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## Economic Update for Local Governments

*April 19, 2017*

*Presented by:*

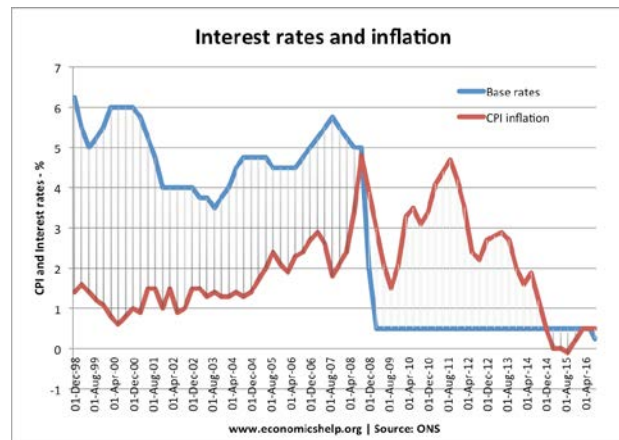
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# Objectives

Review & Discuss Global Economy

Analyze Domestic Economic Indicators

How Interest Rates Will Affect Local Governments



# Global Military Action

“Flight to Quality”

Oil Prices Going Up

Equity Markets Taking a Step Back



# End to Nationalism?

June 2016. BREXIT

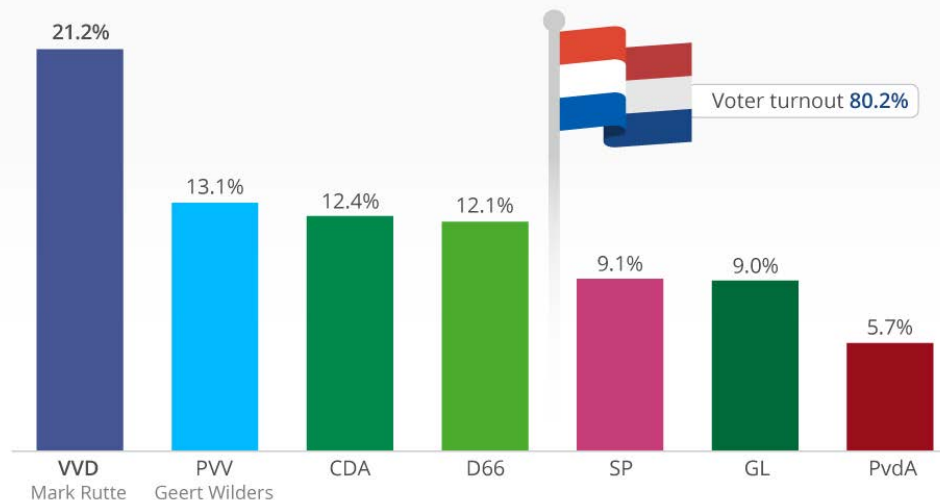
November 2016. Trump Populism

Dutch elected a moderate candidate

France & Germany?

## Mark Rutte Wins Dutch Election

Share of votes received in the Netherlands general election on March 15, 2017\*

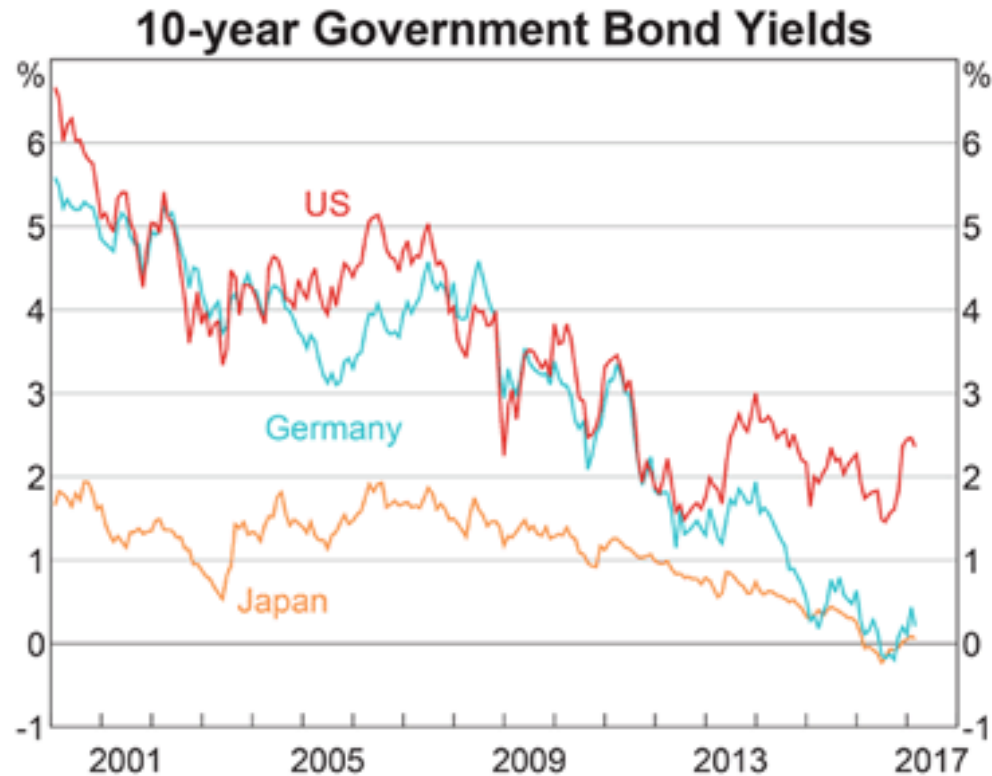


# Global Government Bond Yields

German yields are rising from negative territory

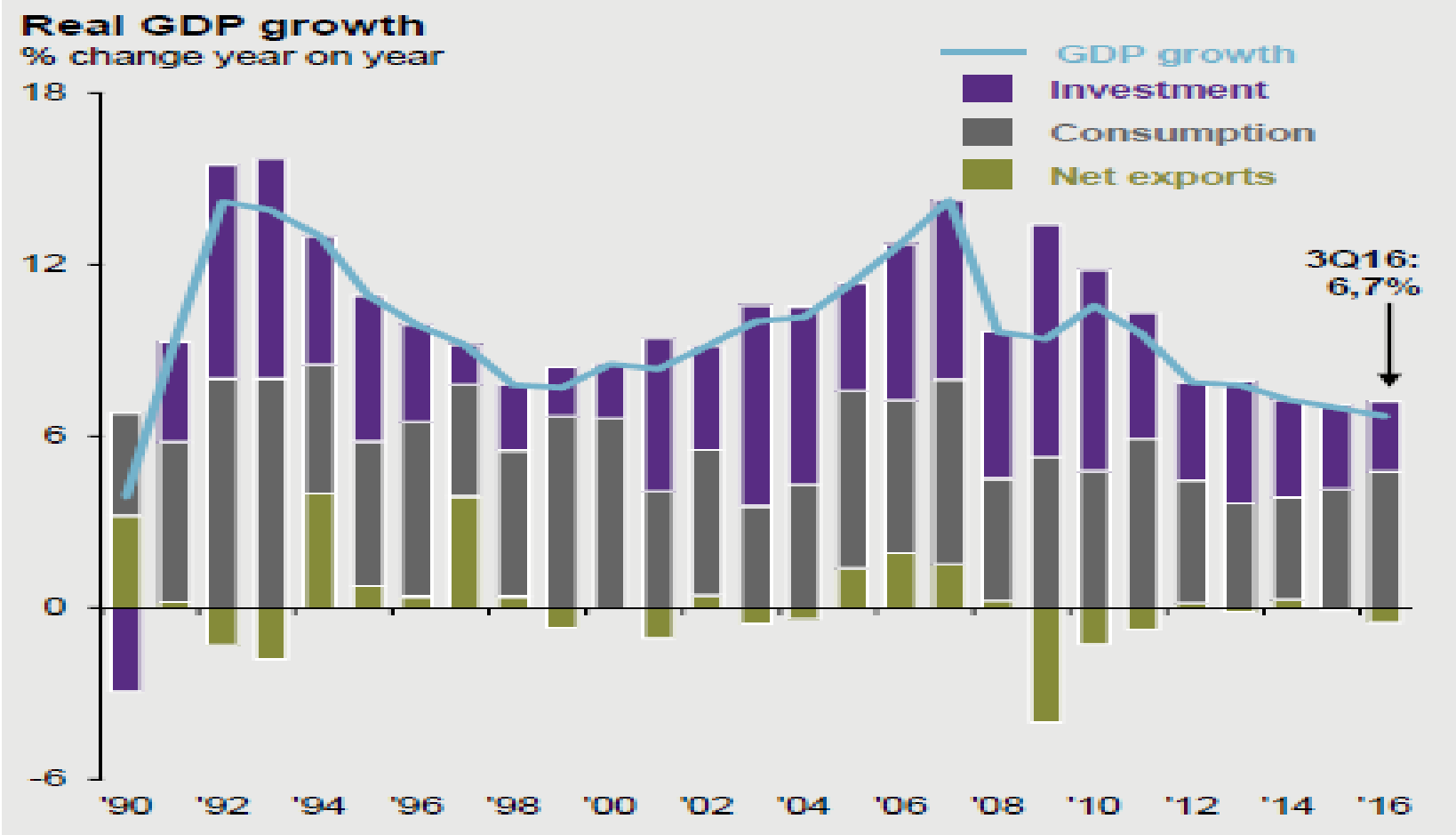
- Have been below U.S. since ECB started bond buying program in 2011

