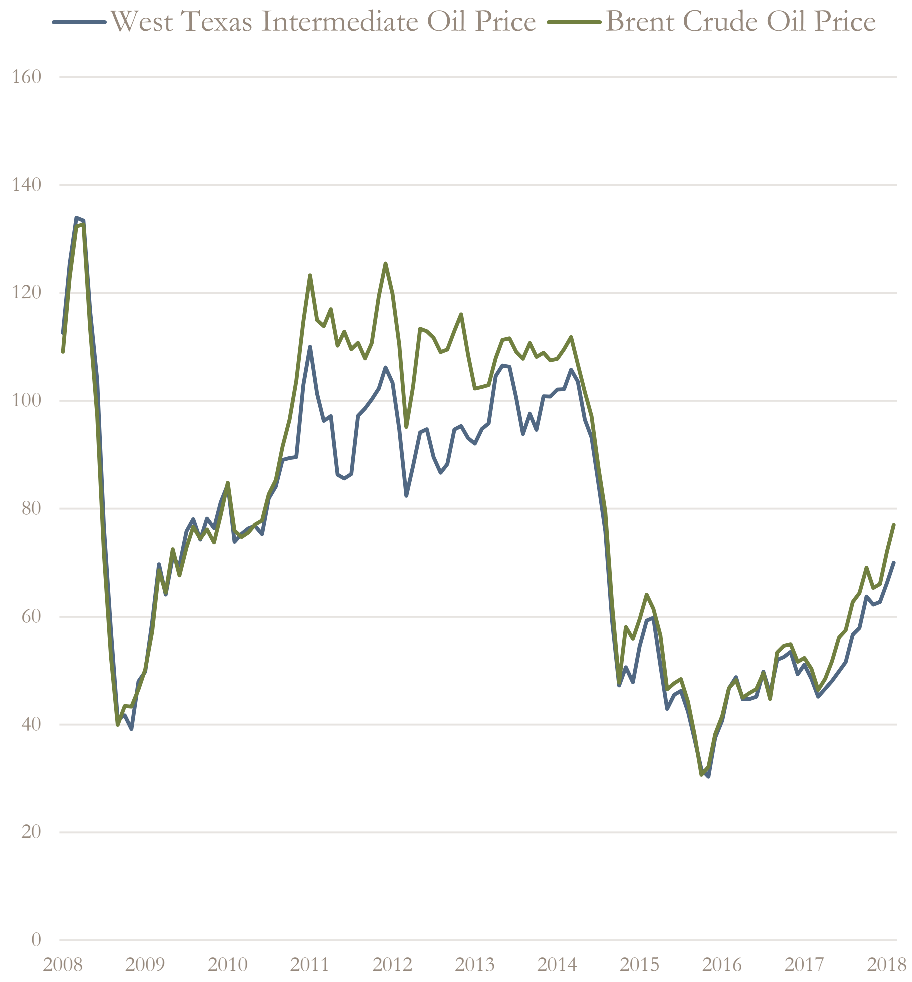
Source: Federal Reserve Bank of St. Louis
Average Hourly Earnings of All Employees: Total Private, Percent Change from Year Ago, Monthly, Seasonally Adjusted(Data Through: March 2018)
Average Hourly Earnings of Production and Nonsupervisory Employees: Total Private, Percent Change from Year Ago, Monthly, Seasonally Adjusted (Data Through: March 2018

» Employment is almost as important as Gross Domestic Product (GDP) growth in determining the health of the U.S. economy.

» 90 straight months of increased jobs is impressive. It signals consistent improvement in overall economic conditions as companies expand their businesses.

» Wages are gradually improving, but have a long way to go to get back to pre-Great Recession levels. The longer employment keeps growing, the more likely wages are to rise further.

THE PRICE OF OIL: A BIG ISSUE FOR BUSINESS AND CONSUMERS



Source: Federal Reserve Bank of St. Louis
West Texas Intermediate (WTI) - Cushing, Oklahoma, Dollars per Barrel, Monthly, Not Seasonally Adjusted (Data Through: May 2018)
Brent - Europe, Dollars per Barrel, Monthly, Not Seasonally Adjusted (Data Through: May 2018)

