

Economic Perspectives

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April 18, 2013

AMIDST A LOT OF NOISE – THE U.S. ECONOMY STILL SEEMS TO BE CHUGGING ALONG IN SECOND GEAR.

From surprisingly strong, to disappointingly weak, the first quarter seemed to offer economic reports that reflected a little bit of everything. Taking it all in balance, we believe the data still reflects an economy growing at an average pace of about 2.0% to 2.5%. The GDP number for the first quarter is likely to be stronger, but should be considered in the context of the exceptionally weak fourth quarter.

U.S. economic measures were almost universally better than anticipated in the first two months of the year, but the tone of data began to deteriorate in the second half of March. The key question now is whether the change in economic tone is due to a confluence of temporary factors, or if the economy is truly decelerating amid the burden of higher taxes and government spending cuts.

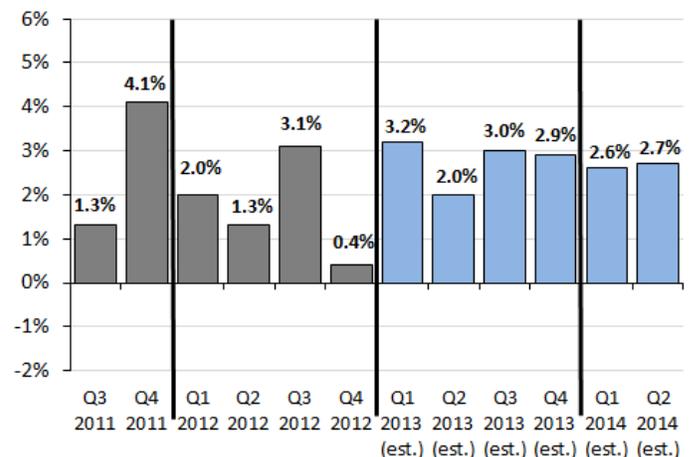
We believe the answer most likely lies somewhere in the middle. This past March was the coldest in many years and not particularly conducive to stimulating retail demand for warm-weather goods and apparel. Conversely, federal government spending cuts under the “sequester” were the second large-scale fiscal constraint to hit the economy in less than three months time. Combining the payroll tax hike that started January 1st (~\$125 billion) with the spending sequester that began in March (~\$85 billion), fiscal policy will subtract approximately \$210 billion from the economic base this year. As a point of reference, total U.S. real Gross Domestic Product (GDP) expanded by \$299 billion in 2012. In other words, growth this year starts with a notable handicap. In this light, we believe it would be a testament to the economy’s improving fundamentals should it prove capable of generating a similar overall pace of real growth (~2.2%).

The mixed message evident in recent economic reports also has its benefits. The relative strength of data in January and February had spurred increasing discussion of an early end to Federal Reserve quantitative easing efforts. More recent data suggests such discussions were premature.

In our view, the Fed could moderate its purchases of Treasury and Mortgage-backed securities in the second half of the year but only if economic conditions permit. Even if the economy strengthens, we believe some Fed bond purchase activity is likely to continue into 2014. As a reminder, the Fed is currently purchasing approximately \$85 billion a month in fixed income securities under its quantitative easing programs - \$40 billion in Treasuries and \$45 billion in mortgage-backed securities. When the Fed eventually does begin to taper its purchases, capital markets are likely to react negatively. We do not believe financial market is as dependent on Fed bond purchases as some others, but it clearly helps.

Overall, Q1 looks good, but... We estimate first quarter real GDP is currently on track to show a gain of about 3.2%. The strength of this number is somewhat misleading, however, as it is at least partially due to a rebound from the exceptional weakness produced in the preceding quarter (+0.4% in Q4-2012). The economy seemed to absorb the burden of higher payroll taxes rather well in Q1, but we are still cautious of the pending impact of the federal government’s spending sequester going forward.