Japan rates barely above zero



Source: Thomson Reuters

# China Growth Decelerating



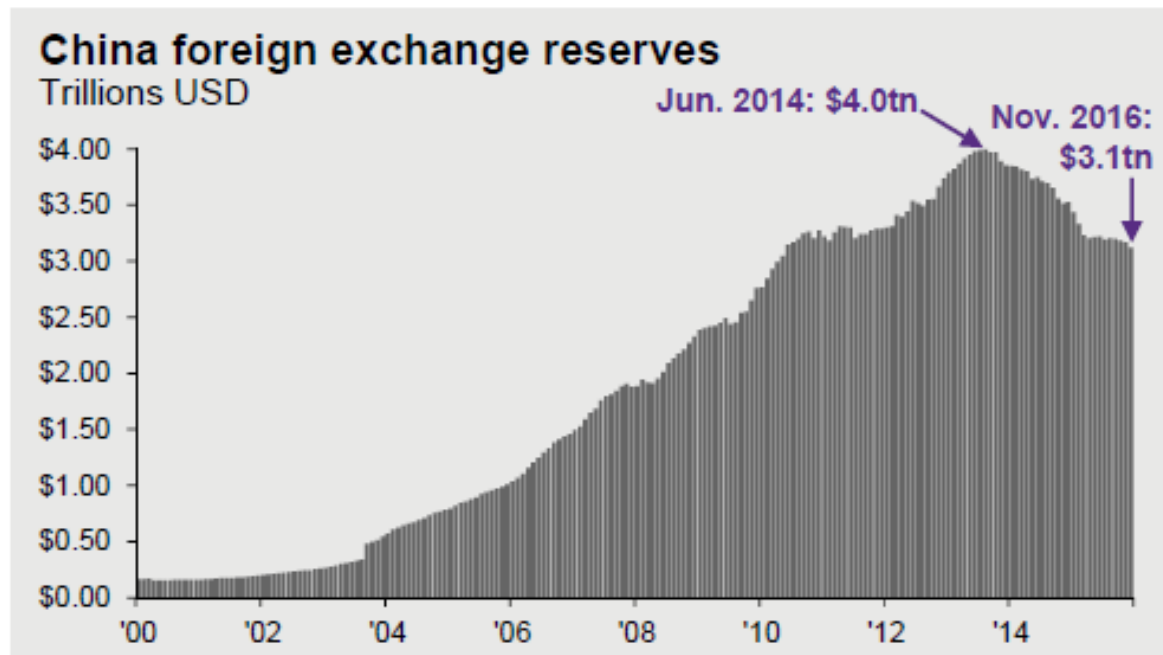
Source: (Left and top right) FactSet, National Bureau of Statistics of China, J.P. Morgan Asset Management.

# China

Foreign exchange reserves now below \$3 trillion

Built reserves initially by buying foreign currencies

- Keeping currency weaker will help exporters
- Now buying yuan to stem capital outflow by concerned citizens

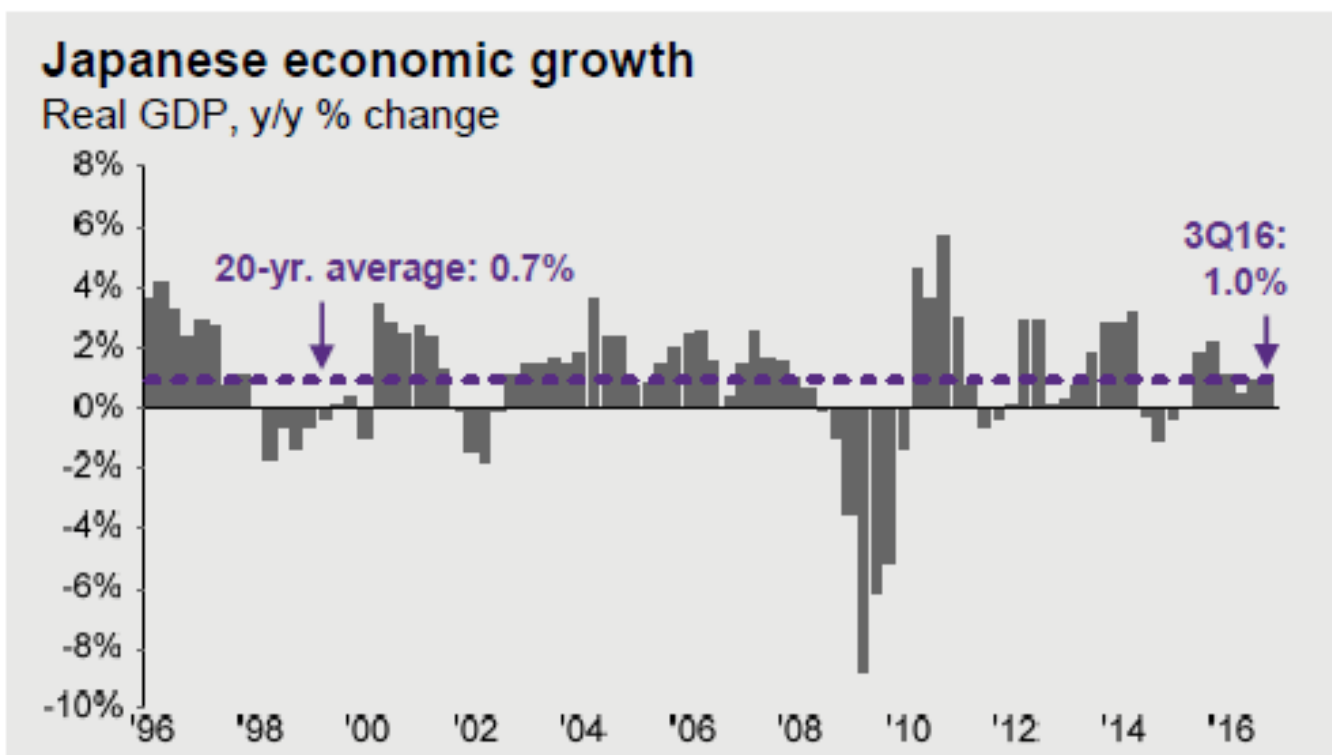


Source: FactSet, J.P. Morgan Asset Management; (Left) CEIC; (Top and bottom right) People's Bank of China.  
*Guide to the Markets – U.S.* Data are as of December 31, 2016.

# Japan

## Third decade of mediocre economic growth

- Aging population
- Strict immigration policies



Source: FactSet, J.P. Morgan Asset Management; (Top and bottom left) Japanese Cabinet Office  
*Guide to the Markets – U.S.* Data are as of December 31, 2016.



# Domestic Economy

## Trump Administration

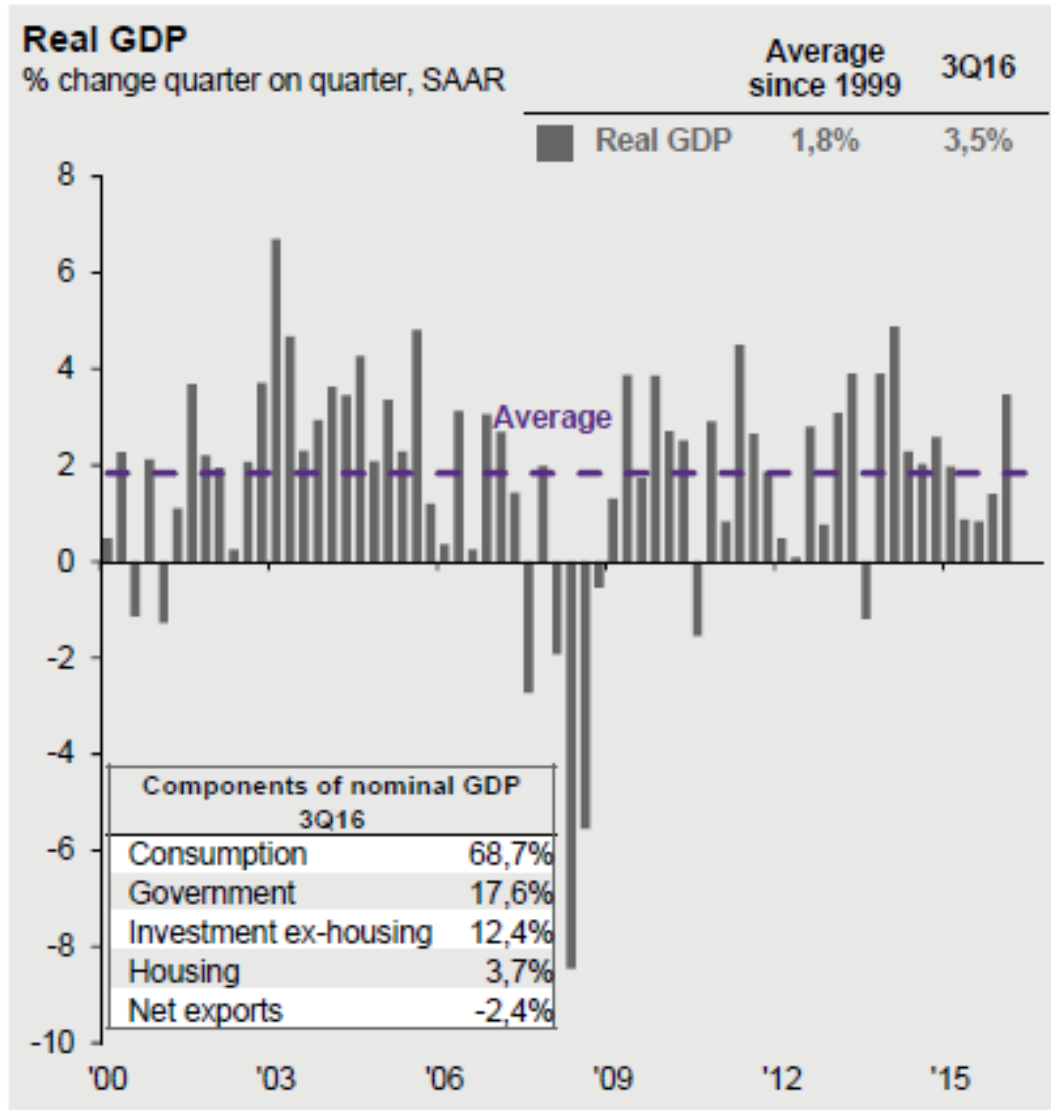
- Market view positive at first and now “wait and see”
- Expect more “volatility” going forward



