FLORIDA SAFE INVESTMENT POOL

Economic Update

April 27, 2017

PMA PRUDENT MAN ADVISORS

Economic Commentary

Economic Overview

In an effort to return to a more normal interest rate environment, the Federal Reserve Bank has increased interest rates twice within the last three months. As a result, the economic environment is changing from that of low interest rates, low inflation and an easy monetary policy to one of rising interest rates, somewhat higher inflation with a more hawkish Federal Reserve Bank. Since 2009, economic growth in the U.S. has remained below the long-run average of 3.1%. In an effort to boost economic growth, the Federal Reserve Bank has maintained low interest rates for more than a decade. Finally, it appears that the Fed's efforts to stimulate growth are starting to pay off. According to the third estimate released by the Bureau of Economic Analysis, fourth quarter gross domestic product (GDP) grew at a 2.1 percent annualized rate following a 3.5 percent gain during the third quarter. Growth was primarily driven by consumer spending, private inventory investment, residential and non-residential fixed investment, and state and local government spending. Federal spending and exports detracted from growth. For all of 2016, economic activity grew by 1.6 percent, the lowest since 2011, following a 2.6 percent growth in 2015.

Political drama continues to dominate headlines as market participants sit on the sidelines waiting for policy detail from the Trump Administration.

Economic Commentary

Incoming economic data appears mixed. Retail sales were relatively weak in February. Retail sales rose 0.1 percent versus the prior month at a gain of 0.6 percent. Only four out of thirteen major retail categories saw gains in February. The weakness was attributable to a delay in tax refunds. U.S. auto sales fell 1.1 percent to 1.33 million vehicles on an annualized basis compared to the same period last year. This was the second consecutive month of declines, possibly due to the cold winter weather. The good news is that the labor market remained resilient. The unemployment rate fell to 4.5 percent in March from 4.7 percent in February and remains at full employment based on the Fed's long-run estimate. Going forward, we expect modest improvements in the labor market. As the labor market tightens, we should see an uptick in wage growth and inflation. In February, average hourly earnings, a measure of wage growth rose to 2.8 percent from 2.5 percent in January on an annualized basis. Overall, all the above factors point to an economy that is growing at a moderate pace. In addition, over time, we expect Trump's administration policies which include tax cuts, infrastructure spending, as well as less regulations to contribute to improvement in economic growth.

In 2017, we expect economic growth to trend at 2 – 2.5 percent, higher than what we observed in 2016 (1.6 percent). Business spending which accounts for 16 percent of GDP growth will likely increase due to higher energy prices and clarity regarding corporate tax reform under Trump's administration. Consumer spending, which accounts for 70 percent of GDP is expected to remain strong supported by further job gains, rising wages and expectations of personal income tax cuts. Increased economic activity may lead to higher inflation. Going forward, we expect headline inflation to rise and converge with core inflation above 2 percent. In the absence of exogenous shocks, we expect the Fed to continue towards normalizing monetary policy.

