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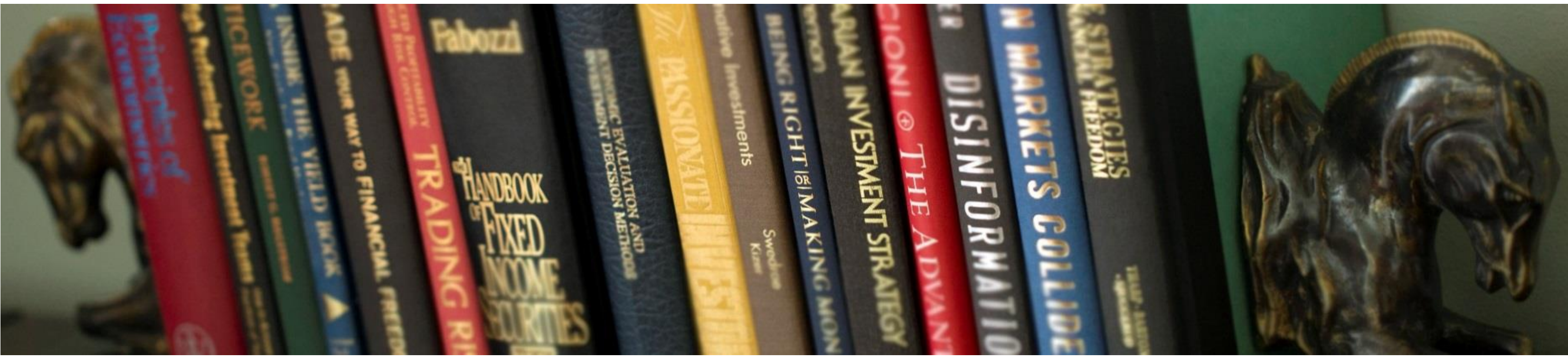
Monthly Note

July 2016



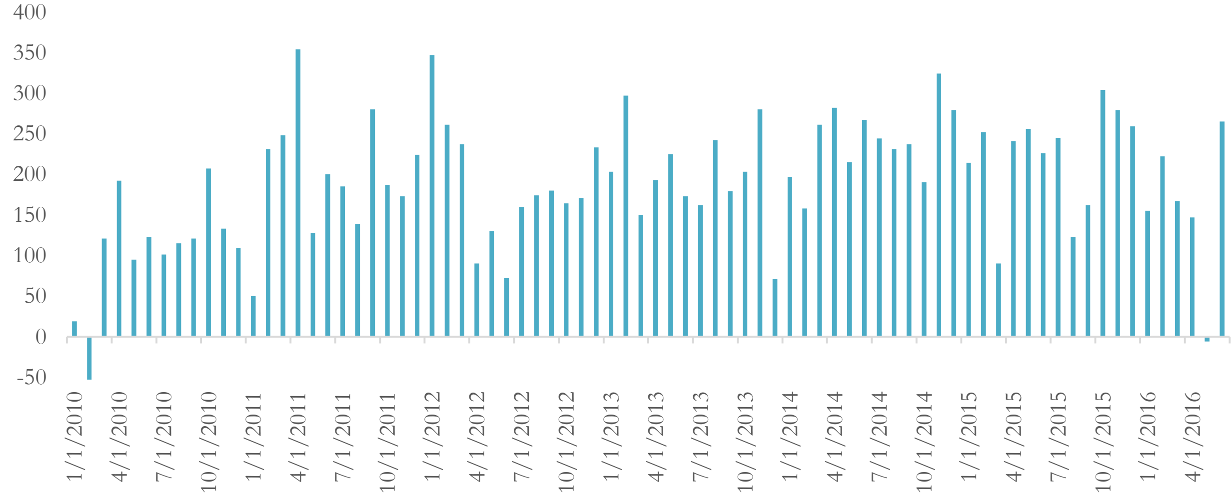
- **In the US, employment figures bounced back after a disappointing May, and consumption was strong enough to save an otherwise mediocre second quarter GDP. US inflation moved higher primarily due to increases in rent over the past year. Overall, economic data in the US surprised to the upside.**

- **For the most part, central banks held back from further stimulus at their July meetings. Following Brexit, speculation leaned toward further easing in Europe and Japan.**

After a weak May, the June jobs report showed the labor markets resiliency with strong internals as people returned to the labor force and received higher wages on a broad sector basis. While creating 287,000 jobs is positive, it is likely that the trend will be closer to 150,000 as we progress through 2016. This lower trend is healthy for this level of unemployment. It will take a sustained increase in participation in the labor force to grow much more quickly. The consumer price index (CPI) rose 1% from a year ago in June, the same reading as May. Excluding food and energy, CPI rose 2.3% driven by a sustained surge in the cost of shelter. Weighted at about one-third of the index, shelter grew 3.5% from a year ago, and constitutes the majority of the inflation pressure present. In fact, on an unadjusted basis, the overall price index excluding shelter was negative 0.2% from a year ago.

Total Private Nonfarm Payrolls

(MoM Net Change SA)



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The most disappointing economic news in the US was the second quarter GDP report; the US economy grew a meager 1.2%. The personal consumption expenditures ("the consumer") grew at a 4.2% annual rate—the fastest pace since the end of 2014, carrying far more than its own weight. Business investment detracted, but much of the decline, about 67%, was due to oil drilling and oilfield related equipment. Overall, the US economy remains around a 2% annual growth rate.

For most of July, economic data surprised to the upside in the US. However, this is a sign of expectations declining to meet reality rather than a reacceleration in growth. Given the weak GDP print, the US Federal Reserve is likely to wait and see how the data evolves going forward, a mantra the Fed has followed since beginning to tighten policy.

The Central bank policies were largely unchanged in July. The European Central Bank chose to stay put with its current stimulus package as the effects of Brexit are not apparent, yet. ECB President Draghi stated the ECB has not discussed tapering its QE. With a limited number of levers to pull at this point, the ECB decision seems prudent. Meanwhile, Japan was rumored to be discussing 'helicopter money' or the direct financing of fiscal stimulus by the Bank of Japan. Furthering these rumors, Prime Minister Abe announced a $265B fiscal stimulus package ahead of the BoJ's policy announcement. Instead of helicopter money, the BoJ announced much less stimulus than markets expected.

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Following Brexit, the Bank of England held its policy rate steady at 0.50% with only one vote against doing so. Prior to the meeting, there was an 80% chance of a rate cut priced into the market. However, the statement made clear that August was likely to see some form of easing, and not simply by cutting interest rates.

The Federal Reserve left interest rates at 0.25-0.50%, but upgraded the outlook for the US economy. The statement was hawkish, aimed to keep rate hikes a possibility in 2016. The only caveats in the statement were the decline in inflation expectations and business investment. However, the FOMC continues to see inflation rising toward 2% as "as the transitory effects of past declines in energy and import prices dissipate." Overall, the Fed remains in a tightening cycle, but it appears to be waning. The US economy is not growing particularly quickly, but it is growing. This choppy, inconsistent speed is likely to persist in the second half of the year.

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Publication Date: 8/1/2016