REPUBLICAN EFFORT  
TO REPEAL THE  
AFFORDABLE CARE ACT  
FACES ENORMOUS  
CHALLENGES

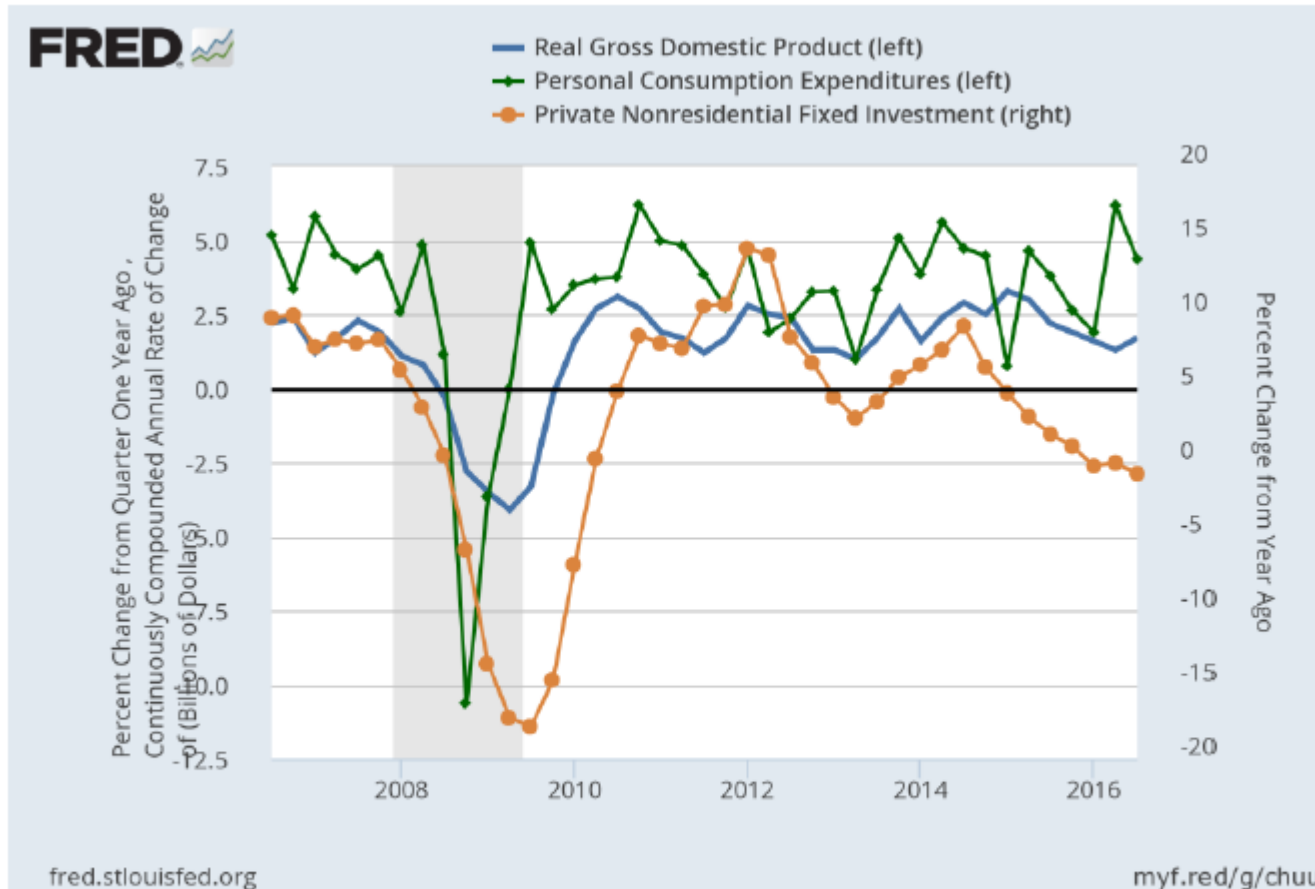
A graphic of the IRS 1040EZ-ALL Tax Form. It includes the IRS logo and the text "Department of the Treasury Internal Revenue Service". The form number "1040EZ-ALL Tax Form" is in the top right. The first question is "1. How much money did you make?" followed by a dollar sign and a row of ten boxes for digits. The second question is "2. Send it to us."

# Gross Domestic Product



Source: (Left) BEA, FactSet, J.P. Morgan Asset Management.

# Private Investment Lagging



fred.stlouisfed.org

Source: [www.fred.stlouisfed.org](http://www.fred.stlouisfed.org)

Date: 1/5/2017

Past performance is no guarantee of future results.

# Infrastructure

## Trump Administration

- Lower taxes and less regulations
- Tax credits to bring in private investment
  - Usage Tolls

## Republican Congress

- Will they craft bi-partisan legislation or will they push Republican only agenda?
- Any public expenditures need to be revenue neutral

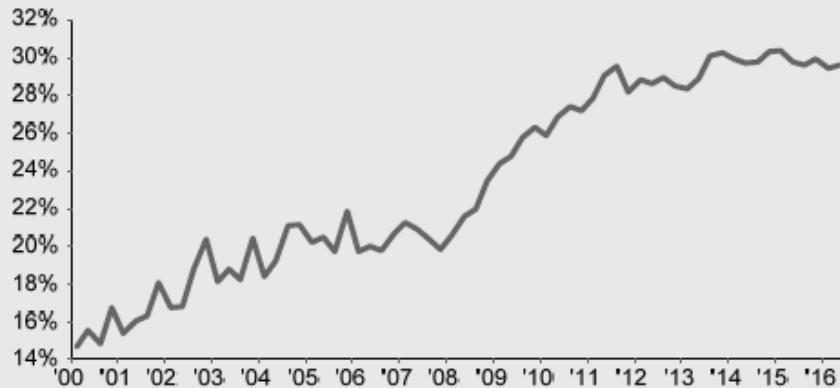


# Corporate Cash Horde

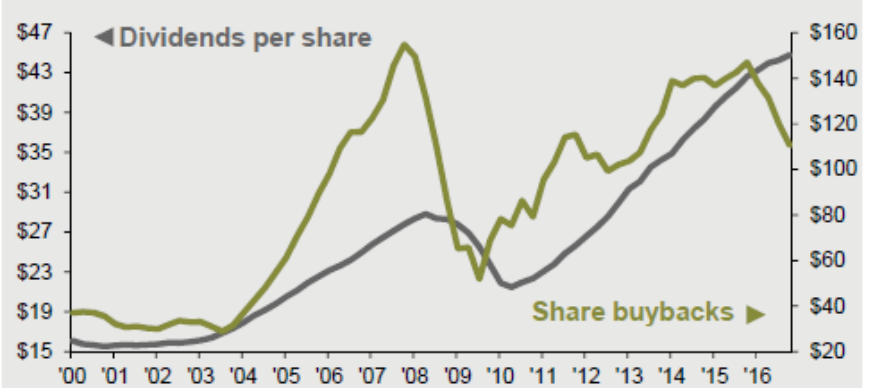
Healthy corporate profits

Lack of investment opportunities

**Corporate cash as a % of current assets**  
S&P 500 companies – cash and cash equivalents, quarterly



**Cash returned to shareholders**  
S&P 500 companies, rolling 4-quarter averages, \$bn



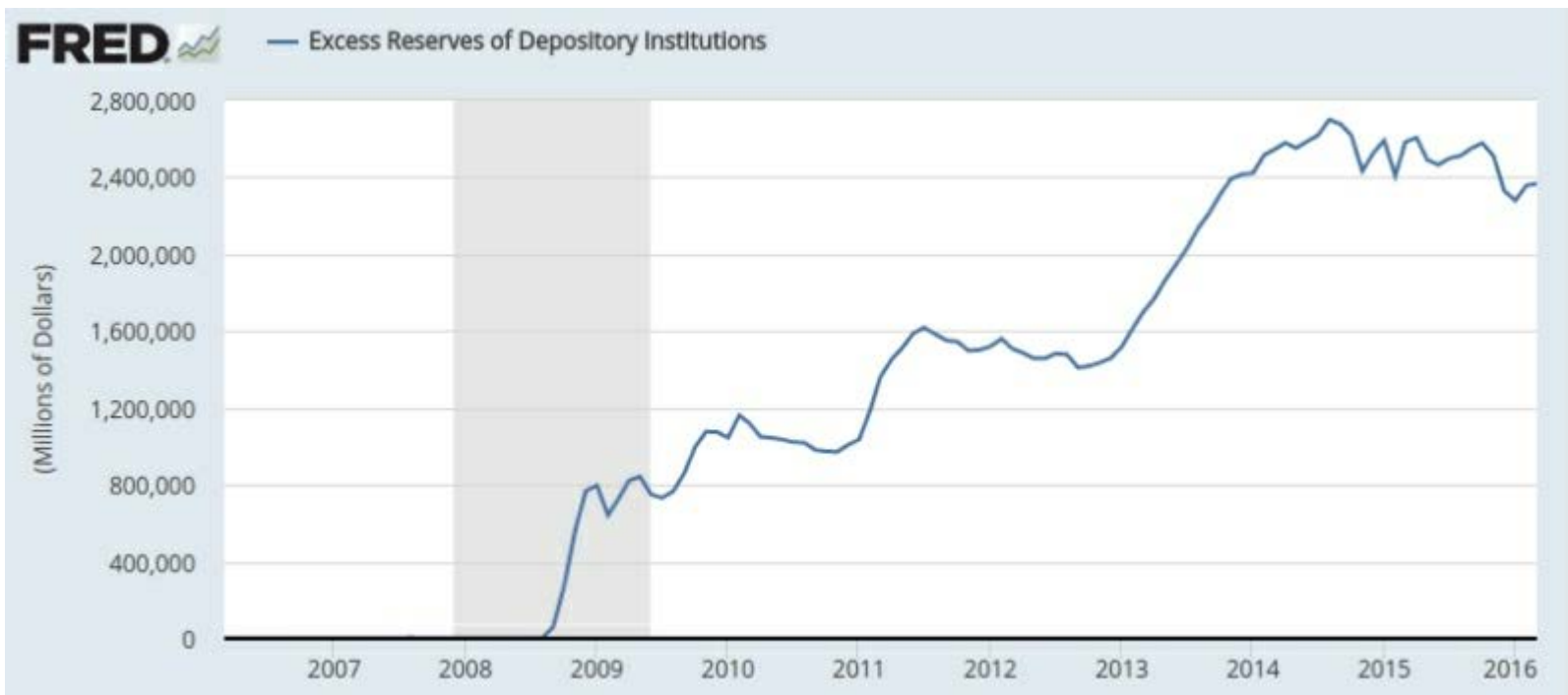
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom left) BEA, Federal Reserve; (Bottom right) Bloomberg, BEA. M&A activity is the quarterly value of officially announced transactions, and capital expenditures are private nonresidential fixed domestic investment. *Guide to the Markets – U.S.* Data are as of December 31, 2016.

