Rod Smyth

CHIEF INVESTMENT STRATEGIST

# Watching a Baton Pass – Eurozone Momentum

Our 2017 Outlook, published in January, was called *Passing the Baton*. We anticipated a series of changing economic and market drivers – baton passes – across the global economy. We felt investors had focused so much on political risk in the Eurozone during 2016 that the potential persistence of the economic and earnings recovery was underappreciated. Last week, the monthly surveys from companies around the world combined with the monthly employment numbers in the US suggest two things to us:

1. Growth momentum outside the US, especially in the Eurozone, is slightly stronger.
2. Absent the anticipated stimulus (tax cuts, infrastructure spending etc.), employment growth is slowing somewhat, as is car buying. That said, the US surveys are positive, as is employment growth. We expect growth to continue and await greater clarity from Washington.

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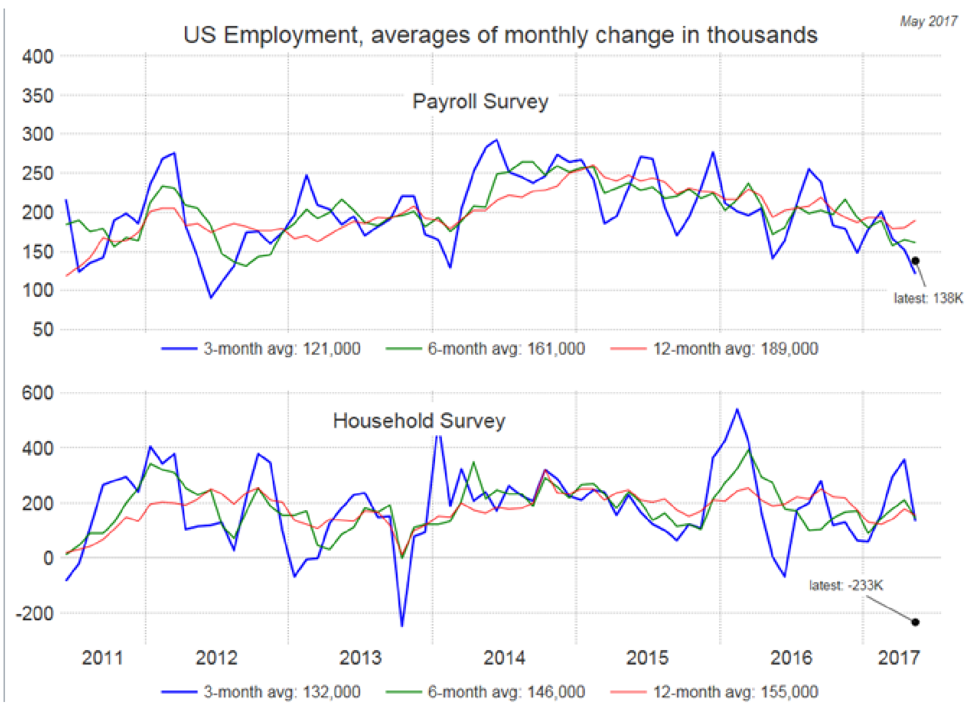
***Recent economic and earnings data from the Eurozone has been encouraging, and this has led to a strong start to the year for European stock markets.***

In analyzing the employment numbers, we take great care to recognize that monthly information on the labor market is volatile and seek to smooth it out. The chart below shows the two major US surveys with each of them smoothed out into a 3 month, 6 month and 12 month average. Looking at the last 6 years, the 12 month average has been pretty consistent at around 200,000 new jobs per month for both surveys. The payroll survey is from companies and is more widely published, but it is the household survey that the Labor Department uses to calculate the unemployment rate, currently at the historically low level of 4.3% (see our chart on page 2).

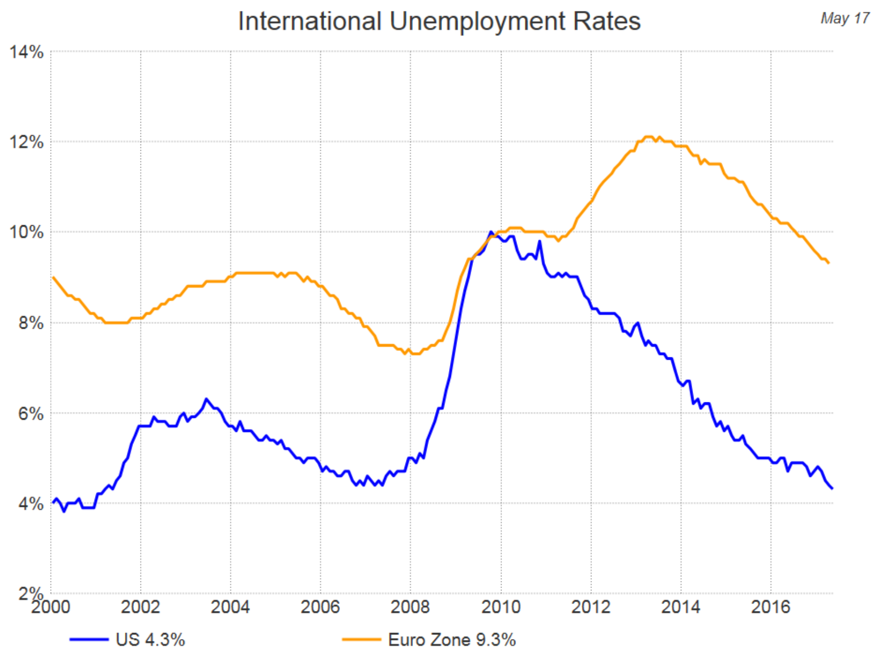



*Source: Thomson Reuters Datastream, RiverFront Investment Group. Past performance is no guarantee of future results.*

In looking at the payroll survey, a downtrend has occurred over the last six months. With unemployment at low levels, this may be just a maturing of the job market for this cycle, especially as there has not been much upward pressure on wages, suggesting the employment market is growing at a balanced rate. A persistent dip below 100,000 jobs per month might suggest a more significant cyclical change.

From an interest rate perspective, we believe the current slowdown is welcome news for mortgage buyers and bond holders as it has allowed five and ten year Treasury rates to decline slightly in 2017. We think the Fed will continue to move short-term interest rates gradually higher, but the slightly weaker data and a lack of clarity on policy outcomes from the administration and Congress likely means they do not feel a great sense of urgency.

Meanwhile in Europe, despite a busy political calendar, the economic and earnings data has been encouraging, and this has led to a strong start to the year for European stock markets. The political calendar remains eventful and is once again producing surprises. It currently looks as though Theresa May's gamble of calling an early election to secure a larger majority in parliament may backfire. Her challenge now is to re-secure a majority. We currently prefer the markets in the Eurozone, which are at a different stage of the economic and monetary cycle than the UK and especially the US. In seeking to illustrate this, we find the chart below simply showing the unemployment rate in the US and Eurozone compelling.

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Note in the chart above how the US unemployment rate rose five percentage points between 2008 and 2010. In the Eurozone the rise was about half that. We believe US companies responded much more aggressively to the financial crisis and impending recession in part because of more aggressive management style, but also largely due to less onerous labor laws. Ultimately the Eurozone rate rose by the same roughly five percentage points, but it took close to six years and two back-to-back recessions. Unemployment in the Eurozone since its inception has been structurally higher, but it seems clear to us that a new downtrend is clearly established and has further to go. We understand why the Federal Reserve is slowly raising rates with US unemployment rate approaching 4%, but we think the ECB is still keen to see growth continue and unemployment rate to fall further.

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*In a rising interest rate environment, the value of fixed-income securities generally declines.*

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