Ameriprise Financial U.S. GDP Outlook



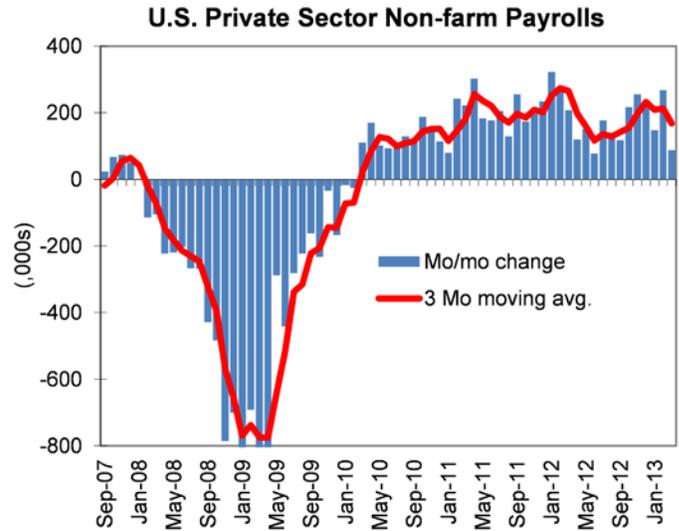
Source: Commerce Department, Ameriprise Financial Services, Inc.

EMPLOYMENT OFFERS A MIXED PICTURE.

Of all economic reports, employment measures have seen some of the most volatile swings over the last two months. The U.S. economy generated a strong 268,000 net new jobs in the month of February (the best increase in a year), only to see employment gains in March drop to a paltry 88,000 (see chart at right).

Similarly, new claims for unemployment insurance showed a very encouraging, but ultimately short-lived, improvement trend in early March. Over the first three weeks of the month, new claims averaged an attractive 338,000. The 4-week moving average of claims even dropped to its lowest level in over 5 years (340,000).

By months-end, however, initial claims turned sour. The number of individuals signing up for unemployment benefits jumped to 385,000 in the final week of March – their highest since last November. We believe the jump was more related to the Labor Department’s difficulty in seasonally adjusting its numbers around holidays (Easter in this case) than truly representative of rising layoff activity. As evidence, new claims subsequently dropped considerably in the first week of April (348,000), and corporate layoff announcements in general remain close to historical lows. Overall, we believe new claims should moderate over the near-term with an estimated average range of approximately 340,000 to 360,000.



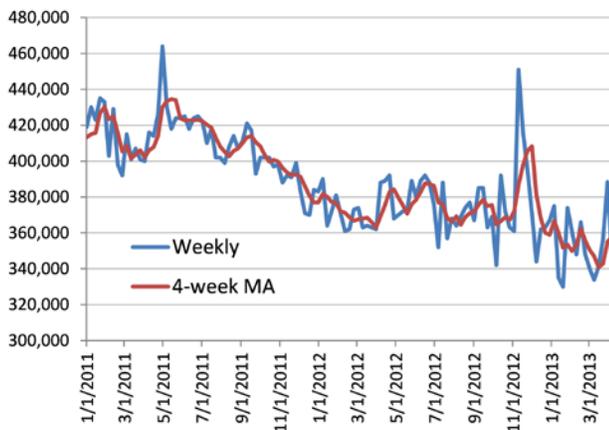
Source: Labor Department, Ameriprise Financial Services, Inc.

We also expect total payroll growth to improve in April, with the creation of approximately 175,000 to 185,000 net new jobs. Adverse weather conditions appear to have been a material factor behind the weakness in March job growth and we suspect totals for April could see the benefit of a rebound.

Is weather a legitimate reason, or just an excuse? According to the National Weather Service, last month was the coldest March in 11 years, and the extent of snow cover in the lower 48 states was the 10th largest ever recorded for the month. Such conditions are not exactly conducive to retail demand for warm-weather goods and apparel, construction activity, landscaping or a host of other warm weather endeavors. Indeed, retail employment dropped by 24,000 in March, as retail sales declined by 0.4%. There was also a significant late-season snow storm which dropped 20 inches of snow or more in some locations of the Upper Midwest and Northeast from March 4th to 9th. The timing here is significant as the Labor Department typically conducts its employment survey in the week that contains the 12th day of the month. If there were some delays to new hiring due to the snow storm, we could see some “catch-up” in the data for April. Our expectations for April, however, are still somewhat tempered by the uncertain impact of the “sequester”.