# Excess Reserves at the Fed

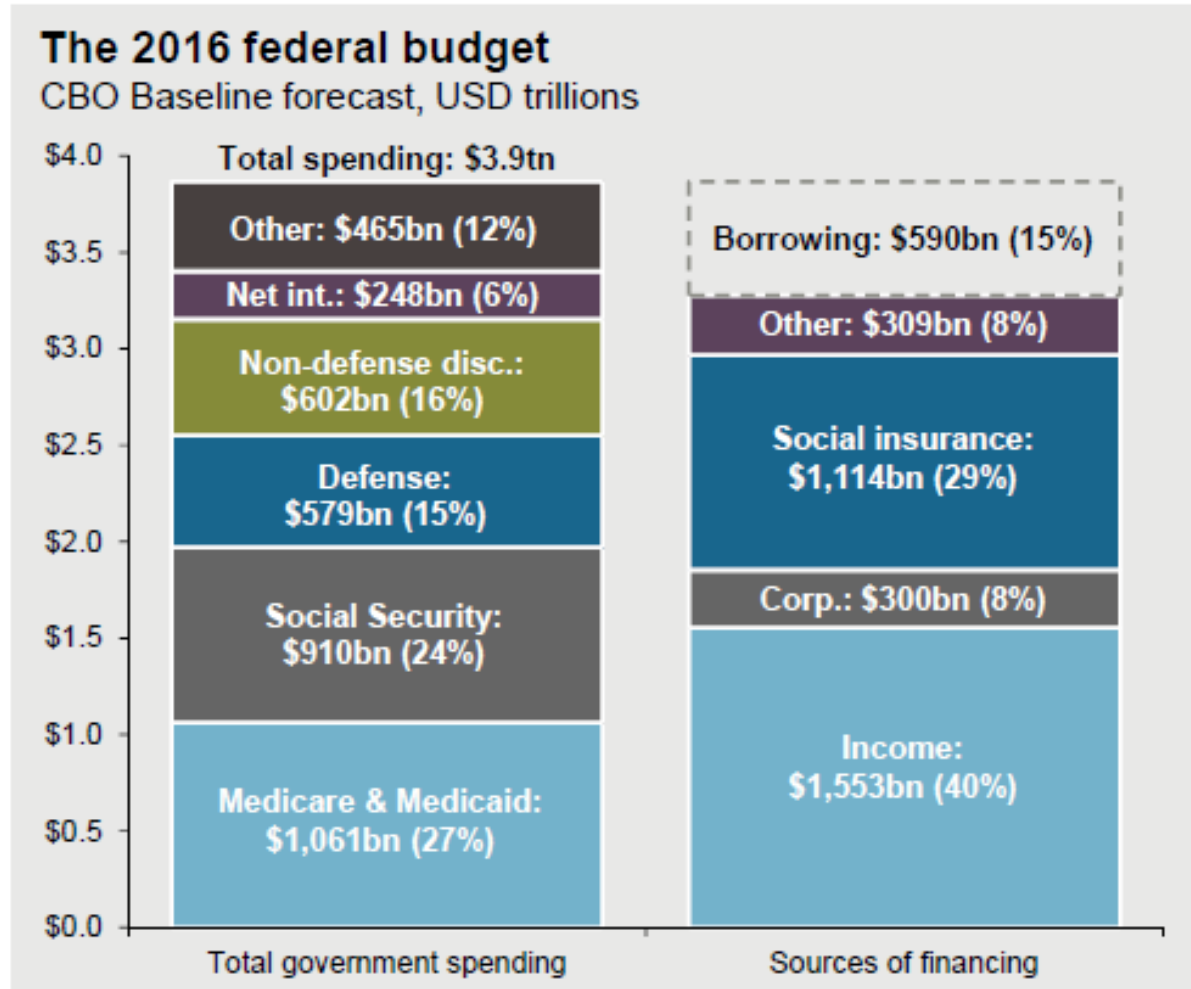
Federal Reserve Bank of New York buys bonds from financial institutions

Some funds are deposited back at the Fed

Velocity of money is extremely low



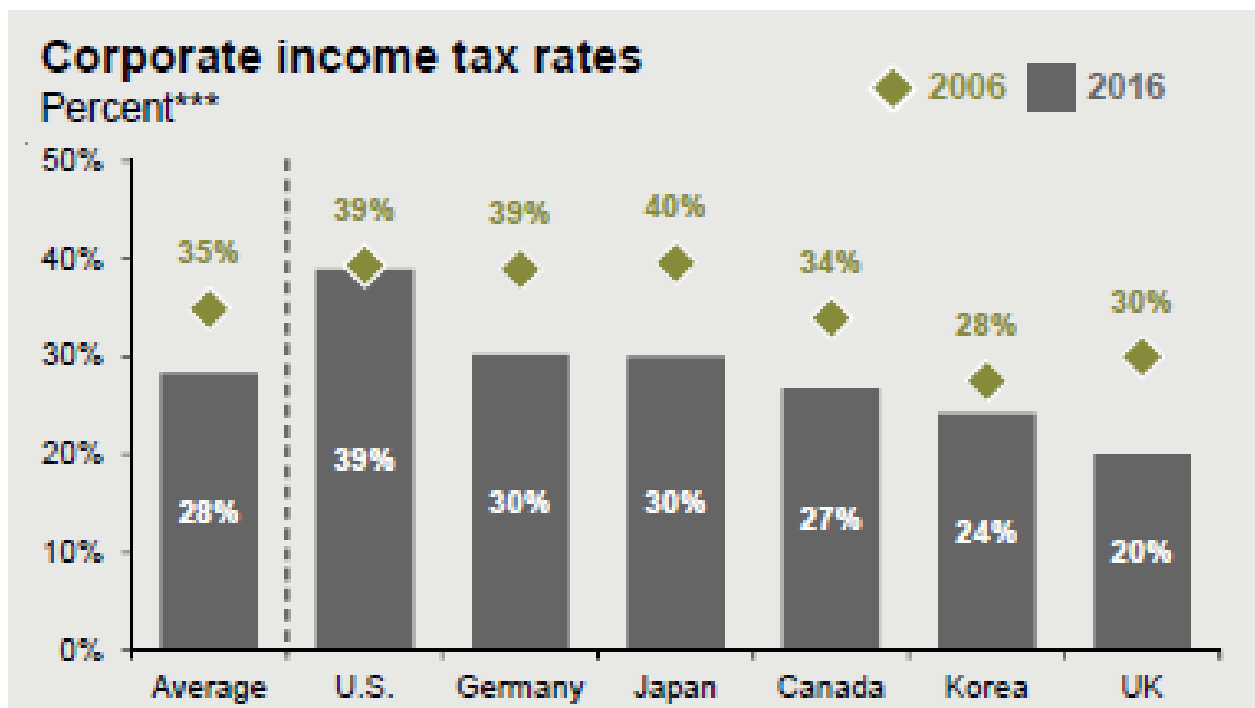
# Taxes



2016 Federal Budget is based on the Congressional Budget Office (CBO) August 2016 Baseline Budget Forecast.

# Tax Reform

- U.S. has the highest stated corporate tax rate among developed nations



\*\*\*Corporate income tax rates include state and local taxes.



# Tax Reform

- Effective Tax Rate

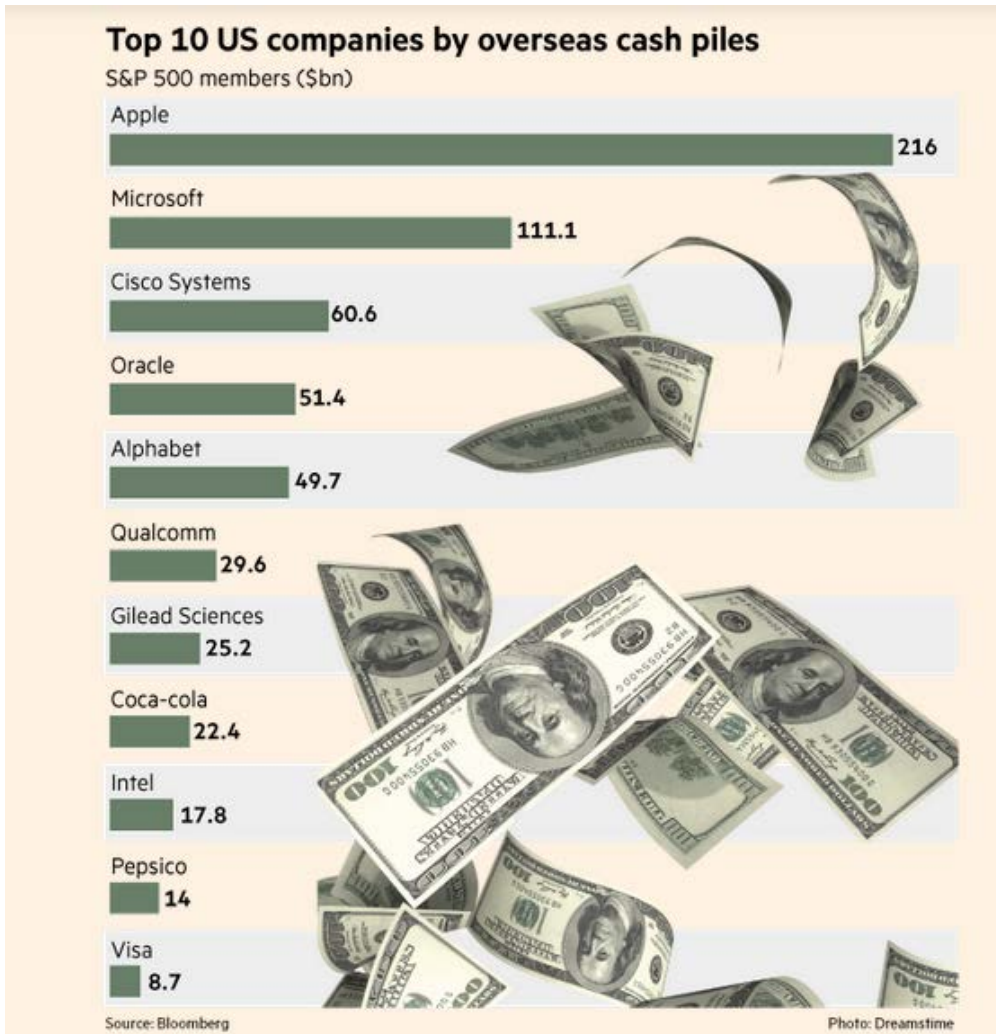
**Table 5: Average Effective Tax Rates for Profitable Large Corporations (Schedule M-3 Filers), Tax Years 2008 through 2012**

