



2016 Economic Outlook

January 27, 2016



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The Rat Pack

...1964



Dean Martin....Maybe Frank, Maybe Sammy

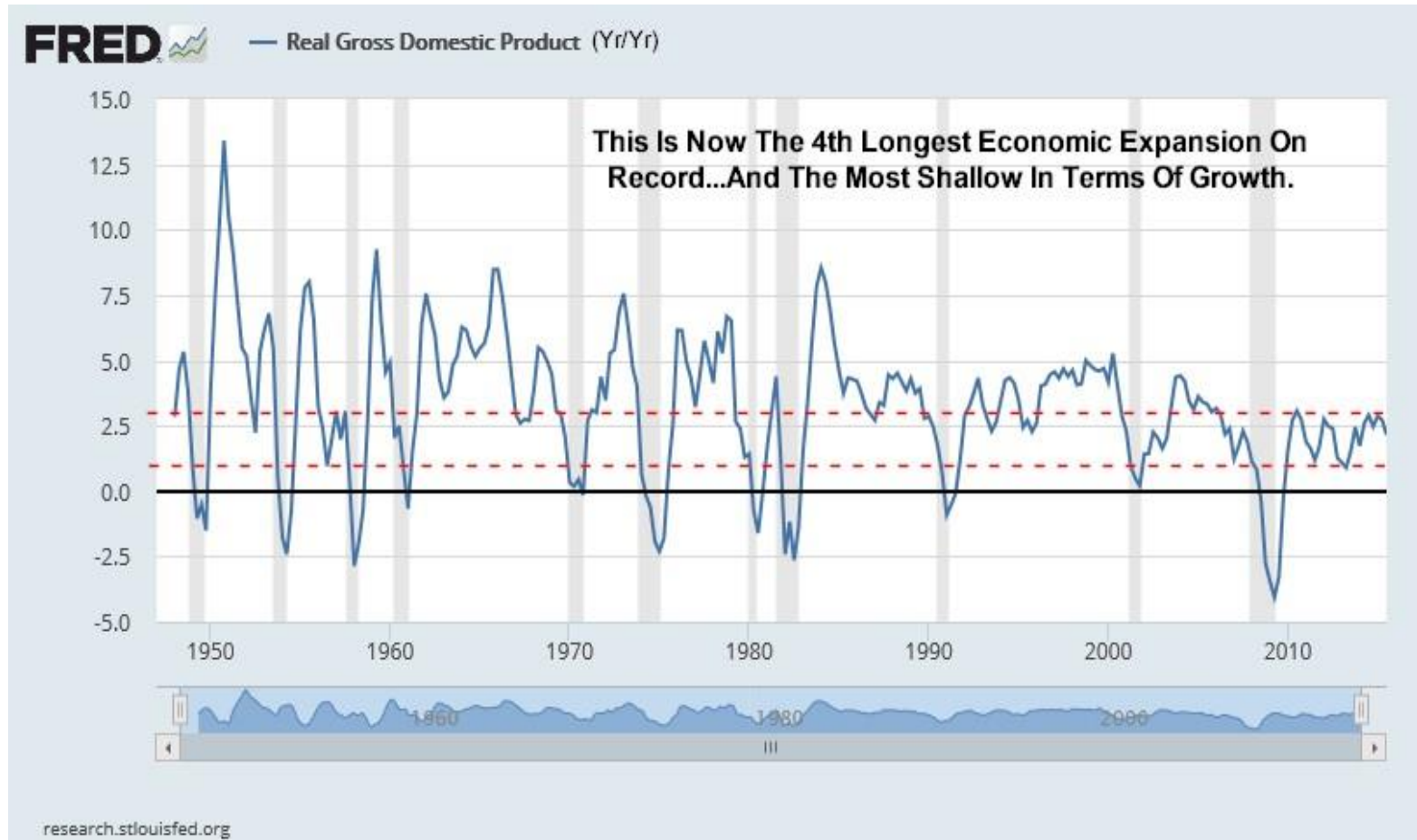
...2016



Janet Yellen....Maybe Mario, Maybe Shinzo

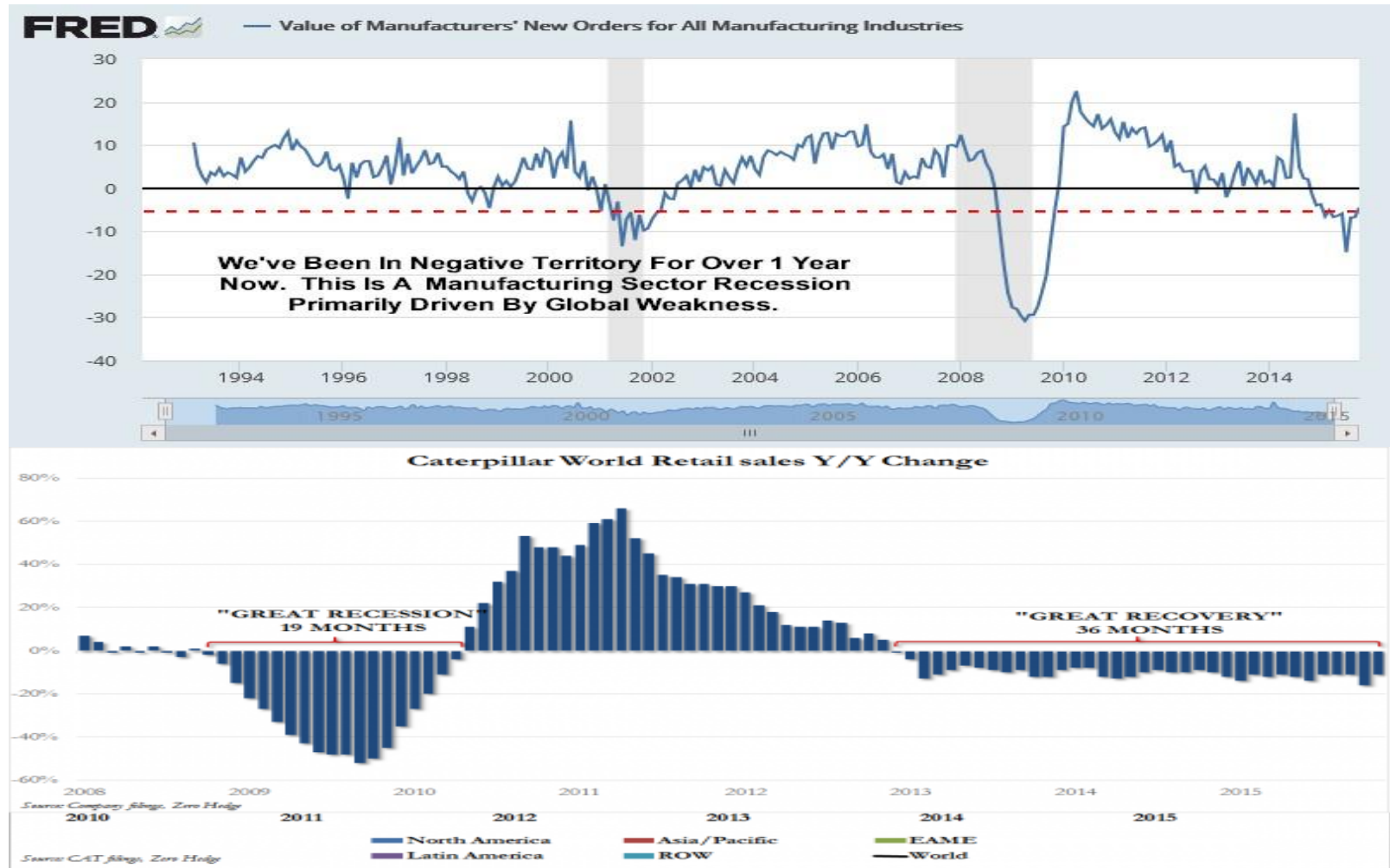
Real GDP

Baby, It's Cold Outside



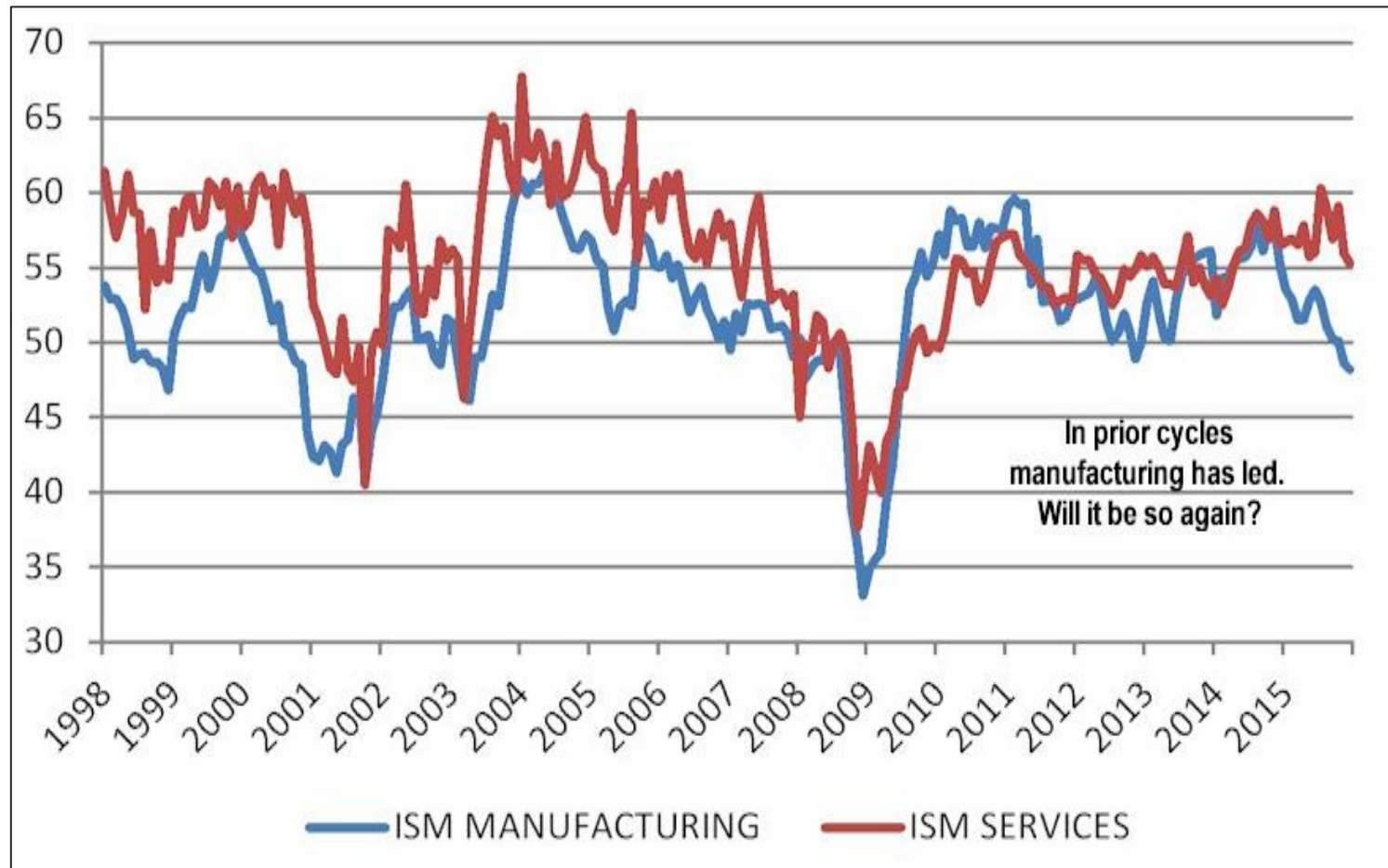
The Leading Economic Indicators