Despite the uneven performance in Q1, we are still projecting 2.3 to 2.5 million net new jobs to be created in 2013 versus the 2.2 million created in 2012. We believe the unemployment rate should end the year at around 7.2%, versus the 2012 ending rate of 7.9%.

Initial Jobless Claims



Source: Labor Department, Ameriprise Financial Services, Inc.

For the first quarter as a whole, new claims averaged 354,000 per week, down from the fourth quarter’s 380,000. Generally speaking, a sustained rate of claims at, or around, 350,000 are typically indicative of fairly sound labor market conditions, while levels around 300,000 suggest a strong job environment. As a point of reference, during the economic expansion period of 2003 to 2007, new claims averaged 329,000.

HOUSING REMAINS A CLEAR BRIGHT SPOT – BUT ONE OF THE FEW.

One sector of the economy that has clearly maintained consistent strength over the last few quarters is housing. Home prices are rising, new construction activity is surging, demand is growing, and millions of American households are breathing a sigh of relief as their home values rebound.

In March, new housing starts were an exceptional 47% above their year-ago levels as total new starts exceeded the 1 million mark on an annualized basis for the first time since June, 2008 (see chart). Multi-family units (largely apartments) were a significant contributor to this gain, but single-family units were also a very strong 29% higher yr/yr. As a point of comparison, the U.S. economy supported average new home build rates of approximately 1.5 million per year throughout the 1990's (i.e. prior to the “boom” period). In other words, despite the recent recovery, we believe the sector still has significant headroom for further improvement.



Source: Thomson Reuters Baseline

For now, builders just seem to be keeping up with demand as the new home sector currently offers a tight 4.4 months of available supply – or still near a 40-year low on an absolute basis. Inventories are equally tight in the existing home space, but rising prices recently seem to be drawing-in more potential sellers which is a healthy development in our view.



Source: Thomson Reuters Baseline

We still expect the housing recovery to be a strong contributor to economic growth this year. We estimate home construction and remodeling work should directly add about 0.4 tenths of a percent to GDP this year. Meanwhile, rising home values should also have a positive influence on consumer net worth, and by translation, consumer sentiment and spending.

Higher stock prices and rebounding home values have, in fact, enabled American households to re-capture 92% of their net worth lost during the “Great Recession.” According to data from the Federal Reserve, rising home values bolstered homeowner equity by \$1.4 trillion in 2012.

WASHINGTON UPDATE: DID WE REALLY MAKE IT THROUGH A FULL QUARTER WITHOUT A WASHINGTON BUDGET FIGHT?

On March 26th, President Obama signed legislation funding government operations through the remainder of the fiscal year (which ends September 30th). The House and Senate had quietly passed the \$984 billion legislation in the prior week with few changes to current spending plans (note that entitlement programs are not subject to this budget process).

The funding resolution also locked-in the \$85 billion in cuts called for under the “sequester” with some minor adjustments. For meat lovers, the budget resolution shifted \$55 million from other programs to avoid furloughs for government meat inspectors. Some funds were also shifted in the Defense budget to allow for troop training and weapons maintenance, and the Agriculture Department received some additional funds for nutritional assistance for low-income families.

The next target date for Washington is May 19th when we once again come up against the nation’s debt ceiling. As with prior debt ceiling limits, the Treasury Department should be able to keep the bills paid for approximately a month and a half to two months past this date should partisan squabbling erupt again. At this time, we believe odds of another crisis-evoking fight appear to be modest, though a deal to raise the limit may very well come long after the 19th. Both sides seem to now recognize the political risk of being labeled the “bad guy” in these debates, and as shown by the passage of the continuing budget resolution, there appears to be some improvement in cooperation

DID YOU KNOW...Risk /Reward in practice.