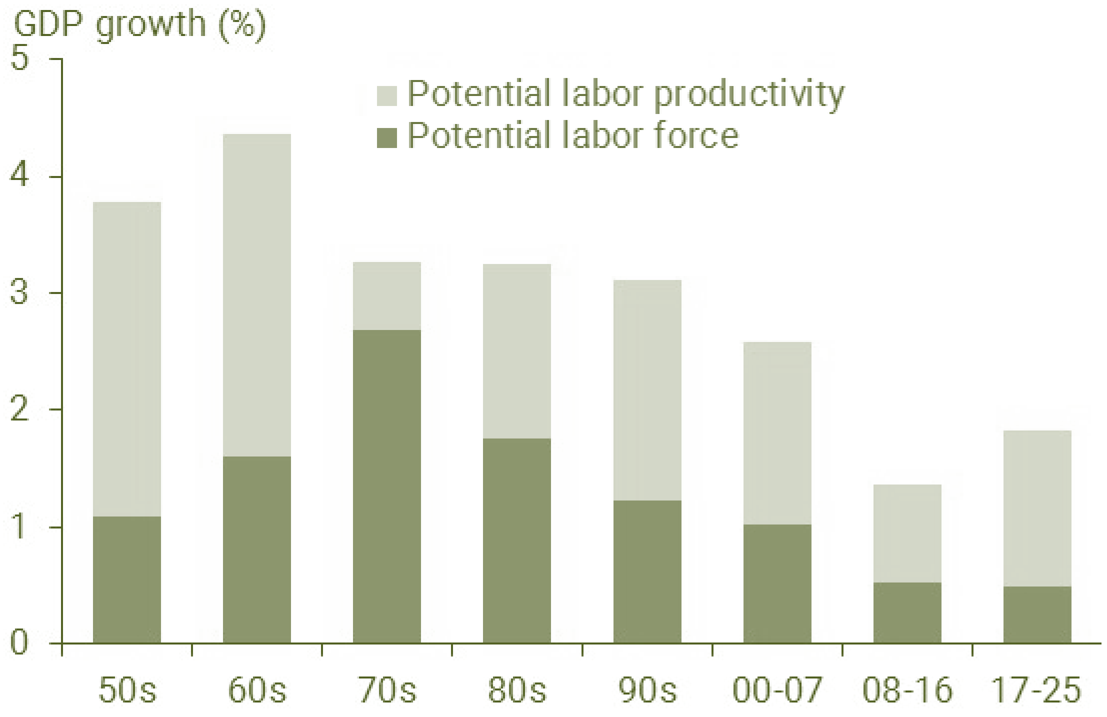
» Oil is a critical ingredient of economic activity since it is widely purchased and used by many businesses and by most consumers.

» The current price of oil, though still depressed relative to peak prices, has recovered sharply since 2014/2015.

» The price increase has two consequences: it has helped improve the fortunes of oil companies, who are major employers, but is a burden to consumers.

» Although consumer finances are in good shape, persistent increases in oil prices could be a threat to overall consumer demand.