Some Cats Just Swing Like That



ISM Manufacturing & Services

Let Me Tell You Brother, You Can't Have One Without The Other?



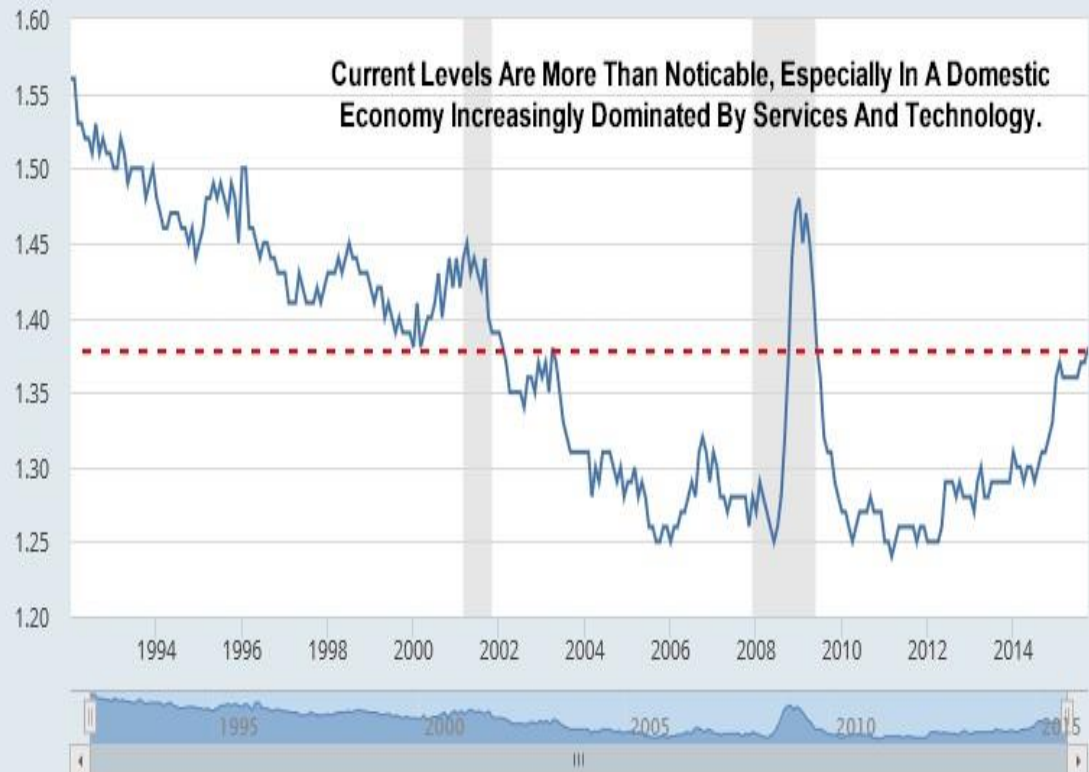
Inventories to Sales

They Call You Lady Luck, But There Is Room For Doubt. At Times You Have A Very Un-lady Like Way Of Running Out



FRED

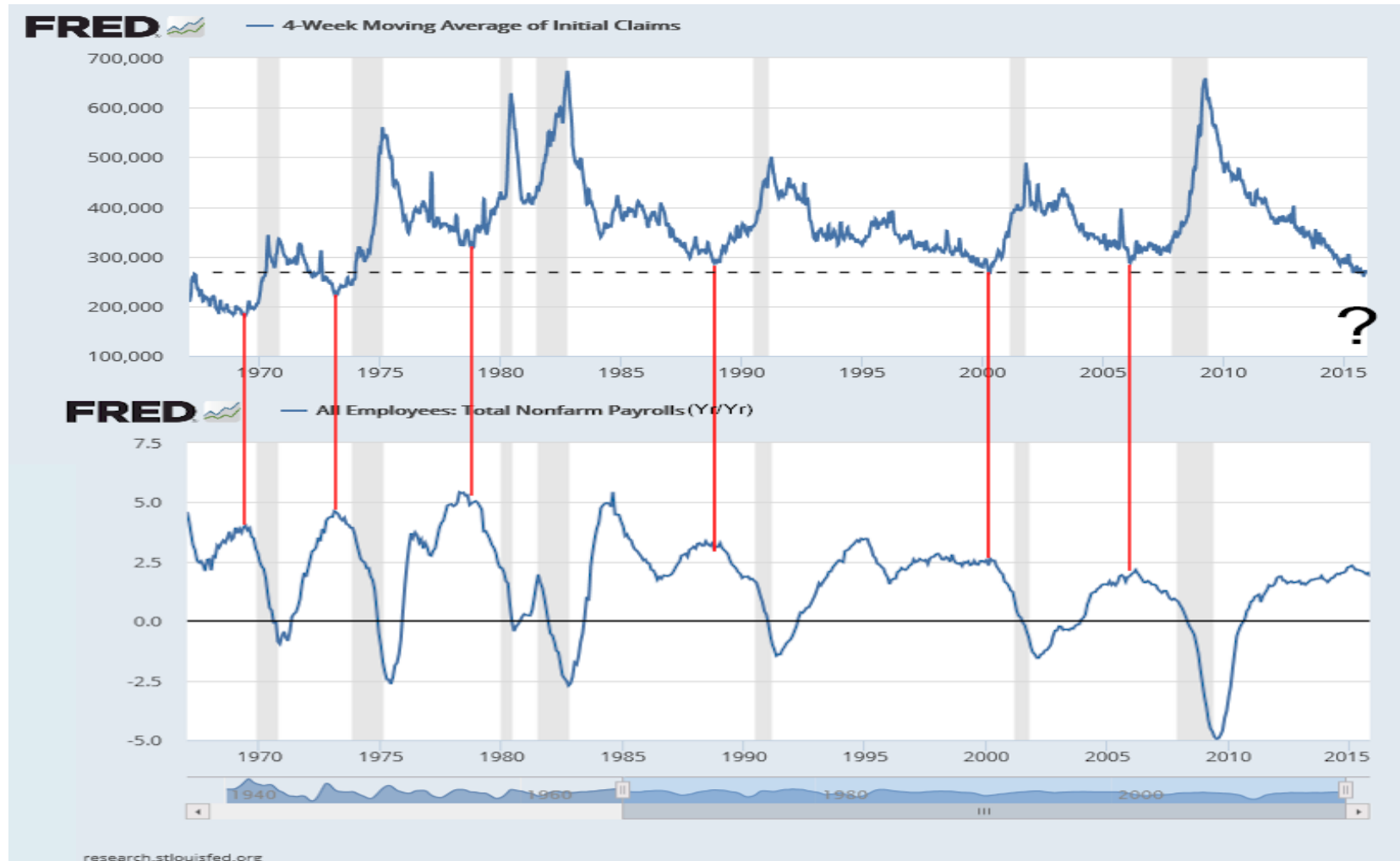
— Total Business: Inventories to Sales Ratio