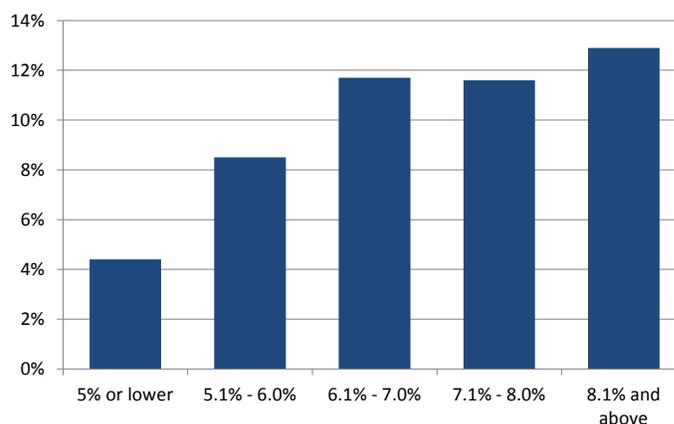
Historically, one of the biggest problems for investors at all levels has been poor timing. We tend to get into stocks at the top of an economic cycle when things look their best, and sell at bottoms when it becomes most apparent that economic conditions, and thus corporate profit prospects, have clearly deteriorated. Of course, we as human beings are simply acting on what seems intuitive.

As such, too many investors end up waiting until economic conditions are truly “good” before venturing back into the stock market. For instance some may decide to wait until the unemployment rate gets back down to 5% or 6% before considering equities again, seeing that as a sign of economic strength, and thus a sign of the stock market being “safe”, relatively speaking.

Unfortunately, history shows that the truth is usually the exact opposite. The best average returns for the S&P 500 have come when unemployment has been high – clearly a prime example of the risk /reward trade-off.

As shown in the chart below, investor returns have historically (since 1942) been their worst (over the next 5-years, via our study) when the unemployment rate was low. The best returns have come to those with the fortitude to buy stocks when the unemployment rate is high. We believe the results reflect the notion that corporate profits can rise as the unemployment rate falls but when the unemployment rate is already low, corporate profits may have little room for further advancement.

Avg. annualized returns for S&P 500 5 years fwd. at various unemployment rates



Source: Labor Department, Moody’s Analytics, Ameriprise Financial Services, Inc.

The pattern, however, also brings to mind one of the longest-held truisms of investing: past performance is no guarantee of future results.

A QUICK LOOK AT INTERNATIONAL CONDITIONS.

Admittedly, we have grown slightly more concerned about global economic prospects over the last month. Most notably, recent economic data leaves us unconvinced of a pending economic improvement in Europe.

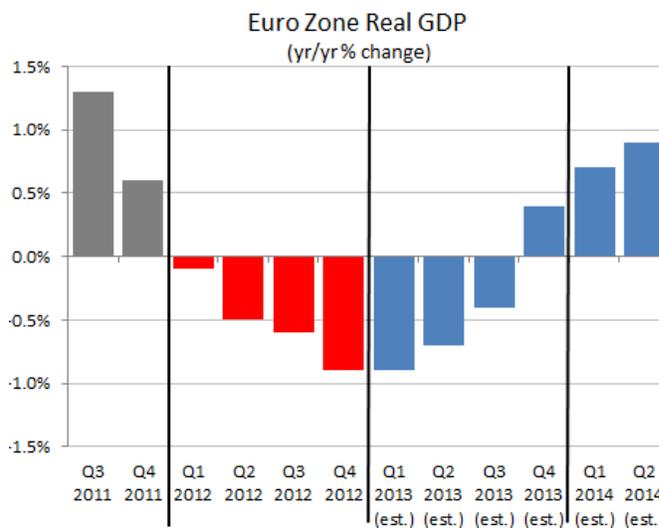
European auto sales were close to a 20-year low in the month of March, although the crisis in Cyprus likely played a role in quelling consumer demand for big-ticket items during the period. Overall, European auto sales were down 10% on a yr/yr basis, while sales in the region's largest, and seemingly strongest economy, Germany, experienced a 17% yr/yr drop.

As we have pointed out previously, many Euro Zone nations have done a decent job of right-sizing their government budgets. However, even harder work, that of making their economies more globally competitive, has not been embraced to any material degree and voters seem increasingly set against such reforms. We point to the recent elections in Italy where market reformer and former technocratic leader, Mario Monti placed poorly, and anti-austerity parties did well. (The newly-elected Italian parliament is still trying to form a coalition government. These efforts look likely to fail and a new round of elections seems likely this summer.)

