C Y P R E S S
Asset Management, Inc.

MARKET COMMENTARY **July, 2017**

The S&P 500 posted its best first half in four years (+9%), boosted by solid growth in corporate earnings and expectations for improving economic growth. Longer term investors have experienced a remarkable run from the early 2009 market lows of the financial crisis. We thought now might be a good time to highlight our views of the current investment environment, key macro themes, and where markets might go from here over the near and intermediate term. For ease of summer reading, this outlook is presented in a bullet point format:

Key Macro Themes

Favorable Economic Backdrop: Slow & Steady Growth / Low Inflation / Low Rates

Global Economic Expansion underway and has considerable room to run

- *US economy remains steady, China growth improving, Euro Zone finally picking up*

Central Bank Policies likely to remain very accommodative, particularly relative to economic conditions

Structurally low inflation: Deflationary forces continue to pressure nominal growth

- Oil Prices under pressure (short and long term): North American Shale Revolution alters global supply, cheap and plentiful natural gas, electric vehicles …
- Commodity Prices low generally (copper, iron ore, agricultural prices like corn, wheat, soybean all down over last 5 years …)
- Disruption is Accelerating and is Everywhere: Amazon, electric vehicles, robotics & artificial intelligence, "over the top" internet delivery of traditional cable and satellite TV subscriptions…
- Consumer and retail environment rapidly changing: millennial generation behavior and the decline of consumer brand loyalty and identification, Amazon and Uber style direct to consumer disruption is pervasive and accelerating

Growth structurally challenged by demographic trends:

Major world economies face declining population and work force. (US outlook flat, Japan and Europe declining, China workforce expected to significantly contract over next 25 years -primarily due to "one child" policy from 1980 -2015).

Lower for longer: *Modest Growth Rate and low inflation lengthen outlook for current economic expansion and reduce near term odds of recession*

Economic & Market Forecast (Intermediate Term)

US Real Growth	2% - 2.5%
US Inflation	1.5% - 2%
Nominal GDP	3.5% - 4.5%

Europe & Japan (rest of G-7): less than US

Emerging Markets	3.5% - 5%
Inflation	2.5% - 3.5%
Nominal Growth	6% - 8.5%

Corporate Earnings (S&P 500): 5% - 6%

3% global growth + 2.25% inflation + .75% productivity = 6% base case

S&P 500 Projected Base Case 10 Year Return: 6% - 7 %

5% earnings growth plus 1.5 % dividend

Notes: Above trend market returns since 2009 balanced somewhat by lower than average returns since 2000.

S&P 500 Returns	
1997 - 2016:	*7.68%*
2000 - 2017:	*4.51%*
2009 - 2016:	*14.45%*

Cypress Equity Outlook

US: Moderately bullish short and intermediate term

- Slow but steady growth
- Investors still skeptical (according to ISI, investors have pulled a cumulative - $422B out of equity mutual funds and ETFs. At the same time, they have poured + $1,650B into bond funds and ETFs)
- Low rates and favorable monetary policy support valuations
- Investors should continue to benefit from better capital allocation, restructuring, and more shareholder oriented management
- Potential for deregulation and tax reform to enhance growth and corporate earnings

European Markets: less bullish than US due to structural challenges to Euro Zone, economic imbalances between northern and southern Europe, weak banking system, and negative demographic trends

China and Emerging Asian Markets: modestly positive (faster growth, reasonable valuations, but higher risks from lack of transparency, accounting issues, less institutional stability and rule of law)

Latin America, Russia, Middle East and Africa: natural resource based economies challenged by low energy and commodity prices

Note: US bull markets of mid 1980s -1990s generally corresponded with low energy and global commodity prices, while bull market in emerging markets generally corresponded with resource and commodity booms of 1970s and late 1990s – 2007.

Risks:

- Geopolitical Risks are significant and elevated around the world
- Fed/Central Bank Policy & Asset Bubbles:

Larry Summers has posited that today's economy needs bubbles just to achieve something near full employment…in the absence of bubbles the economy has a negative natural rate of interest…That creates a problem, however, since "a strategy that relies on interest rates significantly below growth rates for long periods of time virtually guarantees the emergence of substantial bubbles and dangerous build-ups in leverage."