research.stlouisfed.org

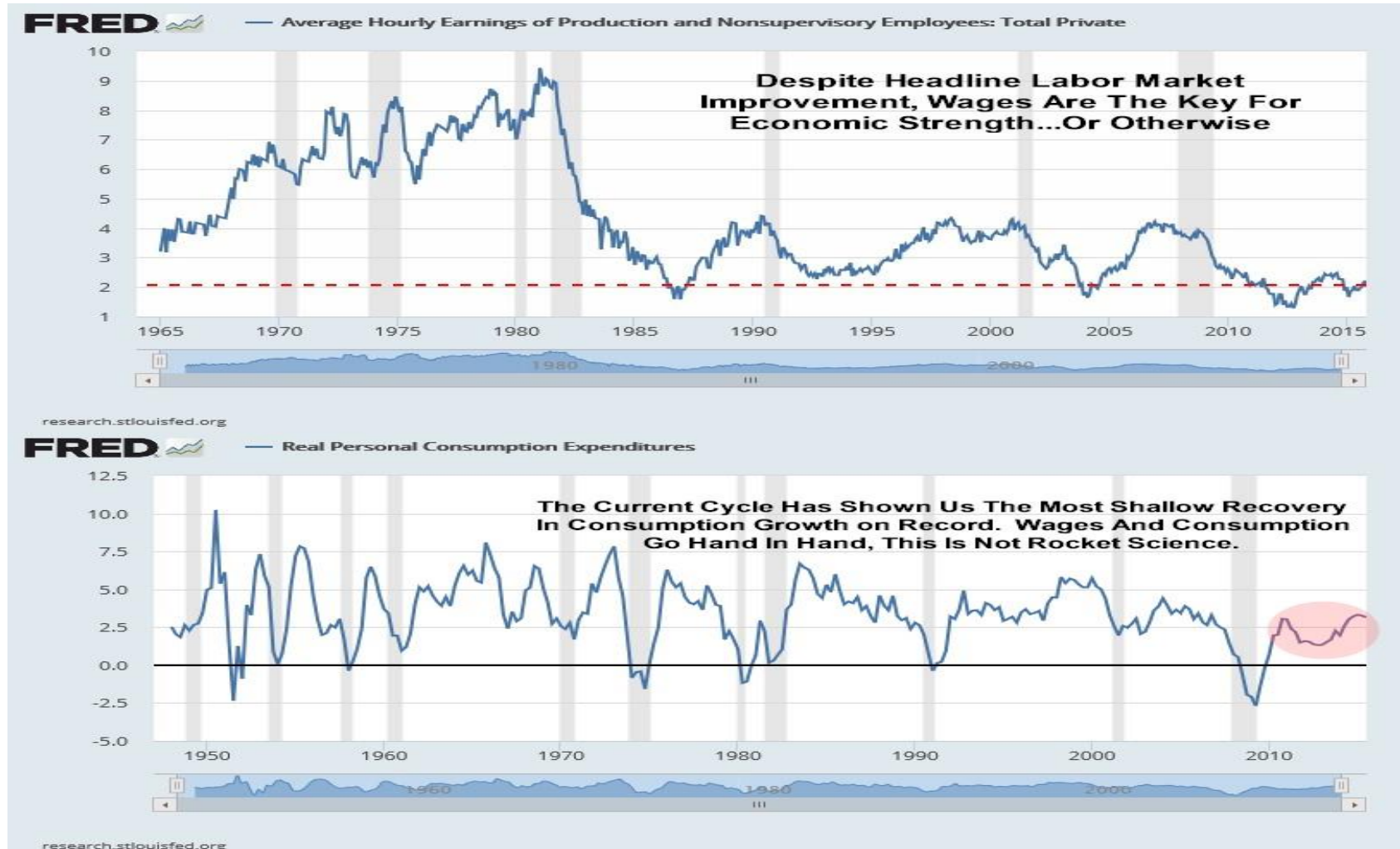
Claims | Payrolls

You Make Me Feel So Young, You Make Me Feel Like Spring Has Sprung



Earnings | Expenditures

When You See A Joe Savin' Half His Dough, You Can Bet He'll Be Minting It For Some Doll



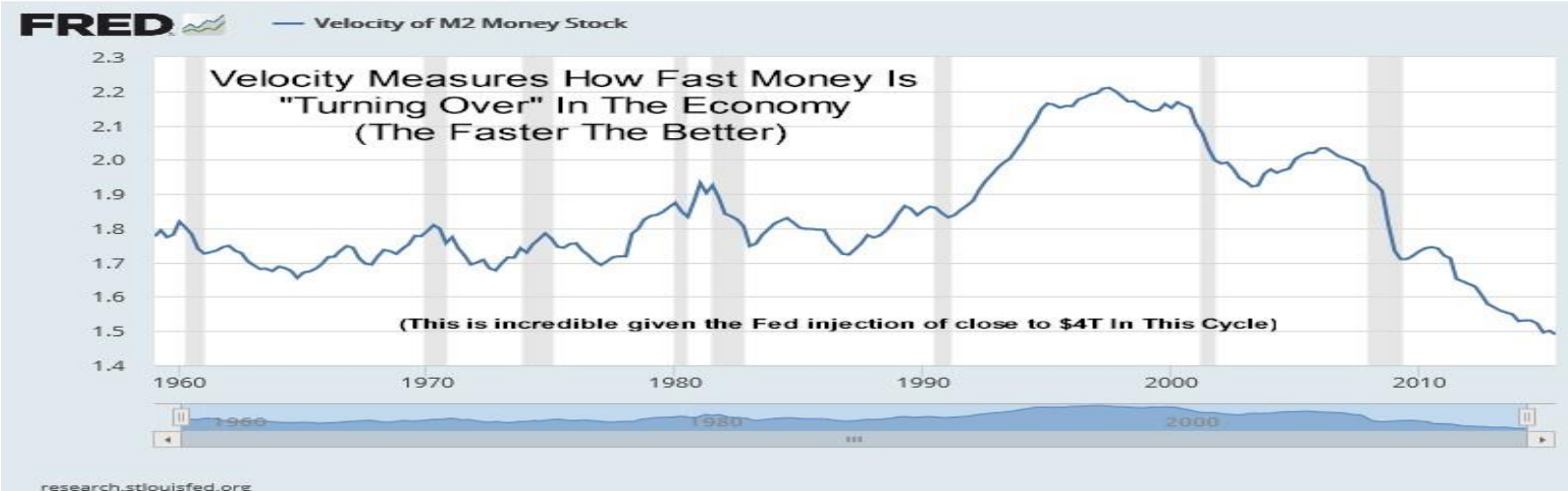
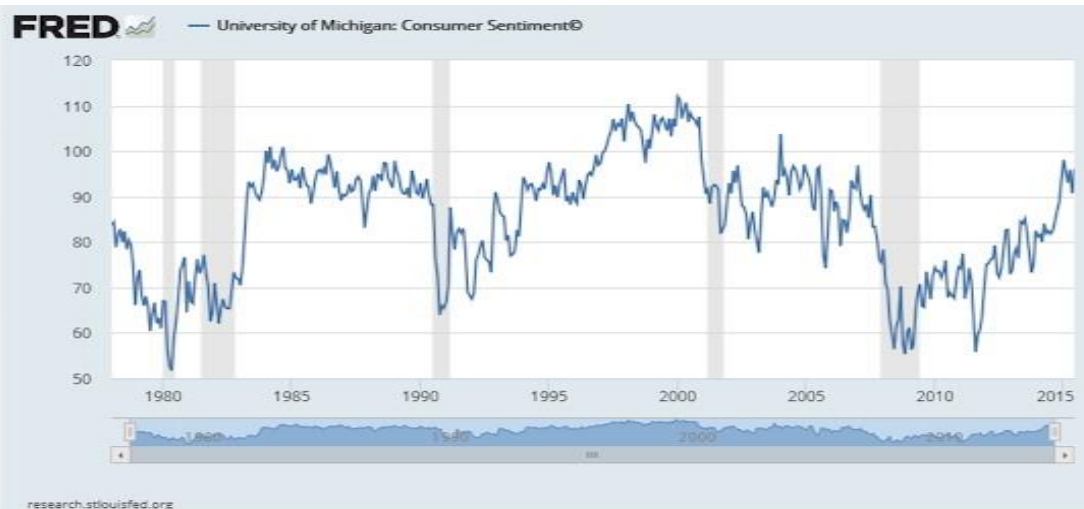
Retail