We also point to the recent constitutional court ruling in Portugal that overruled a government plan to trim public sector wages, benefits, and work rules, as a key example of the stern headwinds such reforms still face across the region. The court said such actions discriminated disproportionately against government workers.

If European growth prospects continue to falter, as we increasingly fear they may, we believe the European Central Bank (ECB) could eventually take a greater role in efforts to stimulate regional business activity. Over the long-term however, the Euro Zone faces a dim economic future, in our view, unless it can find the fortitude to adjust to the changing global economic landscape and achieve greater market competitiveness. The region's greatest challenge remains labor-market flexibility.

Forecasts of a return to economic growth in the Euro Zone have consistently been pushed back over the last several quarters. The region was long-ago expected to be seeing some modest economic expansion by this time, after what was thought would be a year-long recession. Current forecasts now look for the region to emerge from its recession by the end of this year, thus equating to nearly two years of recession.



Source: Consensus estimates via Bloomberg

Global view: The International Monetary Fund (IMF) recently trimmed its 2013 global economic forecast modestly. The organization now expects world growth to reach 3.3% this year (as compared to 3.2% in 2012), rising to 4.0% in 2014. In its January update, the organization said it expected global growth this year of 3.5%.

The most significant adjustment to the IMF forecast was for that of Japan. The organization is now forecasting the Japanese economy to grow by 1.6% this year (fairly good by Japanese economic standards) versus a prior estimate of 1.2%, and by 1.4% in 2014 versus a prior 0.7%. The upward revisions are largely based on Japan's recent moves to stimulate its economy through monetary measures and the resulting decline in the value of the Yen. Unfortunately, currencies are a zero-sum game, so Japan's benefit from a weaker Yen may very well come at the expense of economies elsewhere in the world.

IMF World Economic Outlook: Year-over-year Real GDP

	2012	Projections	
		2013	2014
World	3.2	3.3	4.0
United States	2.2	1.9	3.0
Euro Region	-0.6	-0.3	1.1
Japan	2.0	1.6	1.4
China	7.8	8.0	8.2
Emerging and Developing Economies	5.1	5.3	5.7
India	4.0	5.7	6.2
Russia	3.4	3.4	3.8
Brazil	0.9	3.0	4.0

Source: International Monetary Fund (IMF), Ameriprise Financial Services, Inc.

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

The first quarter earnings release season is just getting underway as of this writing. S&P 500 earnings for the period are expected to be flat on a year-over-year basis and down 4% versus the preceding quarter. Analyst's expectations for the quarter have come down modestly over the last few months as estimates for the period started the year looking for yr/yr earnings growth of about +3%.

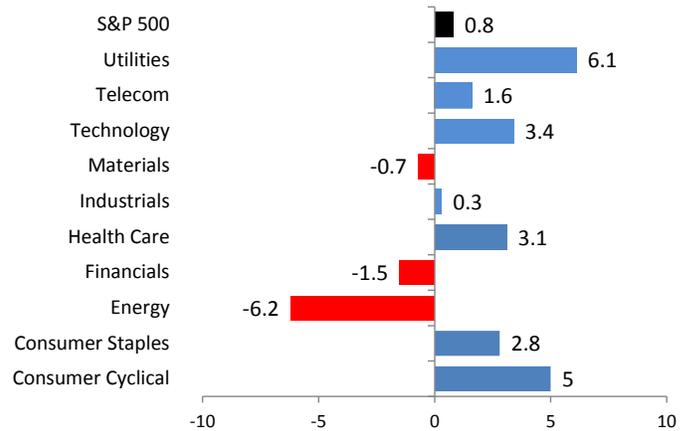
Ultimately, actual results have been outperforming analyst estimates on a fairly consistent basis over the last several quarters. Q4 actual results were 7% higher yr/yr versus expectations for 2% growth. However, the recent "pre-release" season has had a much more negative tone than we have seen in some time. The U.S. economy seems to have performed better than expected in the period but European conditions remain weaker than most forecasters had anticipated.

Consensus estimates currently look for 2013 S&P 500 earnings of \$111.68 (a 7% yr/yr gain).

Revenue results for the first quarter are also expected to see modest growth. According to Bloomberg data, Utilities should benefit from this year's much more winter-like seasonal conditions. Consumer discretionary companies are also expected to benefit from the relative consistency of consumer spending, particularly for automobiles.

