CONGRESS ASSET MANAGEMENT COMPANY

Economic and Market Outlook

Fourth Quarter 2018

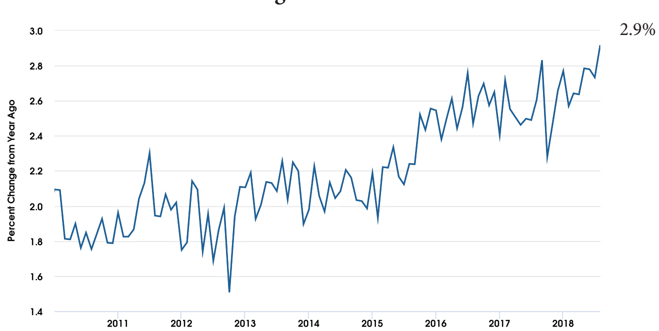
Ten years after the financial crisis, the United States economy is the strongest it has been since 2004. Gross domestic product was revised up for the second quarter to 4.2%, the strongest reading in about 4 years. The expansion has been driven by a robust labor market, low inflation, and more recently, tax cuts and deregulation.

The domestic financial markets have noticed. Bolstered by strong corporate earnings reports, the S&P 500 returned 7.20% during the third quarter. Two stalwarts, Apple and Amazon, both eclipsed $1 trillion in market capitalization. Bond investors have been more recalcitrant. Fearing growth-induced inflation, ten-year treasury bond yields fluctuated throughout the quarter, ending near their high of 3.10%.

The summer months exposed the divergent paths of the U.S. economy and those of the major European countries. The U.S. continues to accelerate while France, Germany, Italy, and the U.K. stagnate. China's official growth rate remains above 6%, but its stock market, along with many in emerging economies, has struggled this year.

It is the exceptionally strong employment numbers which give us confidence that this expansion will continue. The U.S. economy should maintain its growth path despite the European travails predominately based on the robust domestic job market. Indeed, by many measures employment has rarely been stronger. The unemployment rate at 3.9% is close to historical lows while other measures of job growth and availability are at multi-decade highs. And now wages appear to be accelerating - rising nearly 3%, the strongest level in a decade.

U.S. Wage Growth Rates

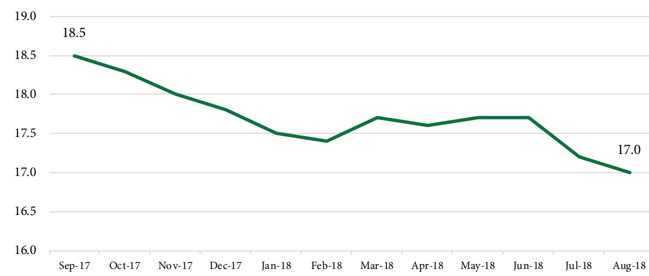


Source: U.S. Bureau of Labor Statistics

The strength in employment supports long term growth, spending, and consumer confidence. Yet, the saving rate at 6% is elevated given the strong job market. This may reflect the caution younger workers have given the depth of the last recession and the difficulty they experienced in finding jobs. It may also act as an economic cushion and provide an impetus for future spending.

Somewhat tempering our enthusiasm are moderating housing and automobile markets. Mortgage rates have ticked up, coinciding with lower levels of home sales. At the same time, domestic and global auto sales may have peaked for this cycle. Both housing and automobiles have broad influence and affect spending across the economy.

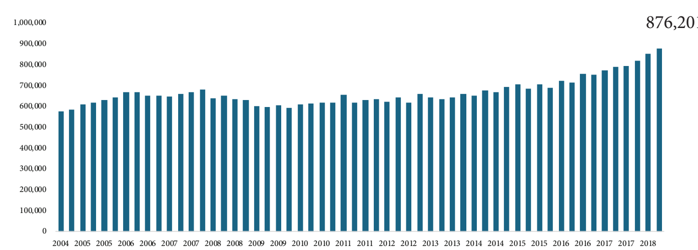
Total Vehicle Sales (millions)



U.S. Bureau of Economic Analysis

It appears that businesses will make up for any slack on the consumer side. Small business optimism is close to record highs and applications for new Employer Identification Numbers indicate that entrepreneurial drive is not dead and is in fact flourishing. Orders for capital goods continue to improve while the ISM Manufacturing Index is solidly in expansionary territory. In response to the tax changes enacted this year, companies are repatriating cash and investing in capital equipment. Regulatory relief is deflationary and over time encourages new business investment and fosters competition.

New Business Applications in the U.S.



U.S. Census Bureau

The technology sector has been an outsized recipient of business spending as the digital economy is transforming work flow and information gathering. Data now has value and how organizations store, analyze, and use data will continue to transform our economy for many years. Technology companies are the natural beneficiaries of this trend. The productivity benefits also accrue to technology users who can experience enhanced efficiencies amongst other ancillary benefits.

Both the stock and bond markets have done well over the past decade. The risks to both are vastly different than they were ten years ago. Inflation, for one, has started to percolate. The Fed remains concerned about inflation's erosion of asset values. In response, the Fed raised short term rates in September and suggested they will maintain a course of gradual increases over the next year. At current levels, U. S. interest rates remain an attractive alternative to interest rates available in many other developed nations. Therefore, it is difficult to predict how either the stock or bond market responds to Fed initiated short term rate hikes.

10-Year Government Bond Yields in Select Developed Nations

Country	Yield
United States	3.06%
Australia	2.66%
Germany	0.47%
Japan	0.12%
United Kingdom	1.57%
Canada	2.42%
France	0.80%

Bloomberg as of 9/28/2018

Of considerable concern to markets is the fluidity of U.S. trade policy. Negotiations with our North American partners are progressing. Talks with China, however, have stalled, and it is unclear whether the issues are about trade policy or the protection of intellectual property rights. In the short term, trade uncertainty weighs on exporters and those that source product from China. Longer term, tariffs are generally considered inflationary and hinder growth. However, organizations eventually adapt to policy changes and predicting winners and losers is not as obvious as it may appear.

As the fourth quarter progresses, we look for the economic momentum to continue. The U.S. economy's potential is greater now than it was a few years ago allowing for stronger, non-inflationary growth. Consumers and businesses should both continue to fare well. Treasury yields at greater than 3% are attractive, but stocks remain the preferred asset class.

Investment Oversight Committee
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