My Fickle Friend, I Lost You To The Summer Wind



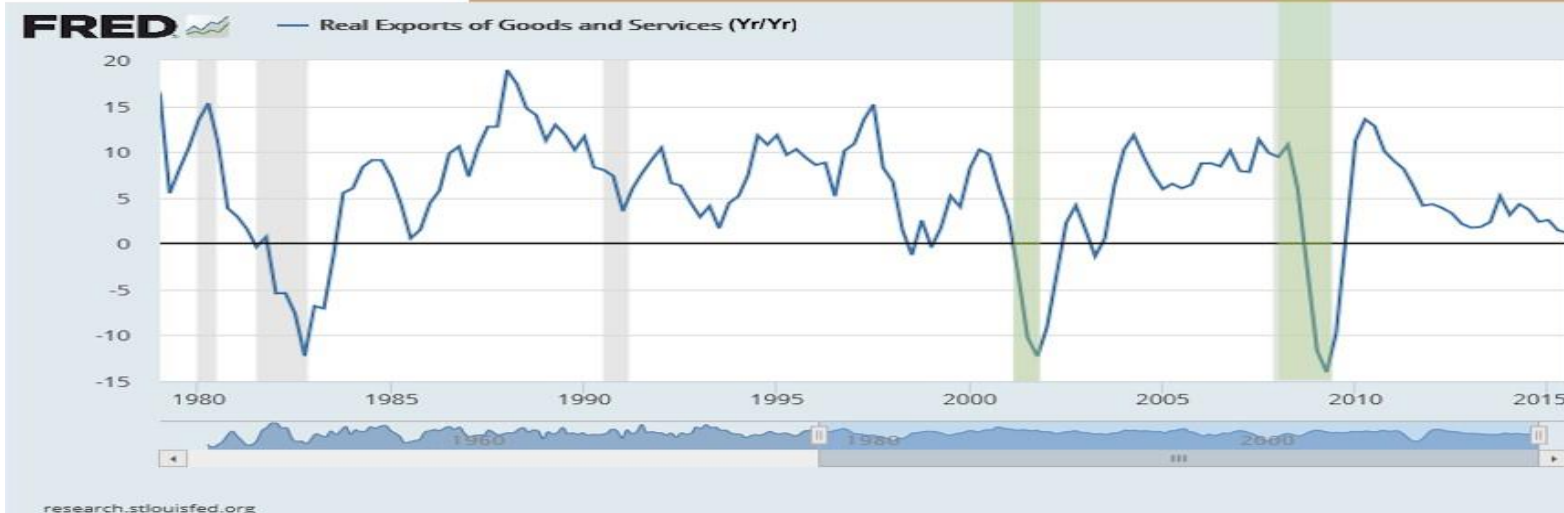
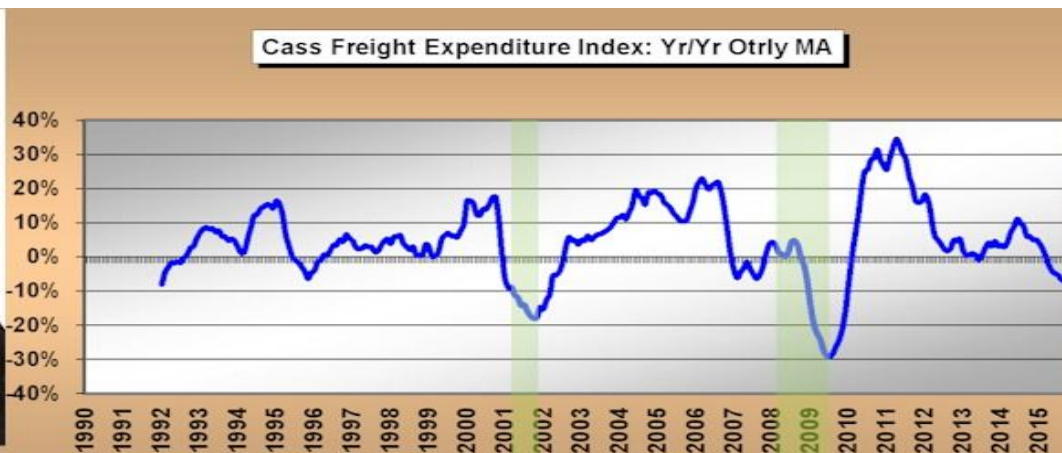
Consumer Sentiment