	Tax year					2008 to 2012 (Average)
	2008	2009	2010	2011	2012	
<b>Federal Effective Tax Rates</b>						
Total book tax	20.7%	17.5	17.0	19.8	18.5	18.6
Current book tax	17.6	13.8	13.1	15.2	17.3	15.3
Actual tax paid	15.3	13.0	12.6	13.1	16.1	14.0
Actual tax paid adjusted for net operating loss deduction	17.3	15.5	15.0	15.4	19.5	16.5

Source: GAO analysis of IRS data for Schedule M-3 filers. | GAO-16-363

Notes: The worldwide effective tax rates are based on the worldwide income and taxes—including federal, foreign, and U.S. state and local income taxes—of entities included in the federal tax return. The measure of pretax net book income used in computing these rates is equal to worldwide net book income plus the total tax expense. The foreign tax credit value is not available for that subpopulation of profitable corporations in tax year 2008 and 2009 and instead we use the sum of the current foreign tax expense and foreign withholding tax expense plus the section 78 gross-up.

# Repatriation of Foreign Earnings



\$2.6 Trillion

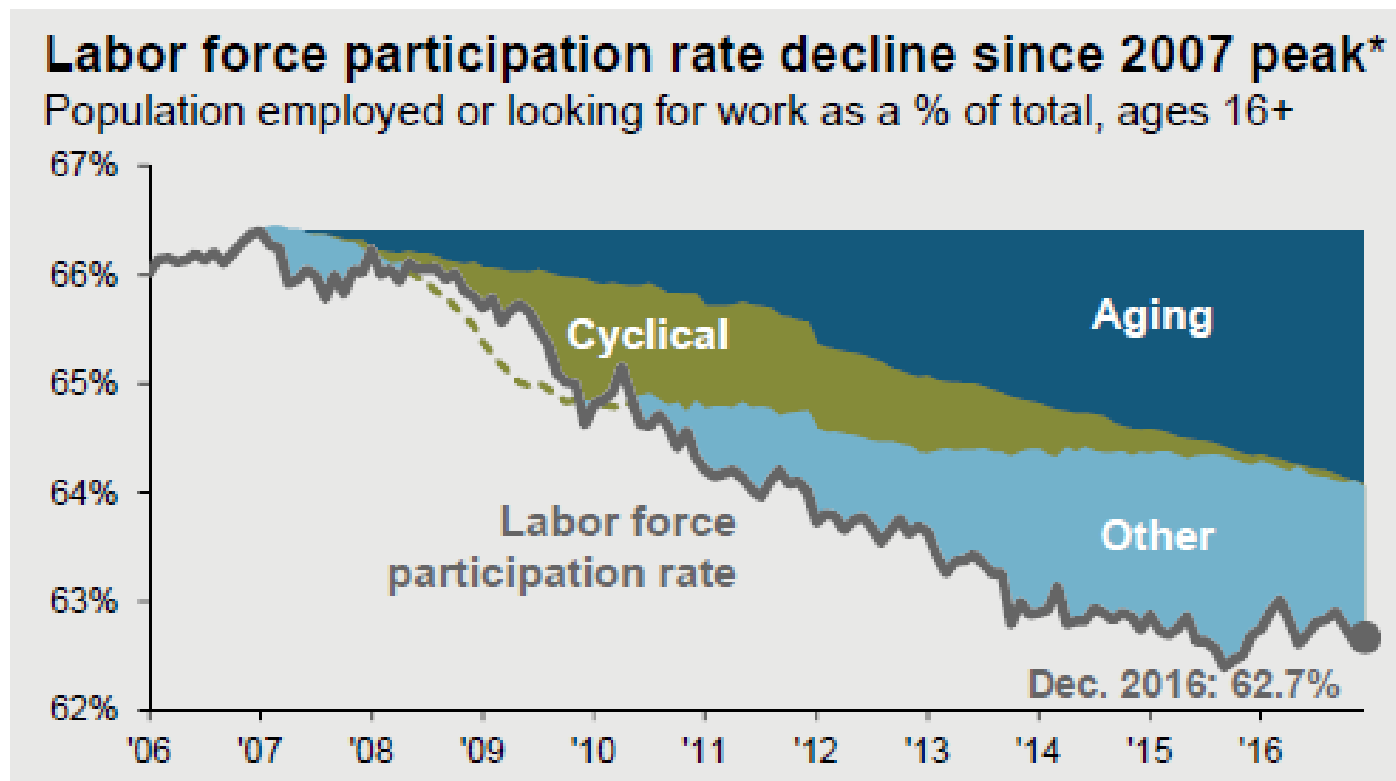
Tax at 15% = \$390  
Billion for U.S. Treasury

- Illustrative purposes only

\$2.21 Trillion for  
corporate purposes

# Labor Force Participation

- Structural or Demographics



\*Aging effect on the labor force participation rate is the estimated number of people who are no longer employed or looking for work because they are retired. Cyclical effect is the estimated number of people who lose their jobs and stop looking for work or do not look for work because of the economic conditions. Other represents the drop in labor force participation from the prior expansion peak that cannot be explained by age or cyclical effects. Estimates for reason of decline in labor force participation rate are made by J.P. Morgan Asset Management.  
*Guide to the Markets – U.S. Data are as of December 31, 2016.*

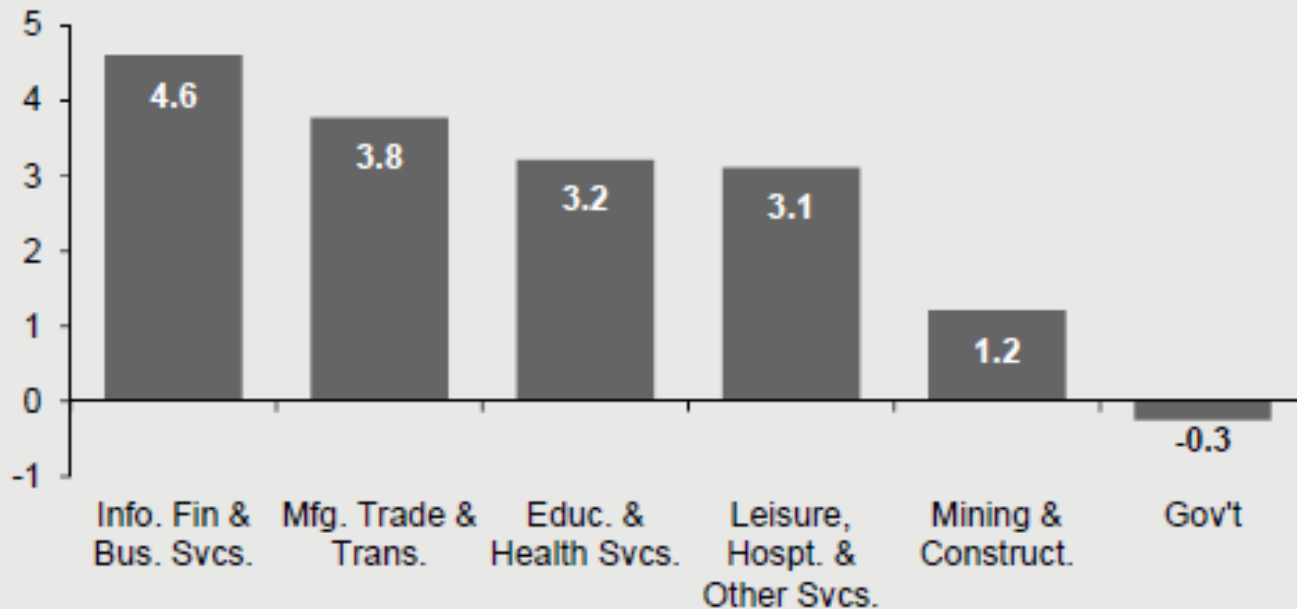
# Jobs Created Since Great Recession

Manufacturing still relevant

Not all jobs are “low paying”