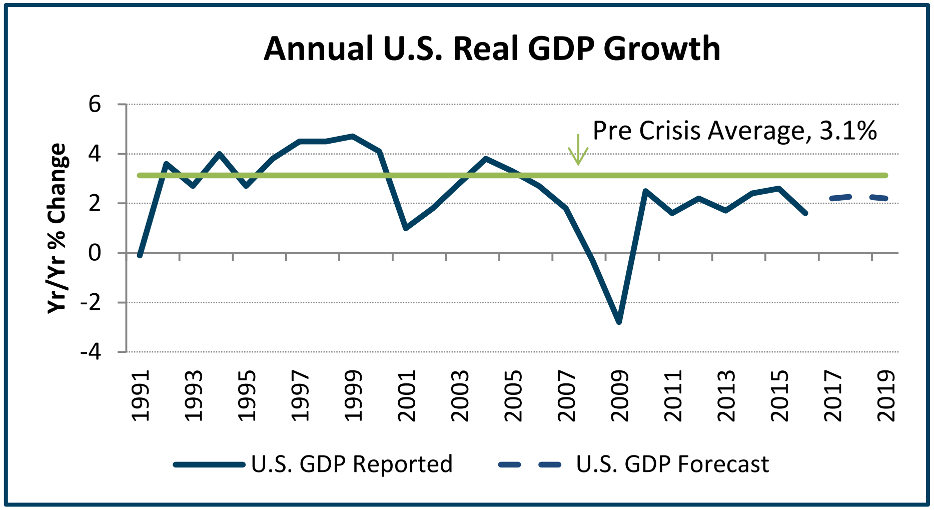
Economic Outlook

Annual GDP Growth

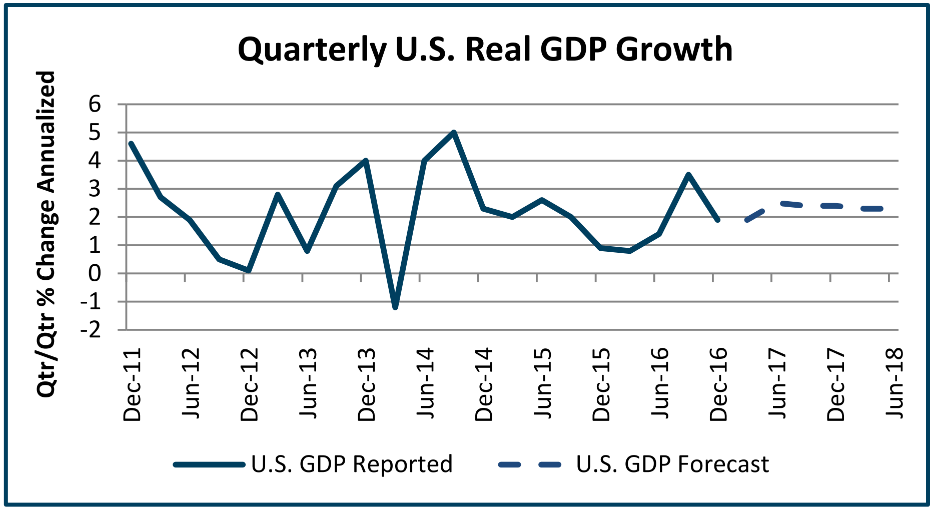
- 2016: 1.6% vs. 2.6% in 2015
- Long term growth expected to remain below 3% average
- 2016 impacted by weaker investment spending
- U.S. policy uncertainty could be a drag on growth in 2017
- Tax cuts, infrastructure spending and lower inventories should contribute to growth in 2017

Quarterly GDP Growth

- Q4 2016 2.1% vs. 3.5% in Q3
- Improved personal consumption expenditures, residential and non-residential fixed investment and government spending
- Federal spending and exports declined



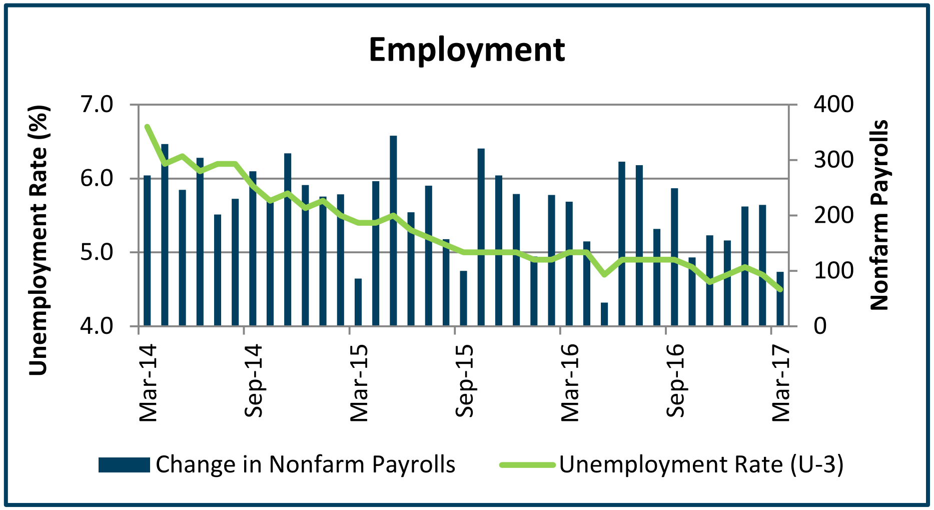
Source: Bloomberg



Source: Bloomberg

Employment

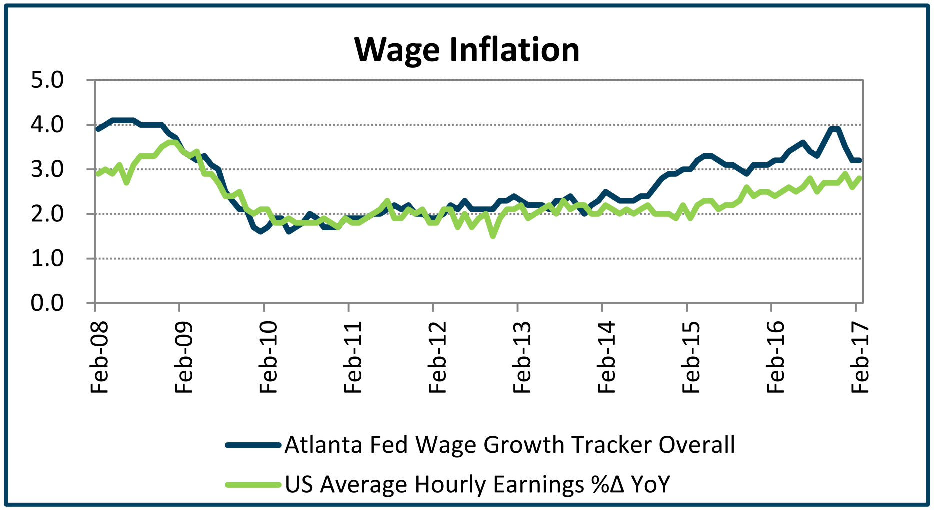
- Unemployment rate 4.5% in March
- Payrolls strong in January and February near 235,000 ; March lower at 98,000
- Key factor in allowing Fed to continue increasing rates



Source: Bloomberg

Wages and Inflation

- Deflationary fears have retreated in recent months
- Inflationary pressure on the rise
- Average hourly earnings rose 2.7% YOY in March and 2.8% YOY in February.



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