When The World Starts To Shine Like You've Had Too Much Wine, That's Amore



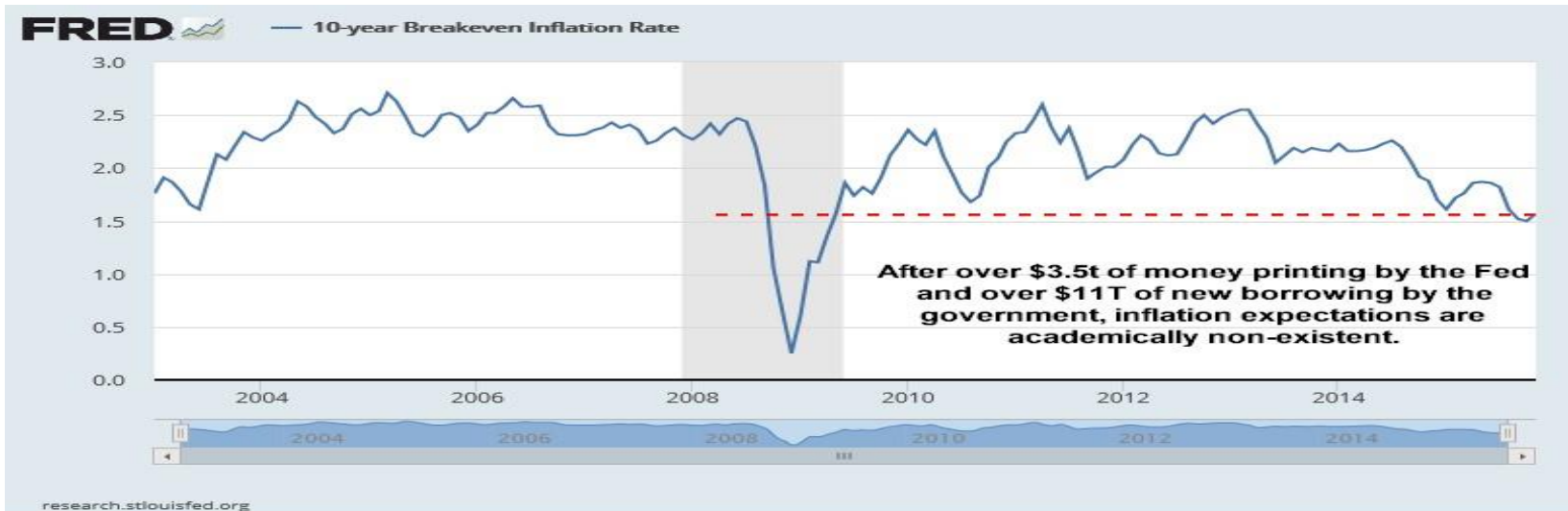
Exports

Got The World On A String, Sittin' On A Rainbow



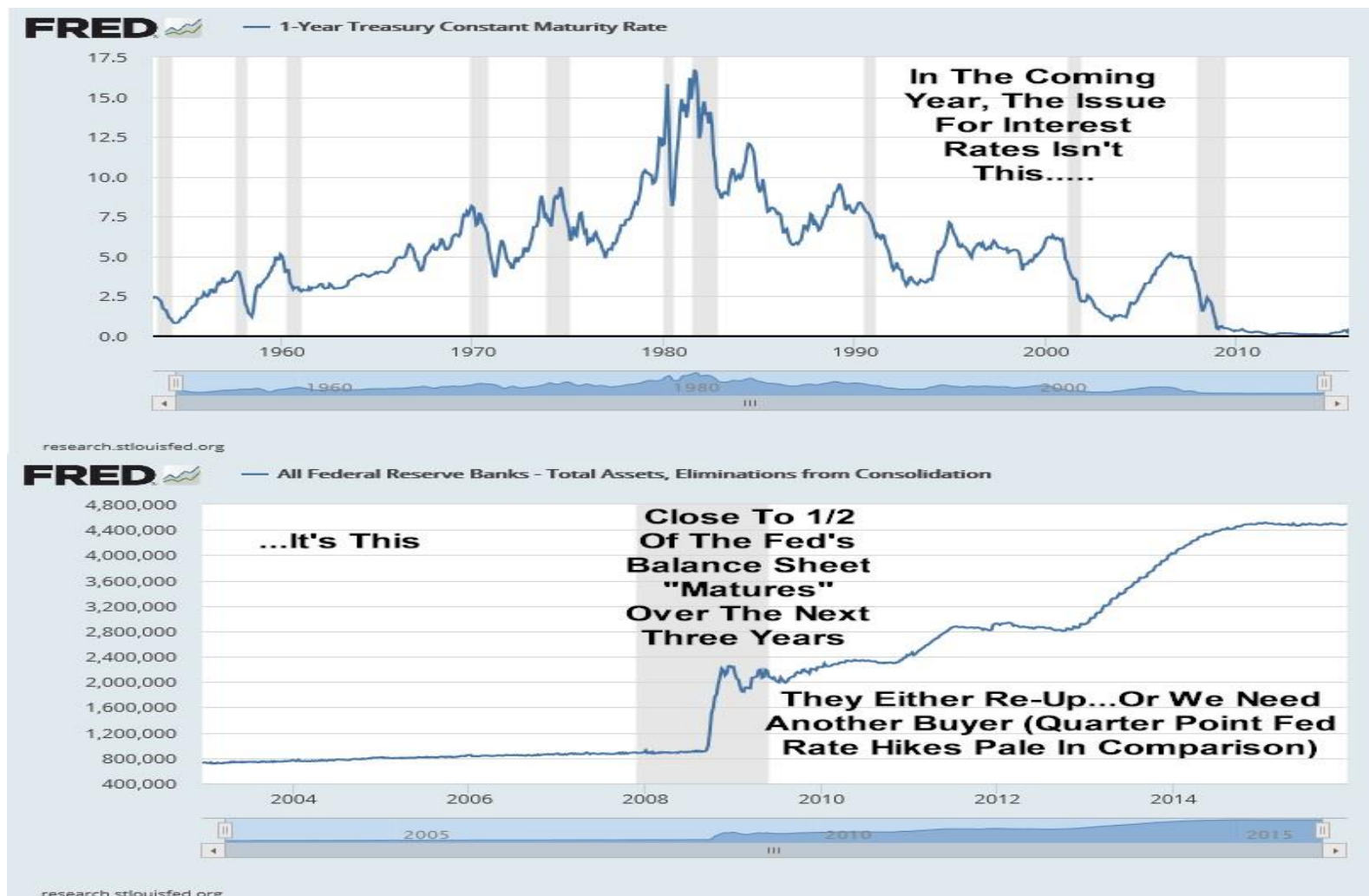
Inflation

Weather-Wise It's Such A Cuckoo Day



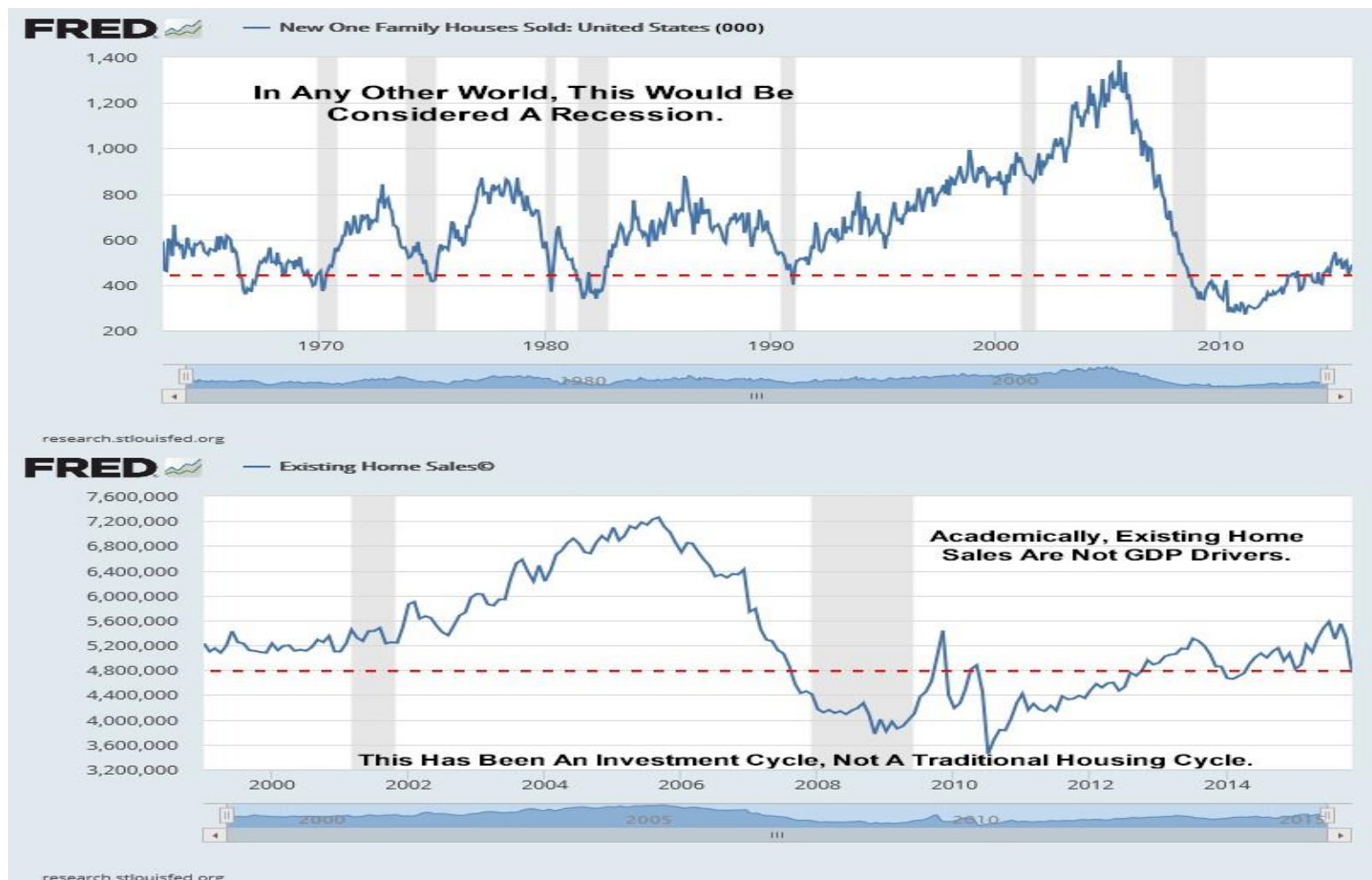
Interest Rates

A Lady Doesn't Wander All Over The Room And Blow On Some Other Guy's Dice



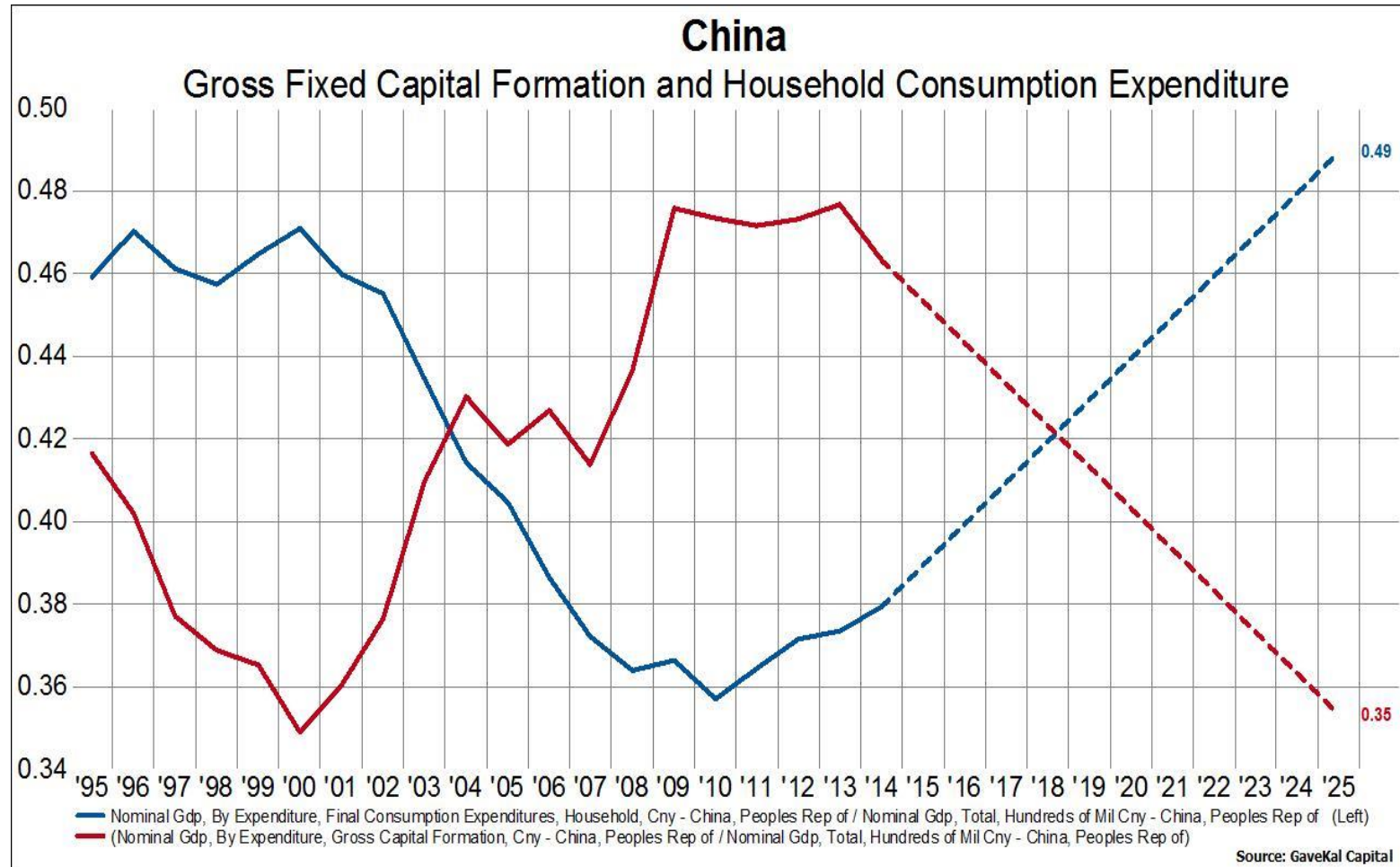
Real Estate

Don't Know What The World Is Commin' To, But In Rome Do As The Roman's Do, Will You On An Evening In Roma?



China

All Or Nothing At All?



Key Macros For 2016 US Economy

My Kind Of Town?

- Never in modern history have events outside of the US precipitated a US recession. Will this cycle be the game changer? Since this has never happened, little to no one is expecting this. The Emerging Market economies are key to domestic outcomes.
- US manufacturing sector is in recession right now. This is the key linkage to the emerging/global economy.
- In the current cycle, the offside balance sheets belong to the government (public) sector. Reconciliation is only a matter of when, not if. This issue is global, not just domestic. How will this impact the “private sector” economy ahead? Taxes hikes and/or spending cuts seem destined to be reality.
- The good news is that outside of the energy sector, there is no “credit crisis” in the US private sector. This is not a 2007-2008 replay for the private sector. Will that be the same for government “credit” before the current cycle plays out?
- What China does in terms of currency devaluation holds the key. Devalue slowly and lose currency reserves? Or devalue quickly and send a deflationary shock across the global economy?

Investment Issues Of Importance

Fundamental Reality:

- Japan again in recession.
- China slowdown is real and impacting global economy.
- US manufacturing and energy sectors in recession.