## Net job creation since Feb. 2010

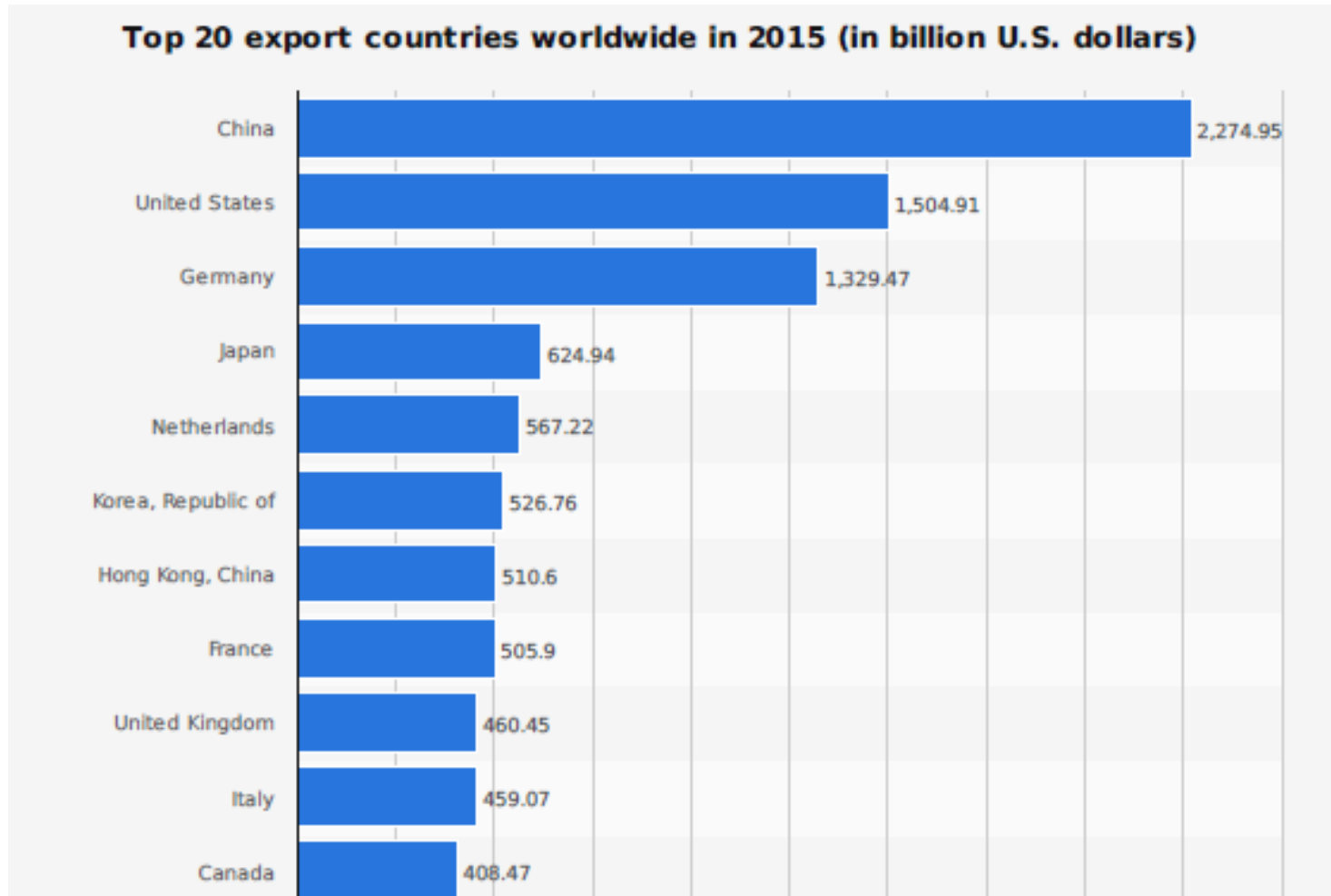
Millions of jobs



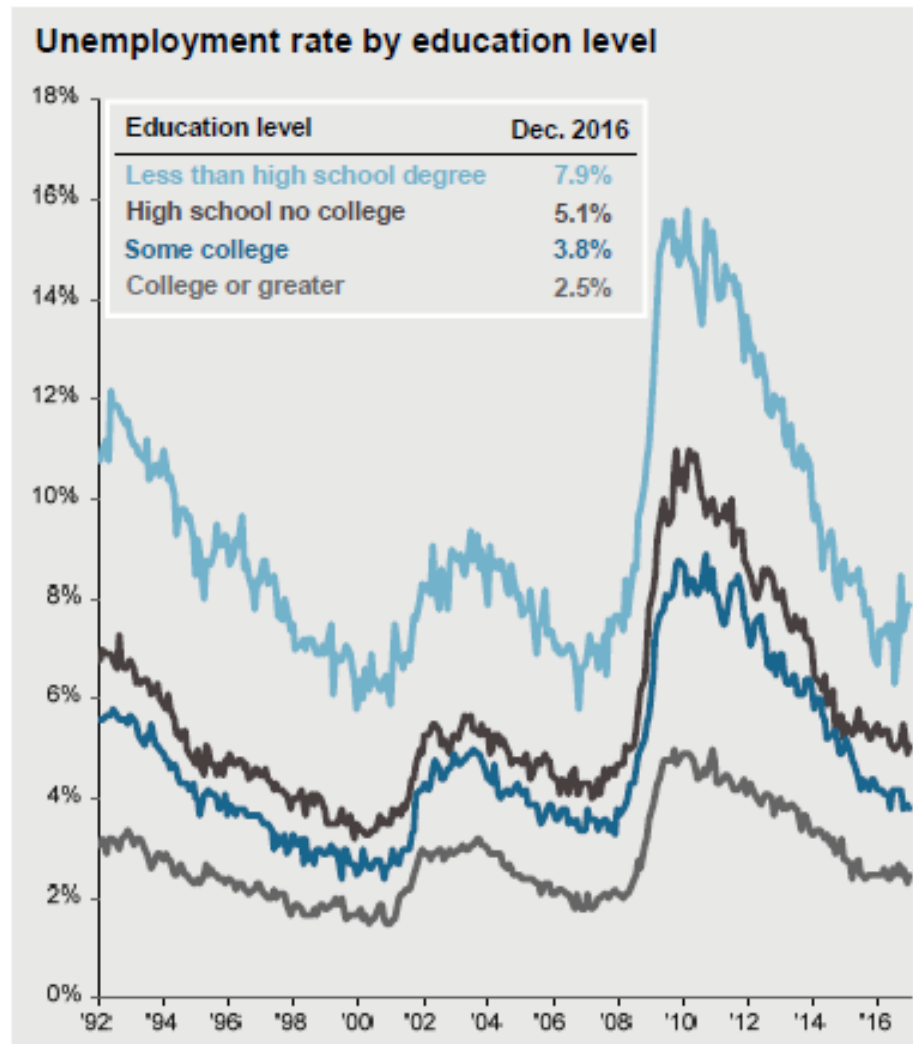
Source: BLS, FactSet, J.P. Morgan Asset Management. (Bottom right) Info. fin. & bus. svcs. = Information, financial activities and professional and business services; Mfg. trade & trans. = Manufacturing, trade, transportation and utilities; Leisure, hospt. & other svcs. = Leisure, hospitality and other services; Educ. & health svcs. = Education & health services; Mining and construct = Natural resources mining & construction; Gov't = Government.

# Largest Exporters by Dollar Volume

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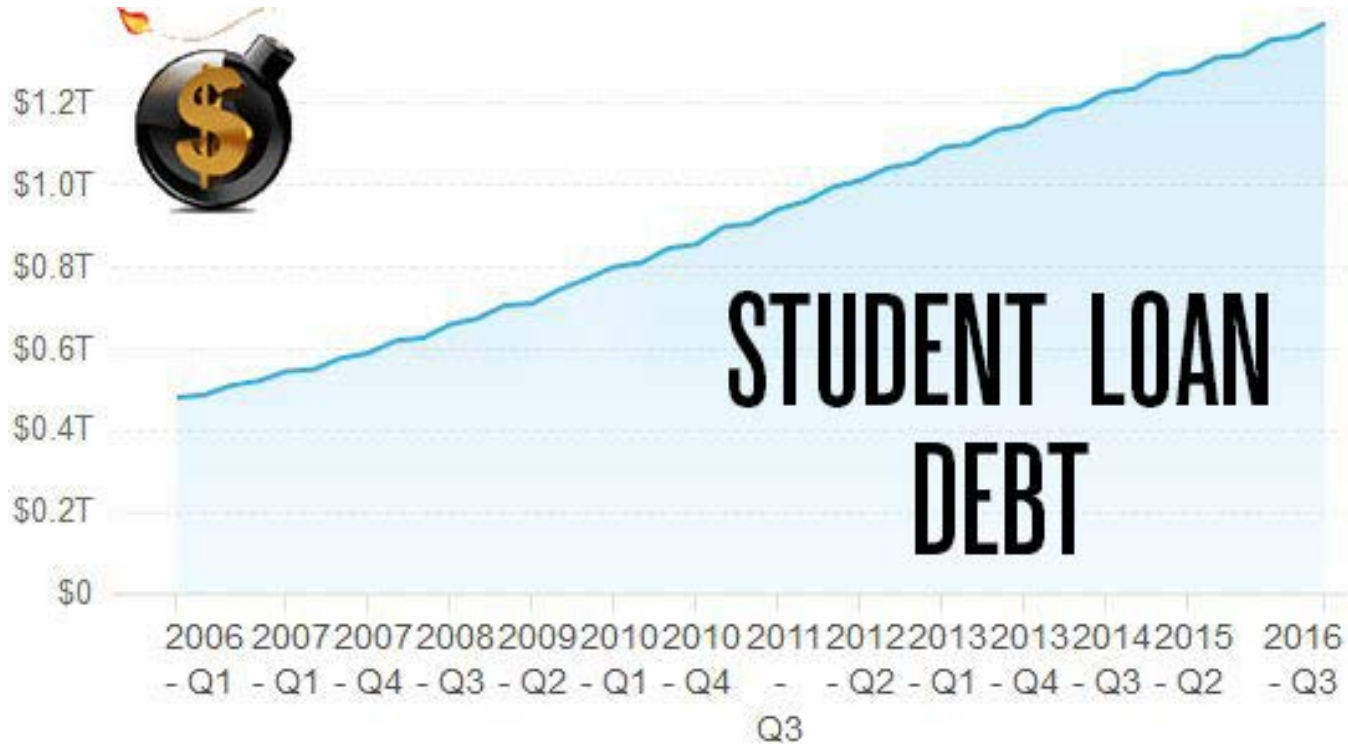
# Education Matters



Source: J.P. Morgan Asset Management; (Left) BLS, FactSet;