On the downside, lackluster global economic growth and weaker commodity prices are expected to weigh on revenues in the Materials and Energy sectors.

Sales per share by Sector
(S&P 500, Q1-2013, yr/yr %)



Source: Bloomberg, Ameriprise Financial Services, Inc.

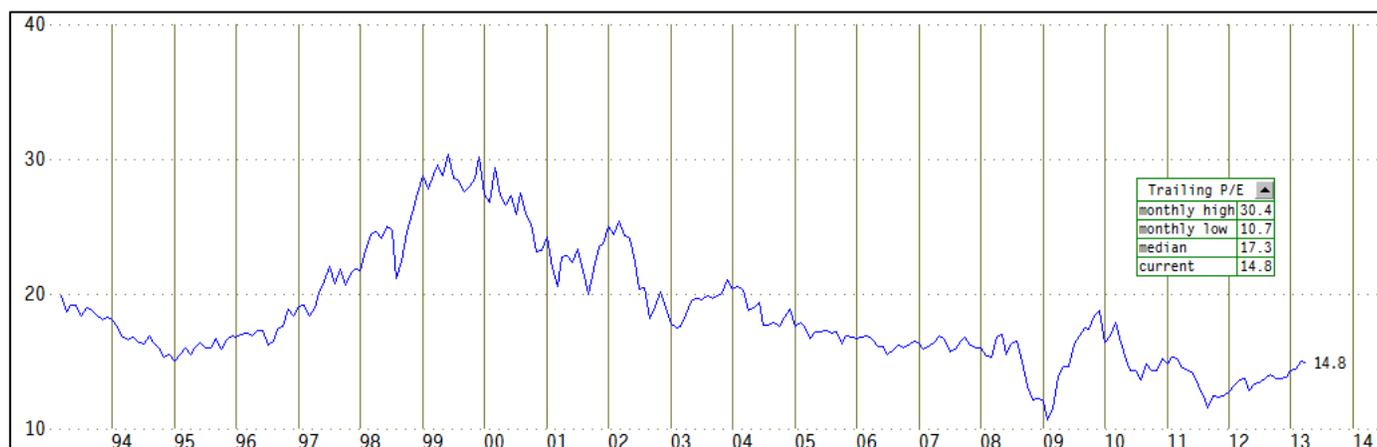
Year-over-year Operating EPS growth: Actuals and Estimates:

	Q1-2012	Q2-2012	Q3-2012	Q4-2012	Q1-2013	Q2-2013	Q3-2013	Q4-2013	Calendar 2011	Calendar 2012	Calendar 2013	Forward P/E
	ACTUAL	ACTUAL	ACTUAL	ACTUAL	Estimate	Estimate	Estimate	Estimate	ACTUAL	Estimates	Estimates	
Consumer Cyclical	9%	1%	11%	16%	5%	15%	13%	12%	10%	9%	10%	17.5
Consumer Staples	6%	-3%	-8%	8%	4%	15%	25%	11%	9%	1%	12%	17.7
Energy	0%	-4%	-12%	12%	-3%	-6%	5%	0%	37%	-2%	-1%	11.8
Financials	-33%	0%	23%	15%	2%	18%	-2%	14%	26%	-4%	7%	12.2
Health Care	2%	4%	1%	0%	0%	2%	6%	13%	8%	2%	5%	15.3
Industrials	17%	13%	3%	-1%	-1%	3%	13%	17%	22%	8%	7%	14.3
Materials	-6%	-17%	-24%	7%	-1%	13%	31%	36%	35%	-12%	16%	13.8
Technology	15%	7%	2%	3%	-3%	1%	12%	10%	18%	7%	2%	13.0
Telecom	6%	-4%	-1%	-6%	-8%	13%	20%	52%	-3%	-1%	16%	19.9
Utilities	-8%	10%	-10%	13%	1%	-16%	5%	1%	0%	-1%	-2%	16.5
S&P 500 Total	-3%	2%	2%	7%	0%	6%	9%	12%	18%	2%	7%	14.2
S&P 500 Trailing												
12-month Operating EPS	\$101.77	\$102.24	\$103.00	\$104.61	\$104.56	\$106.10	\$108.52	\$111.68	\$102.69	\$104.61	\$111.68	

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

Stock market valuations currently reside near the lower band of their historical range. At just under 15, however, valuations are almost a full point higher than their levels of just 6 months ago. Should global economic growth slow or corporate profit growth turn negative, we believe there is room for valuation contraction. However, current levels also suggest fairly sound support. Thus, if economic growth was to accelerate or profits expand at a better than expected pace, valuation levels could offer stock prices some added leverage.