- Corporate Profits Recession – 2 Qtrs in a row, but largely predicated on energy.
- Corporate Revenues – 4 straight down quarters.
- Buybacks are in a big way supporting EPS (Large Cap US Stocks).
- Euro “Issues” Accelerate – Italy and France come to the front page?

Central Bank Reality

- ECB ready to do more QE and lower negative rates?
- Bank Of Japan – They said in early November they would review QE to do possibly more. Is that a lock given recession?
- PBOC – Lowered rates and banking system reserve requirements again. They have room for even more and I expect it. More currency devaluation to come. The currency issue is critical.
- Fed Rate hikes will come slowly. It all depends on financial market outcomes.

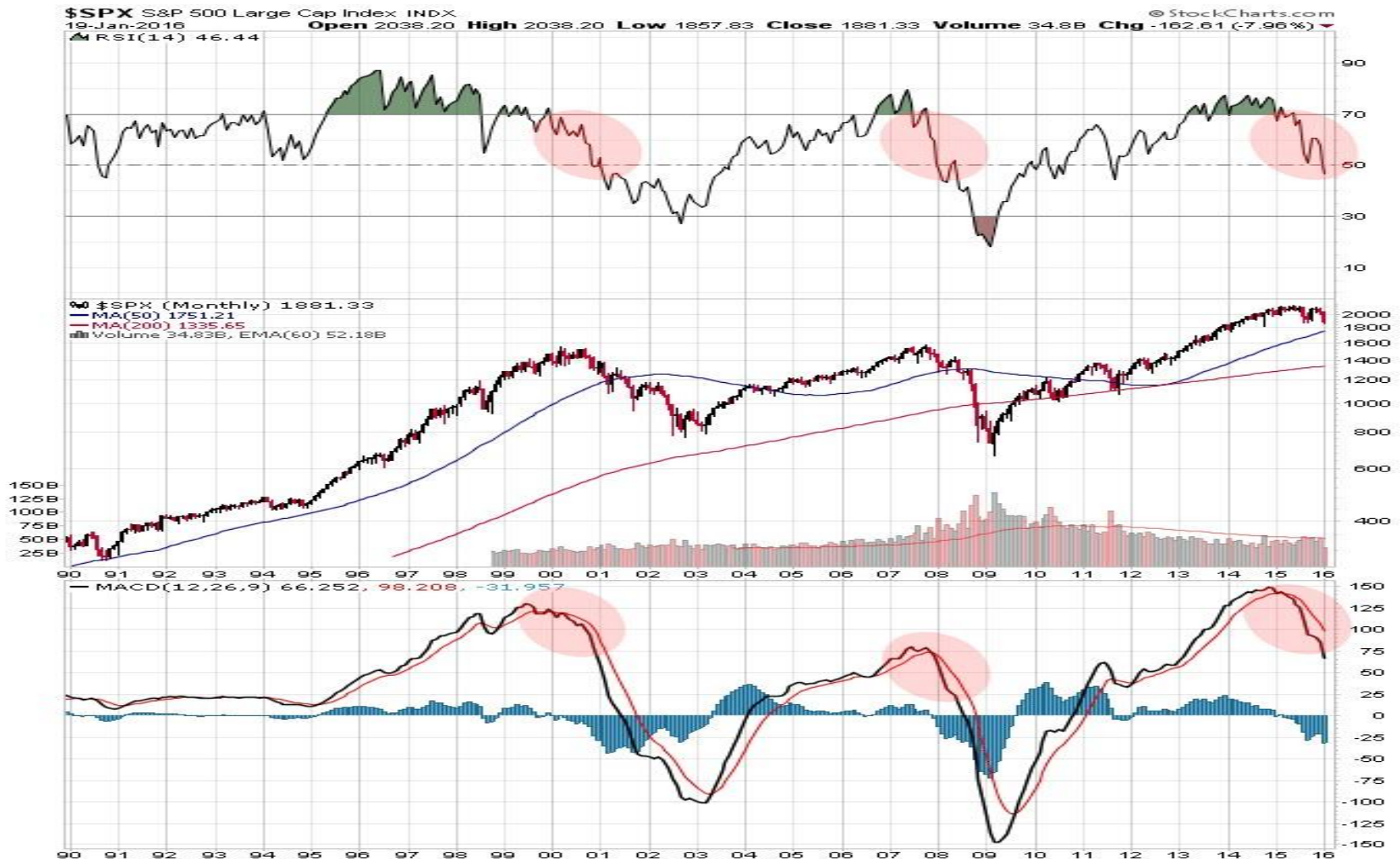
Will We Enter A Bear Market?

(Hint: We're Already In One)

Key Equity Indices Down Over 20% Since 2015 Highs:

- Value Line Index – 1675 Stocks
- Russell 2000 Small Caps
- S&P 600 Mid Cap
- Japan Nikkei
- US Transport Index
- US Semi Conductor Index
- Energy/Commodities
- China
- Bulk of S&P 500 Individual Stocks
- MSCI Emerging Markets
- Euro Stoxx 600
- MSCI World

It's ALL About Risk Management And YOU!



2016 Through A Broken Crystal Ball

The Direction Of The US Dollar Is Probably The Most Important Variable for 2016

Higher Dollar:	US Large Cap Stocks, Currency Hedged Large Cap Foreign Stocks Stay Away From: Emerging Markets, Commodities, Metals (for a while) A risk is the dollar is a very crowded trade.
Lower Dollar:	Emerging Markets, Commodities, Metals, Smaller and Mid Cap US Stocks
Stocks:	Large Cap US Growth, Top NASDAQ, SPX and DOW. Either bear market or spike up. Have a game plan for both.
Bonds:	Be very careful. There just is not a lot of money to be made here and plenty of money to be lost.
Gold:	Will gold bottom in 2016 after a 5 year bear market? IF the markets lose faith in the central banks and politicians, gold will shine.