# Student Loan Debt Rising

- Cannot discharge in personal bankruptcy



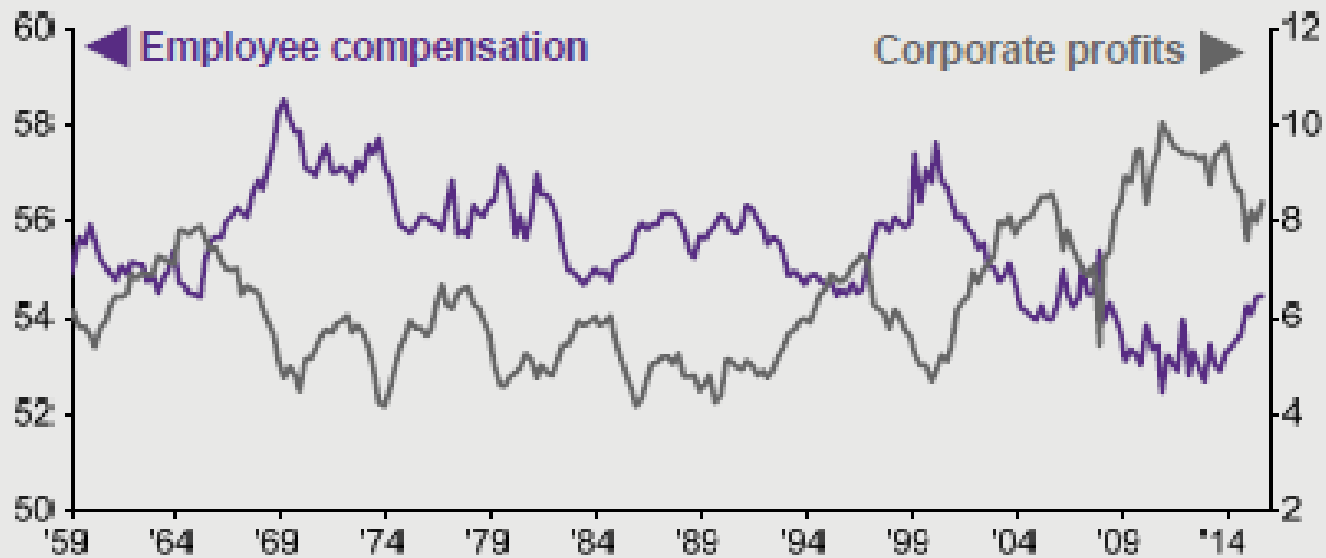
# Income Inequality

Minimum wage increases effective January 2017 in 21 states

Jobs are displaced more by automation than trade

## Employee compensation and profitability

% of GDP



Source: (Top) BEA, FactSet, J.P. Morgan Asset Management.



# Inflation

Health care costs rising

Rents are rising due to excess demand

### Medical, Housing Services, and Core CPI



SOURCE: BLS and FRED®, Federal Reserve Bank of St. Louis.

# Services and Goods Inflation

## Split Decision

Although overall inflation is low, the rate masks a split between the prices of goods and services. Many services prices are rising at a steady clip while many goods are actually falling in price.

Consumer-price indexes, change from previous year



Cumulative change in related goods and services for the five years ended in May

### Goods

Television set	-57.7%
Bottle of wine (for home)	-0.6%
Men's suits and coats	-3.7%
Household cleaning products	0.3%
Stationery	-1.4%
Sports equipment	-15.3%

### Related services

Cable/satellite service	13.7%
Bottle of wine (at restaurant)	12.0%
Dry cleaning	9.2%
Household domestic services	7.8%
Postage for mail delivery	19.2%
Tickets to sporting event	17.3%

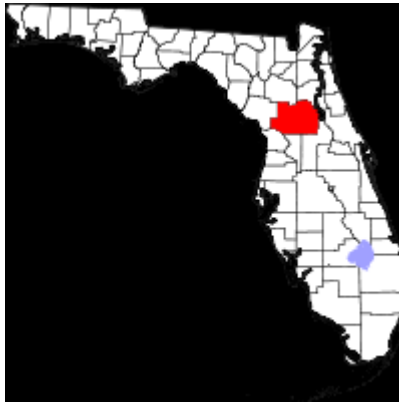
\*Excludes energy †Excludes food and energy Source: Labor Department

THE WALL STREET JOURNAL.

# Ocala Metropolitan Statistical Area (MSA)

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The Ocala Metropolitan Statistical Area (MSA) is expected to show mixed levels of growth in the economic indicators. Personal income growth is expected to average 7.3 percent annually. **Real per capita income level is the second lowest of the twelve metros at an average of \$34,300.** Relative to other metro areas, **Ocala will have the lowest average annual wage level at \$44,600.** Average annual wage growth is expected to be 3.9 percent. The metro has an expected annual average population growth of 1.8 percent. **The Gross Metro Product is expected to average 7,986.82 million dollars, which is the lowest of the studied areas.** Employment growth is expected to average a rate of 2.3 percent annually. **The unemployment rate is estimated to average 5.3 percent, the highest of the researched areas.**



# Top Area Employers

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- Marion County School Board – 6,071
- Munroe Regional Medical Center – 2,648
- State of Florida (all departments) – 2,600
- Wal-Mart Stores Inc. – 2,370
- Ocala Regional Health System – 2,020
- Publix Super Markets, Inc. – 1,488
- Marion County Board of County Commissioners – 1,462
- AT&T – 1,000
- City of Ocala – 994
- Lockheed Martin – 981



Source: Ocala/Marion County Chamber & Economic Partnership



# Market Expectations

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## Stronger Growth & Higher Rates

- Tax reform for everyone
- Infrastructure bill
  - Public funding versus Public Private Partnerships (P3)

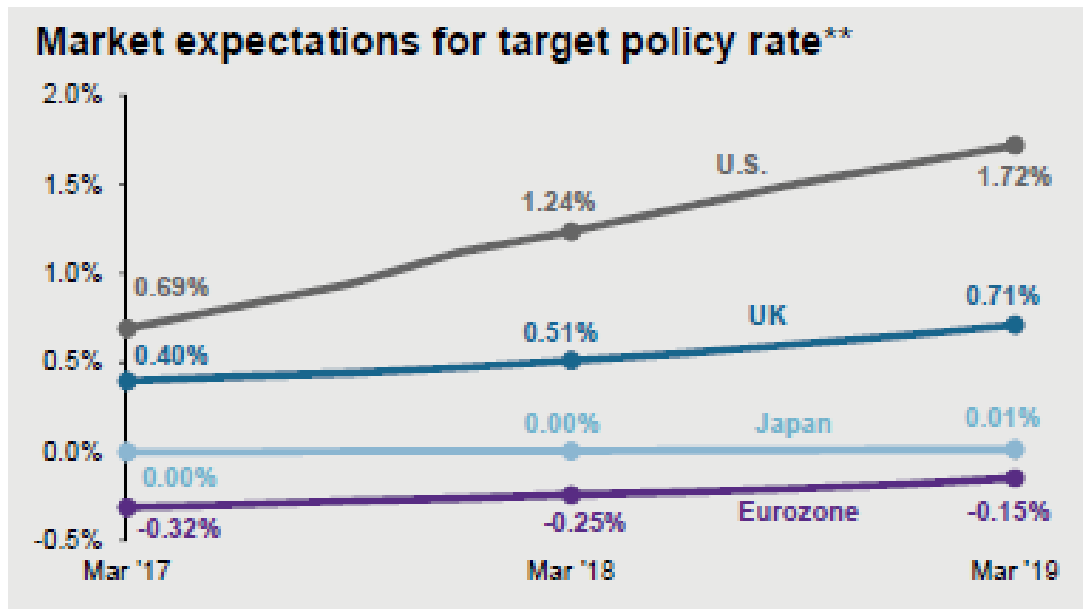
## Stagnant Growth & Volatile Rates

- Trade Barriers
- Tariffs will lead to higher prices for U.S. consumers
- Stronger dollar will hurt exporters
- More uninsured people will burden hospitals and taxpayers

# Interest Rate Outlook

## Cash & Cash Equivalents

- U.S. is in a rising rate environment
- Chairwoman Yellen and the FOMC are still very data dependent
- Rate differential favors the U.S. dollar



# Interest Rate Outlook

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## Concentration Accounts with your main bank

- Is Earnings Credit Rate (ECR) still the best for you?
  - FDIC assessment may reduce ECR by 7-13 basis points
- Fed raised target rate to 75-100 basis points in March
  - Check with your bank to see if ECR or earnings on excess balance has moved higher

## QPD money market accounts

- Community banks maybe more competitive

## Government money market funds

- Rates are lagging other cash options now

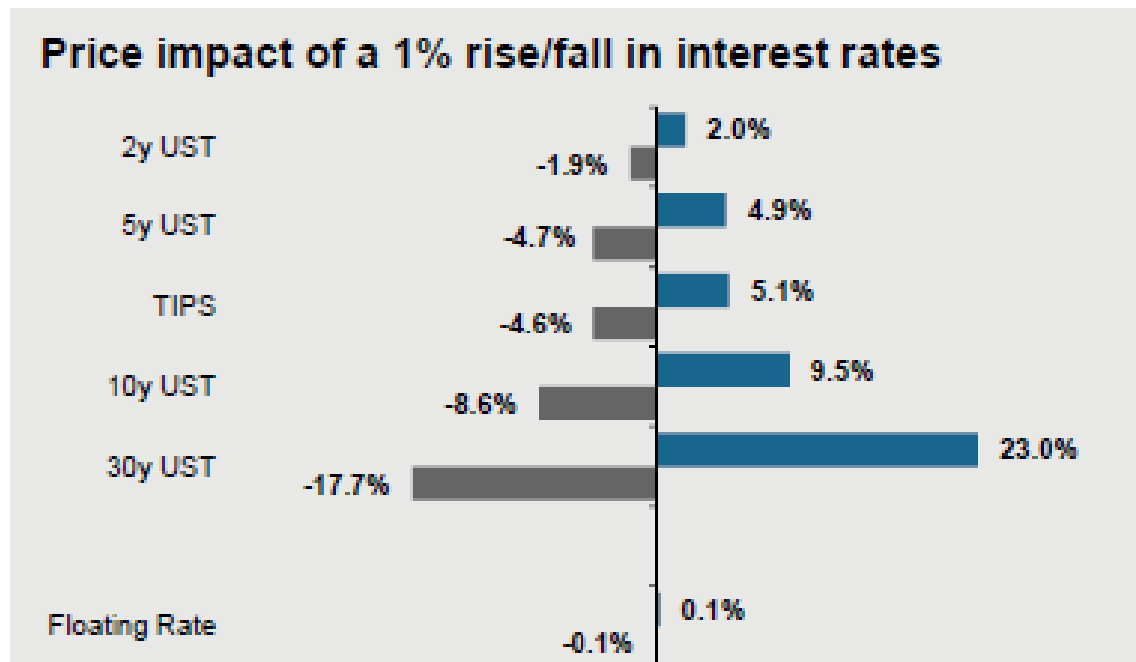
## Local Government Investment Pools

- Stable Net Asset Value (NAV)
- Dollar In/Dollar
- Rates are attractive

# Interest Rate Outlook

## Core Investment Portfolio

- 2-7 year sector most susceptible to rising interest rates





# Interest Rate Outlook

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## Core Investment Portfolio