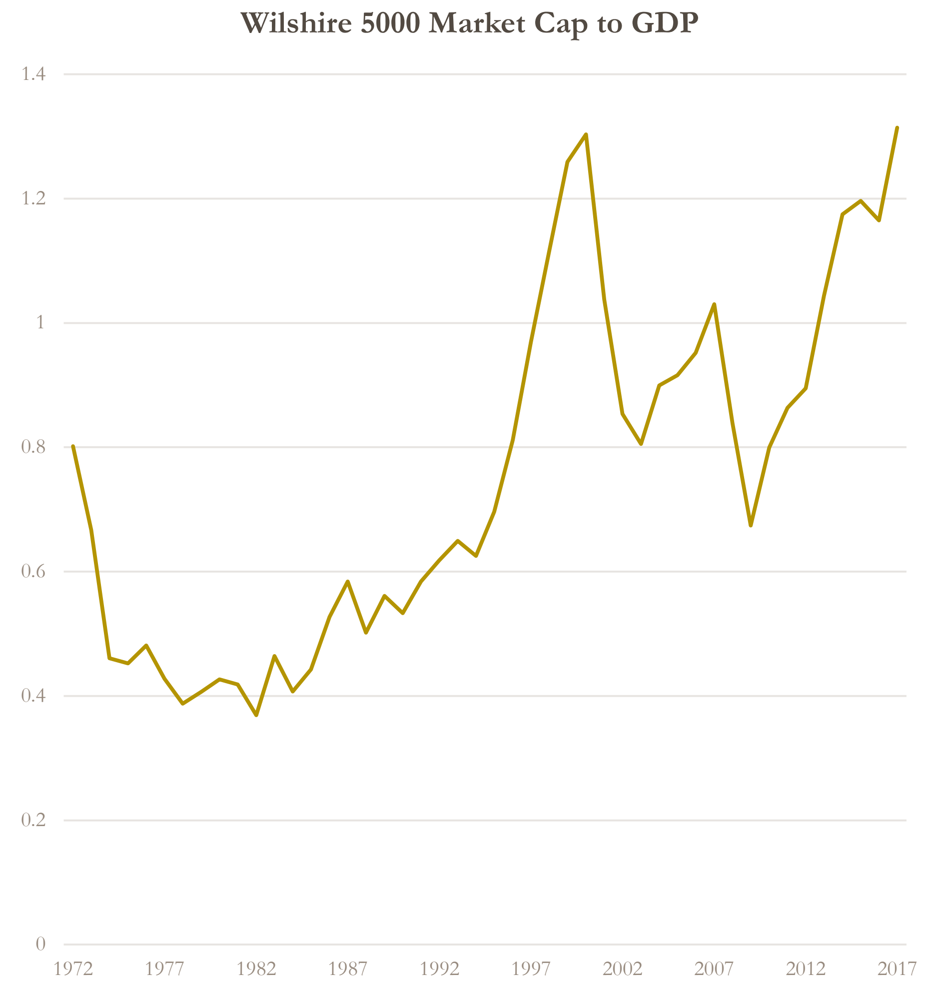
FUTURE ECONOMIC GROWTH: LABOR FORCE GROWTH AND PRODUCTIVITY



Source: Federal Reserve Bank of San Francisco

- Having more people in the labor force and having them work more productively is the formula for economic growth.
- The slowdown in the rate of growth in labor force and productivity has led to our current 2% growth rate, down from an average of 3.5%.
- Notice the last bar for the period 2017-2025. There is hope that productivity can improve, benefitting from potentially increased investment by companies.
- To achieve greater productivity, companies need to use some of their recent gains from the corporate tax cut to invest in productivity-enhancing equipment. We hope they will.

THE STOCK MARKET: WHAT ABOUT VALUATION?



Source: Federal Reserve Bank of St. Louis
Wilshire 5000 Total Market Full Cap Index, Index, Annual, Not Seasonally Adjusted (Data Through: 2017)
Gross Domestic Product, Billions of Dollars, Annual, Seasonally Adjusted Annual Rate (Data Through: 2017)

- There are many ways to measure valuation levels of stocks.
- The Wilshire 5000 index is considered to be the broadest measure of the U.S. stock market.
- Currently, this index trades at its highest level relative to U.S. GDP. This means that over the last 8-9 years the stock market has grown in value much faster than the economy.
- Its current level may not be worrisome if the economy can begin growing faster, thus bringing the valuation down.
- This is not a chart for those wishing to argue that stocks are cheap.

Historical Bull Markets in the United States: More Valuation Data

» Over the last 70 years there have been nine major bull markets, averaging a duration of 78 months.

» In the current bull market the annualized rate of return has been 17.7%, an amazing rate.

» However, there is a mismatch with the rate of return and economic progress relative to that of previous bull markets.

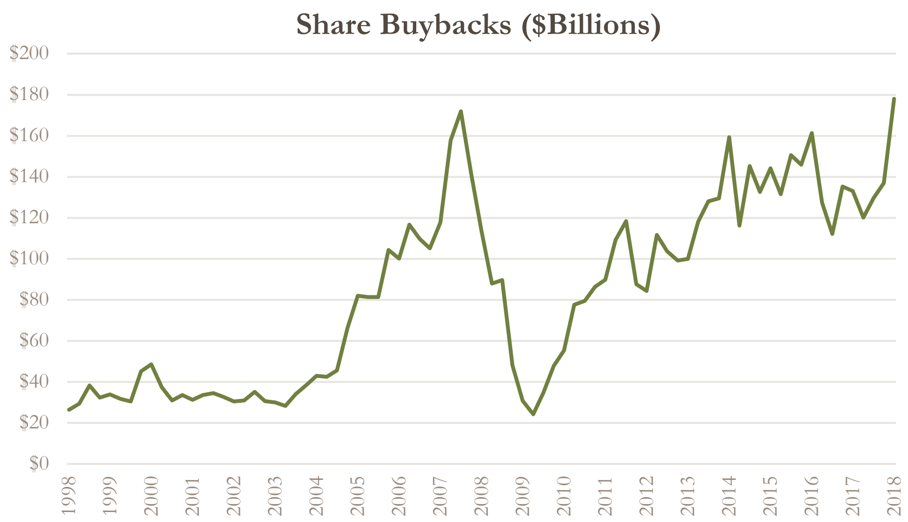
» The investment returns in this cycle have been above average, yet the economic results have been below average.