Investment Issues Of Importance

Key Macros Ahead:

- Global capital is scared (debasement and confiscation) and simply looking for a repository for preservation on a global currency adjusted basis. Safety and liquidity is the goal.
- US Dollar markets deepest and broadest on Earth – liquidity.
- As the Fed raises rates, they will be the only Central Bank on Earth doing so – supportive of a higher dollar, perhaps much higher.
- Global capital flows are the key to financial market outcomes. As such, relative currency movements are inextricably tied to these outcomes.
- KEY risk to potential financial market volatility – loss of faith in central banks and politicians
- Equities have the chance to skyrocket....or tank. We need a plan for both potential outcomes.
- The pension system in the US will probably be the casualty as this cycle ends (along with long overdue government balance sheet reconciliation – markets will force it). Will they be “forced” into stocks as a “last man standing asset class”.

Strategy:

- Use patience and weakness to get existing cash to work.
- For now, dollar centric focus or dollar hedged in foreign exposure.
- Global capital will gravitate primarily toward large caps, not small or mid (just like high end real estate versus low end).
- Capital Preservation remains an overriding objective. Manage risk at the asset level as well as overall portfolio level.



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M&A Market Drivers

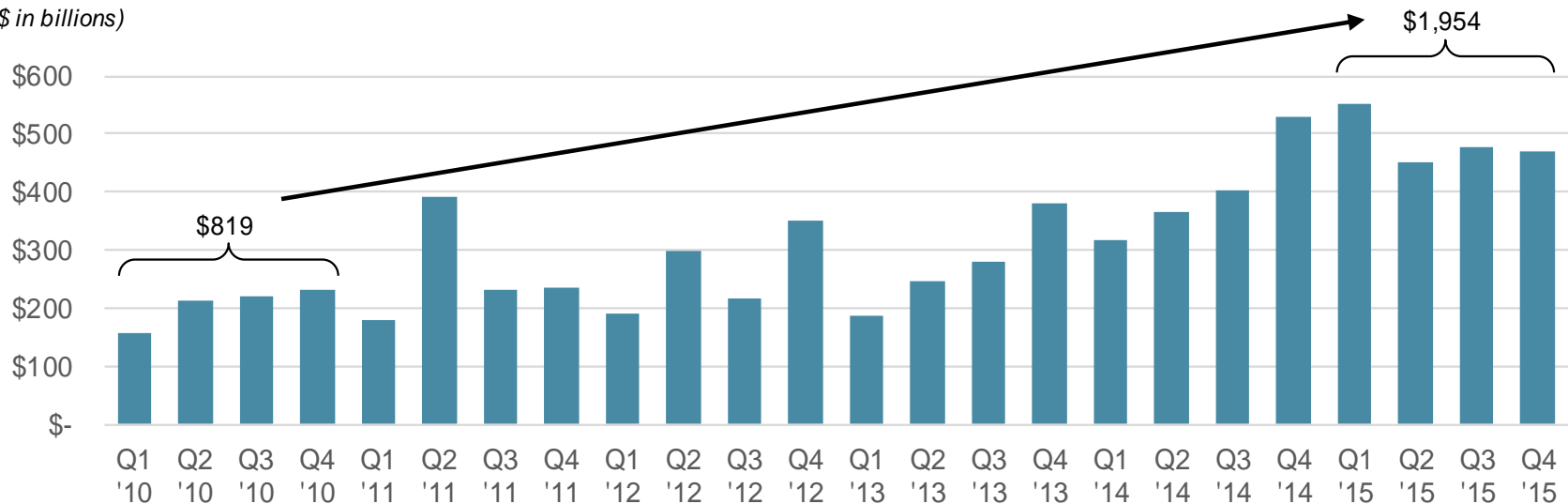
Indicator	Current	Impact
Interest Rates	Prime Rate: 3.50%	Increases access to debt and lowers the cost of capital, which both support higher valuations
GDP	US: 2% China: 7%	Affects organic opportunities for expansion and drives companies to pay premiums for growth opportunities
Corporate Cash	\$1.8 tn	Idle cash does not generate returns, so companies use excess cash for acquisitions to drive growth
PE Capital	\$535 bn	High levels of capital and a limited timeframe to invest can drive up M&A activity and valuations

M&A Volume

- M&A activity picked up at the end of 2013 and remained strong through 2015
- Annual deal value has more than doubled since 2010

M&A Deal Value

(\$ in billions)



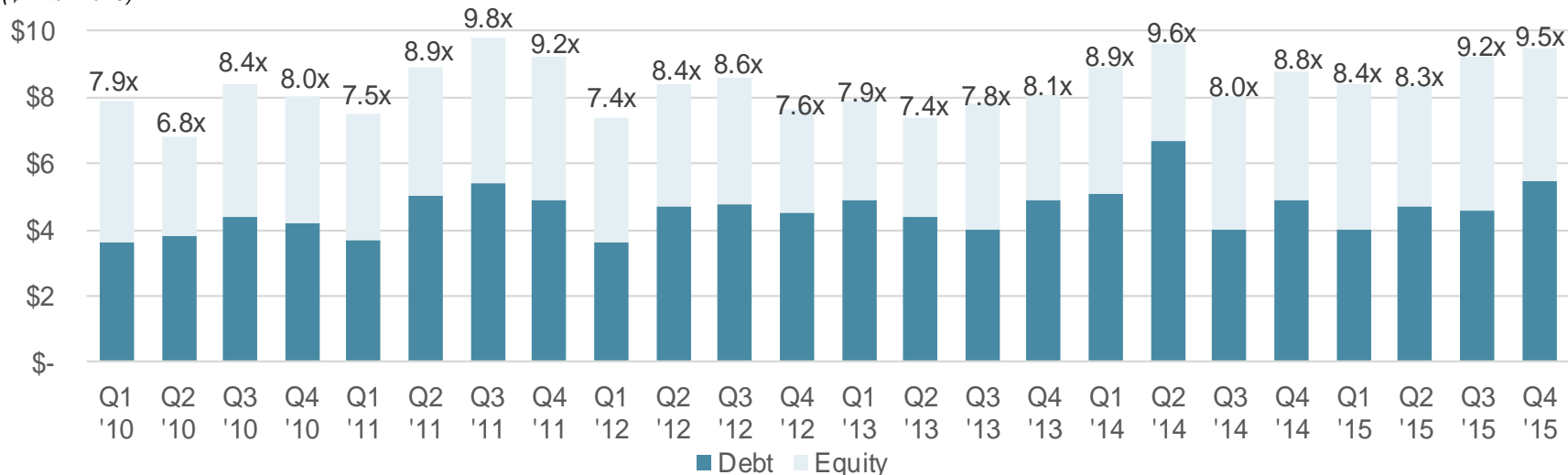
Source: Pitchbook 2015 M&A Report.

M&A Valuations

- M&A Enterprise Value (“EV”) / Earnings Before Interest Taxes Depreciation and Amortization (“EBITDA”) multiples are currently at the high end of their six-year range and well above historical lows

EV / EBITDA

(\$ in billions)



Source: Pitchbook 2015 M&A Report.

Largest M&A Transactions

- The top ten U.S. M&A transactions represented \$537 billion in enterprise value and were completed at high EV / EBITDA multiples
- Notable international transactions include Allergan plc's acquisition of Pfizer, Inc for \$190 billion, SABMiller plc's acquisition of Anheuser-Busch InBev SA/NV for \$116 billion and Acorn Holdings B.V. acquisition of Keurig for \$14 billion.

Top Ten U.S. M&A Transactions

As of December 31, 2015 (\$ in billions)

Date	Target	Buyer	Enterprise	Enterprise Value /	
			Value	Revenue	EBITDA
05/26/15	Time Warner Cable Inc. (NYSE:TWC)	Charter Communications, Inc. (NasdaqGS:CHTR)	\$ 78,224.4	3.40x	9.8x
10/12/15	EMC Corporation (NYSE:EMC)	Denali Holding Inc.	68,074.5	2.75x	13.3x
12/11/15	E. I. du Pont de Nemours and Company (NYSE:DD)	The Dow Chemical Company (NYSE:DOW)	69,104.7	2.15x	12.5x
06/21/15	Williams Companies, Inc. (NYSE:WMB)	Energy Transfer Equity, L.P. (NYSE:ETE)	67,023.3	8.63x	21.0x
03/25/15	Kraft Foods Group, Inc.	The Kraft Heinz Company (NasdaqGS:KHC)	53,739.0	2.95x	22.6x
06/20/15	Cigna Corp. (NYSE:CI)	Anthem, Inc. (NYSE:ANTM)	50,531.6	1.38x	12.9x
07/27/15	Allergan plc, Global Generic Pharmaceuticals Business	Teva Pharmaceutical Industries Limited (NYSE:TEVA)	40,500.0	-	-
07/03/15	Humana Inc. (NYSE:HUM)	Aetna Inc. (NYSE:AET)	37,102.4	0.71x	14.3x
08/10/15	Precision Castparts Corp. (NYSE:PCP)	Berkshire Hathaway Inc. (NYSE:BRK.A)	36,860.7	3.72x	13.9x
11/17/15	Norfolk Southern Corporation (NYSE:NSC)	Canadian Pacific Railway Limited (TSX:CP)	36,606.2	3.37x	8.8x
Median			\$ 52,135.3	2.95x	13.3x