- Coupon or interest income biggest component of total return
  - Other two components: realized gains/losses and unrealized gains/losses
  - GASB 31 & GASB 72

## Laddered CD portfolio

- No mark to market
- Most likely will trail actively managed portfolios in a rising interest rate environment

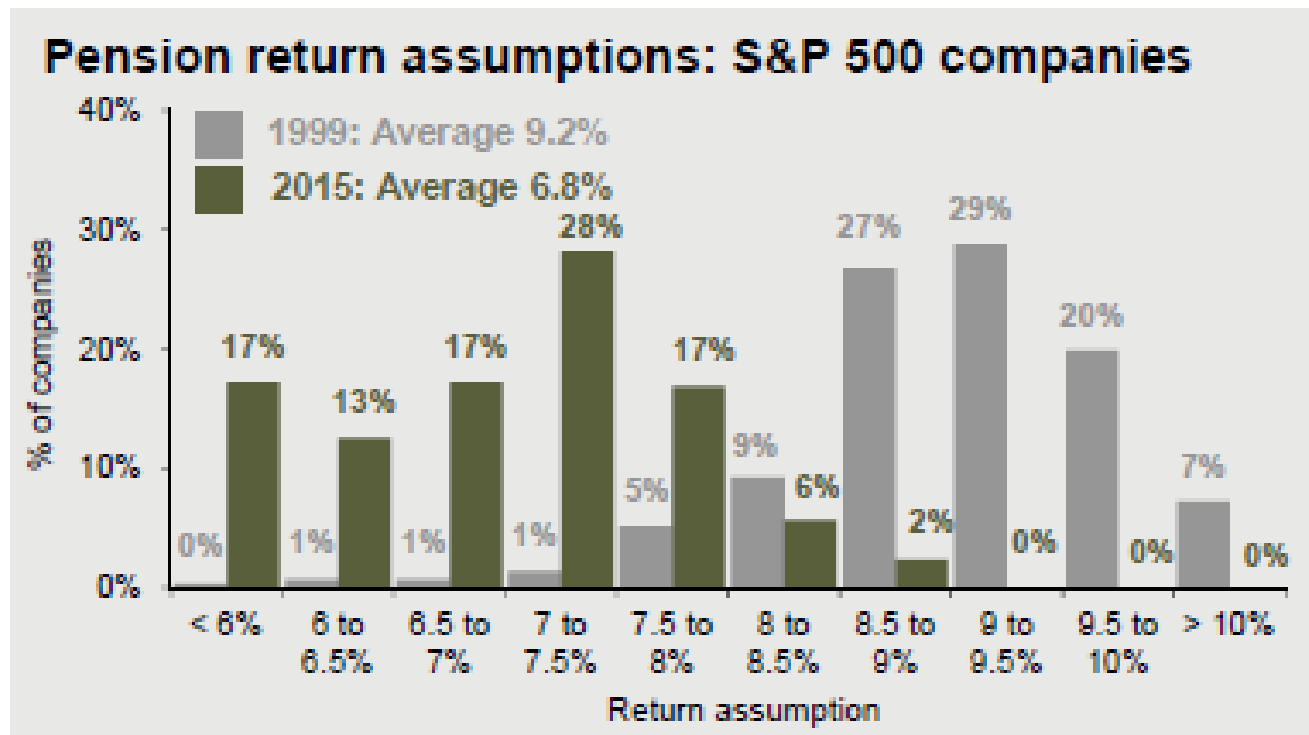
## Shorten duration by reallocating to an “Enhanced Cash” strategy

- Bridges cash and core portfolios

# Interest Rate Outlook

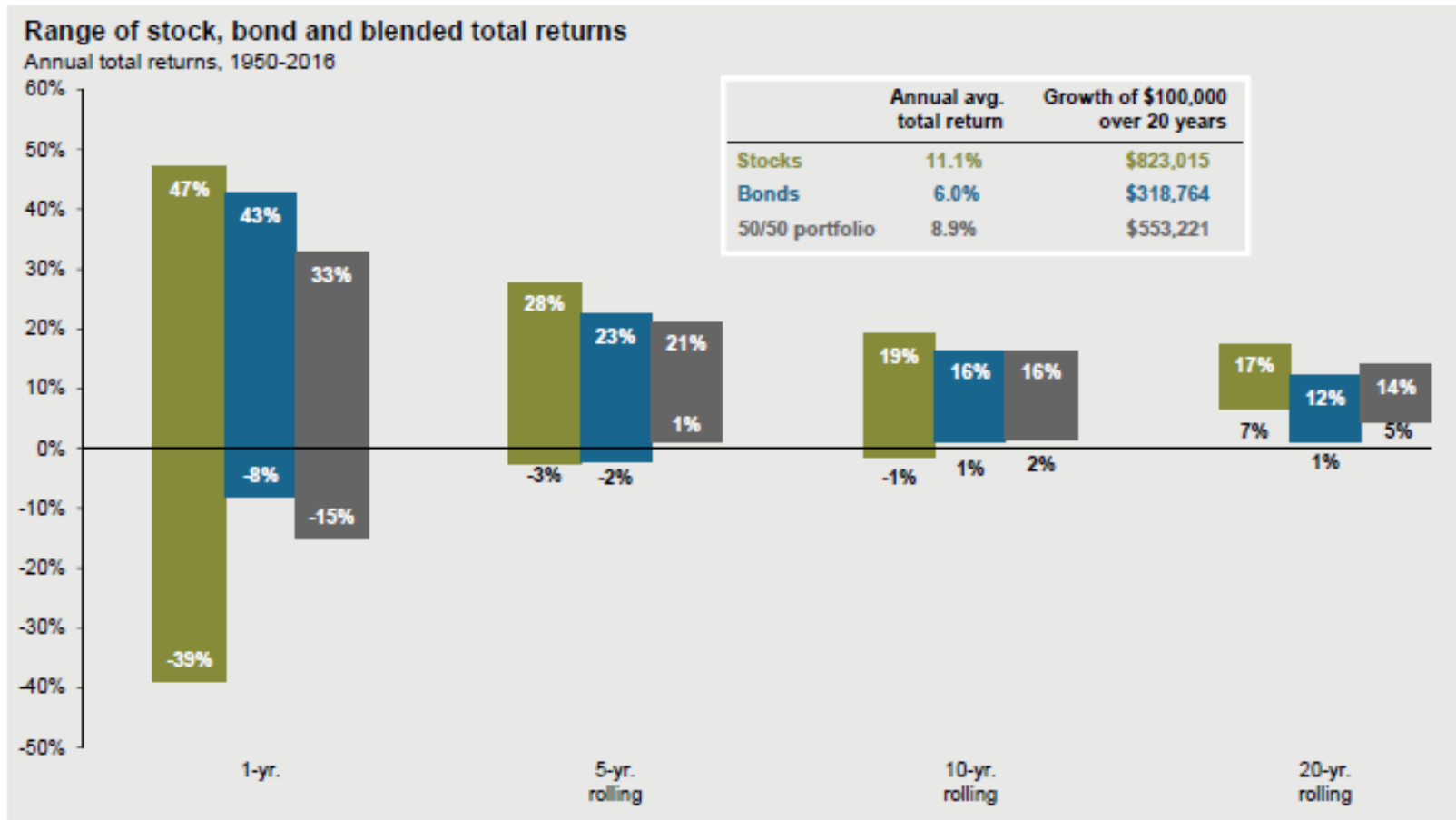
## Pension Portfolios

- Higher inflation & interest rates will help
- Return assumptions lower than in the past
  - higher annual contributions required if return assumptions go lower



# Interest Rate Outlook

- Shorter time horizon equals higher volatility



Source: Barclays, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management.  
Returns shown are based on calendar year returns from 1950 to 2016. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Barclays Aggregate thereafter. Growth of \$100,000 is based on annual average total returns from 1950 to 2016.  
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# Summary

## Trump Administration Still Considered Pro-Business

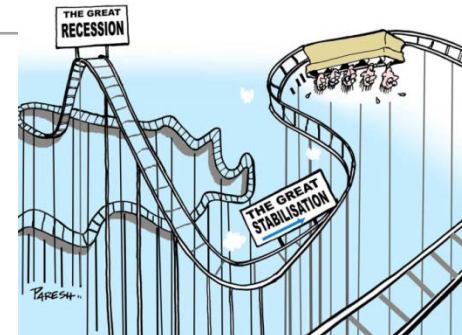
- Markets waiting on details of tax and regulation reforms
- Congress will still need to pass legislation for the President's Agenda
  - Initial Affordable Care Act replacement has failed

## Markets Expect Higher Volatility

- New government stimulus will increase inflation concerns
- Foreign policy and trade barriers may create artificial demand for U.S. dollars
- Rates remain below historical average

## Short Term Rates will continue to rise

- Still data dependent
- Fed announced 2 rate hikes for 2017
  - And 3 rate hikes for 2018
- More sustained growth will mean more Fed action



# Disclosures

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