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



Source: Thomson Reuters Baseline.

First Call S&P 500 earnings outlook:

S&P 500 Earnings Estimates	2012				2013				2014			
	Actual Q1	Actual Q2	Actual Q3	Actual Q4	Estimate Q1	Estimate Q2	Estimate Q3	Estimate Q4	Estimate Q1	Estimate Q2	Estimate Q3	Estimate Q4
4/16/2013												
Quarterly \$\$ amount	\$25.71	\$26.00	\$26.11	\$26.76	\$25.69	\$27.54	\$28.53	\$29.92	\$28.89	\$30.77	\$31.56	\$32.78
yr/yr	-3%	2%	2%	7%	0%	6%	9%	12%	12%	12%	11%	10%
qtr/qtr	3%	1%	1%	1%	-4%	7%	4%	5%	-3%	7%	3%	4%
Trailing 4 quarters \$\$	\$101.77	\$102.24	\$103.00	\$104.61	\$104.56	\$106.10	\$108.52	\$111.68	\$114.88	\$118.11	\$121.14	\$124.00
yr/yr				2%				7%				11%
Implied P/E based on a S&P 500 level of 1552.0	14.9	14.8	14.7	14.5	14.8	14.6	14.3	13.9	13.5	13.1	12.8	12.5

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

SUMMARY

Recently, some U.S. economic measures have faltered in comparison to early-year strength. We believe this to be a confluence of the reduction in consumer disposable income due to higher payroll taxes, recently instituted government spending cuts, and very difficult winter weather conditions (many of us were reminded of what winter is *supposed* to feel like this year). These influences should generally fade as we move forward.

We still believe underlying fundamentals are in an economically supportive position so as to foster a modestly faster pace of expansion in the second half of the year (~3.0%). In fact, we believe the improvement in many fundamental balances has been key to keeping the economy on a positive path amidst recent fiscal headwinds.

As we enter 2014, we are likely to face yet another modest headwind in the added costs and uncertainty associated with the Affordable Care Act. The added taxes, costs, and complexity of this transformative new health care arrangement will not come without some economic cost. Overall, we believe such adjustments will likely come at a cost of about 0.5 percentage points of potential GDP.

Over the intermediate-term (3 to 5 years), we continue to see a modest pace of economic expansion for both the U.S. and global economy. The housing market is recovering, employment growth is slowly accelerating, consumer balance sheets are improving, and despite the constant battles, there has even been some progress on U.S. deficit reduction (though still not nearly enough). However, there remains a need for further deleveraging at the government level. Combining these factors, we believe economic growth is likely to remain in a fair but sustainable range of 2.0% to 3.0% for some time. On a positive note, such conditions should foster a continuation of today's relatively benign inflation backdrop, as well as keep interest rates relatively low for a prolonged period (though rising slowly off of today's near-historic lows).

RISKS

Though we have confidence in our forecast of a slow, continuing economic recovery, we recognize that a number of serious economic and financial market challenges remain. The European Sovereign Debt crisis remains very dynamic and subject to market sentiment. Should this situation actually come to a "make-or-break" crisis momentum, we are somewhat confident the European Central Bank would step in as a lender of last resort, but such support is far from guaranteed.

Government debt loads are exceptionally high in many 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.

Additionally, we are still in uncharted 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.

Oil and other commodity prices also pose a risk to the economic outlook. Crude oil prices have the potential to place a ceiling on global growth prospects as prices seem to rise with every sign of economic life, as would potential spikes related to tensions with Iran. Of course, the unpredictable aggressive behavior of North Korea also poses a considerable risk to global stability going forward as well.

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