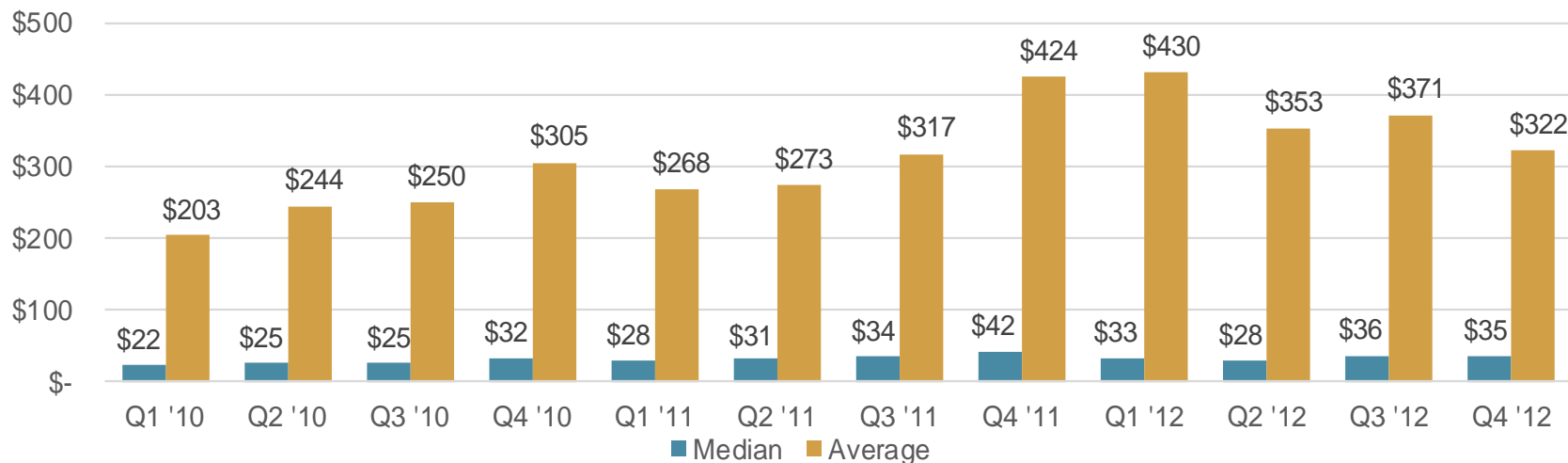
Source: CapitalIQ.

M&A Transaction Size

- Large deals distort the average transaction size
- The median transaction size shows that majority of the transactions are between \$20 million and \$40 million

Transaction Size

(\$ in millions)



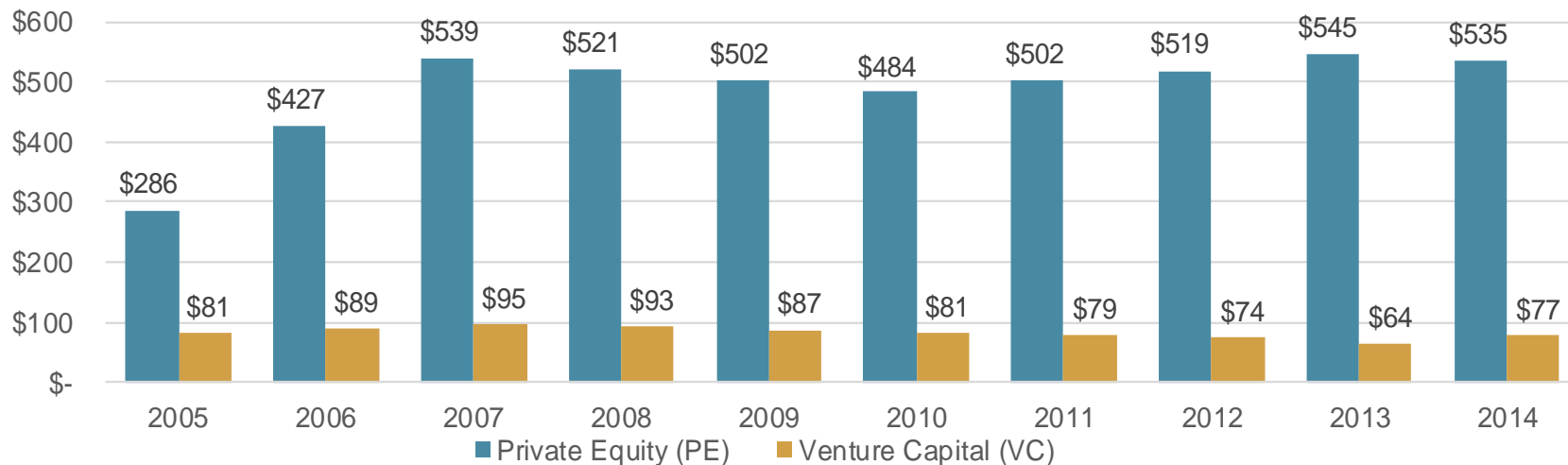
Source: Pitchbook 2015 M&A Report.

Private Equity

- The difference between committed capital and invested capital (“Capital Overhang” or “Dry Powder”) in private equity funds doubled from 2005 to 2007 leading up to the financial crisis
- The PE Capital Overhang has remained high due to limited opportunities during the financial crisis and continued inflows from investors seeking higher returns

PE & VC Capital Overhang

(\$ in billions)



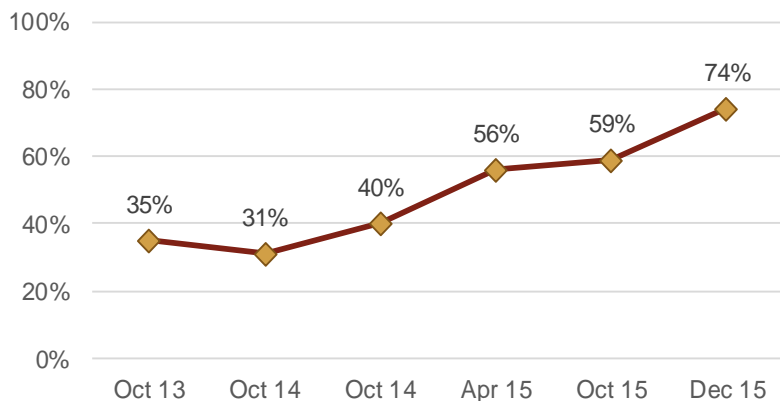
Source: Pitchbook 1H 2015 PE and VC Fundraising and Capital Overhang Report.

2016 M&A Outlook

We anticipate the M&A market having another banner year....Investor activism, a slow growth global economy, modest organic enterprise growth and high levels of cash on the balance sheet should support our outlook. Even if there are more restrictive U.S. federal tax policies, we do not see tax inversions tripping up the bigger M&A picture.

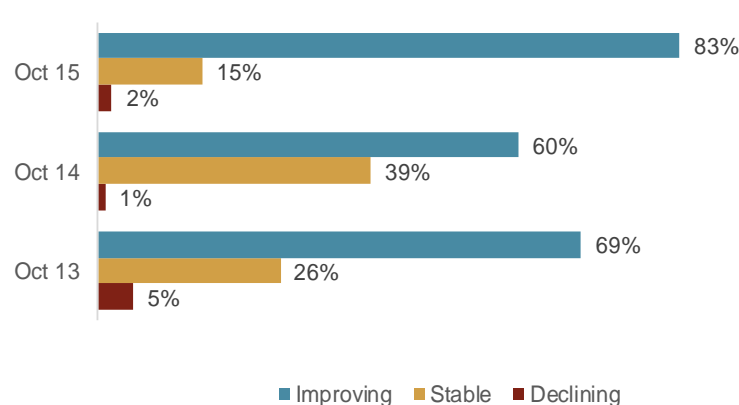
S&P Capital IQ

Companies Pursuing Acquisitions In Next 12 Months



Source: Ernst & Young Capital Confidence Barometer M&A Outlook Survey.

M&A Market Sentiment



Source: Ernst & Young Capital Confidence Barometer M&A Outlook Survey.

Conclusion

- Sellers
 - M&A activity and valuations are expected to remain high in 2016
 - Although EBITDA may continue to grow, enterprise value may not change dramatically in the mid-term if valuations decline from their current levels
 - Interest rate increases will likely have a negative impact on M&A activity
 - Stock market declines will lower M&A valuations
- Buyers
 - Even at higher valuations, acquisitions can be accretive
 - Synergies increase EBITDA and lower the implied purchase multiple
 - More sellers increase the likelihood of finding attractive targets



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