» One explanation for the mismatch is that inflation and interest rates have been far lower in this bull cycle, perhaps justifying higher valuation.

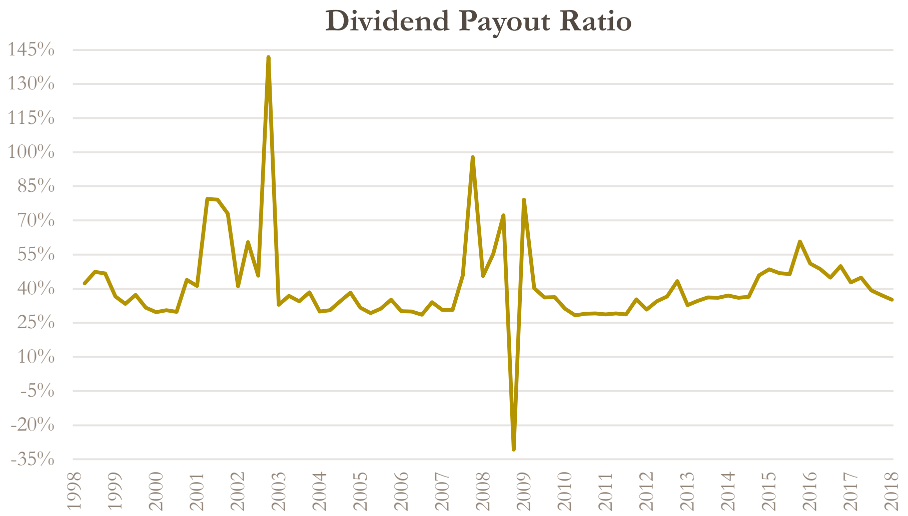
Trough Date	Peak Date	S&P 500	Nominal GDP	Real GDP	Months
6/13/1949	7/15/1957	17.3	7.3	4.6	97
10/22/1957	1/3/1962	15.4	5.4	3.8	51
6/26/1962	11/29/1968	12.0	7.7	5.0	77
5/26/1970	1/11/1973	23.3	10.0	5.1	32
10/3/1974	11/28/1980	14.1	10.8	3.2	73
8/12/1982	7/16/1990	17.5	7.6	4.2	95
10/11/1990	3/24/2000	19.0	5.6	3.5	113
10/9/2002	10/9/2007	15.0	5.8	2.9	60
3/9/2009	1/26/2018	17.7	3.7	2.1	106
Average		16.8	7.1	3.8	78.2
Median		17.3	7.3	3.8	77.0

Source: Gluskin Sheff + Associates, Inc

The Stock Market: Shareholders Continue To Be Rewarded



Source: S&P Dow Jones Indices
S&P 500, quarterly (Data Through: 3/29/2018)



Source: S&P Dow Jones Indices
S&P 500, quarterly (Data Through: 3/29/2018)

» Valuations in stocks may be high, but shareholders are not complaining. They continue to be rewarded.

» Companies have a strong appetite for their own shares. This rewards investors in several ways, most important of which is steady demand under the shares.

» Dividends have been rising basically in line with earnings. This is fine but, at around 40%, the payout ratio has the potential to go higher, thereby enhancing shareholder returns.

Bonds: What is the Yield Curve Telling Us?

Source: Federal Reserve Bank of St. Louis
10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity, Percent, Monthly, Not Seasonally Adjusted (Data Through: May 2018)

- The yield curve measures the difference in yield between two points on the maturity spectrum.
- One of the more frequently used yield curve measures is the 2-year U.S. Treasury Note yield compared to the 10-year U.S Treasury Note. Currently the difference in yield is only 34 basis points.
- The downward slope in the line indicates that the yield curve has been flattening since 2011.
- The chief influence on the curve currently is the Federal Reserve. They continue to raise short-term interest rates while longer-term rates are holding steady. This flattens the curve.
- If the longer maturities do not increase in yield, it will be difficult for the Fed to continue its interest rate "normalization" process for fear of creating an inverted yield curve.

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