

**Economic Comment and Market Outlook**  
**FAYEZ SAROFIM & CO.**  
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2016 has delivered no shortage of market shocks – January’s renewed commodities crash, China devaluation, and the unprecedented U.K. vote to leave the European Union, to name a few – to a global economy already plagued by weak growth conditions. In spite of a tumultuous start to the year, improving economic data and healthy consumer fundamentals enabled investors to enter the second quarter with cautious optimism. A weaker U.S. dollar and a sizeable share of upwards earnings revisions in May cushioned equities throughout most of the period, but the surprising outcome of the U.K. referendum in late June triggered a sell-off that saw global stock markets lose a record \$3 trillion in just two days. The S&P 500 dropped more than 5% in the aftermath, and then staged a dramatic rally in the last three days of June that offset the decline and allowed the index to land squarely in positive territory for the second quarter.

Perhaps not surprisingly, markets increasingly exhibited the ability to absorb stress and recalibrate as investors adjusted to chronic uncertainty. The energy rebound that began earlier in the year picked up steam as unexpected outages in Canada, Nigeria, Libya and Iraq reduced the global oil surplus. The inflection in oil prices significantly eased financial volatility, and the resulting shift in investor sentiment helped to drive a broad-based pickup in earnings estimates. Nevertheless, equities remained range-bound.

Financial markets continue to be constrained by structural challenges and an uninspiring global growth outlook. The Federal Reserve pushed rate hike expectations even further out following the Brexit vote, suppressing post-referendum U.S. dollar appreciation, but leaving no end in sight to the ultra-low interest rate environment. The move exacerbated mounting frustration with policymakers in major developed markets who have been unable to halt a relentless deterioration in growth prospects despite extraordinary easing efforts. Moreover, investors fear the U.K. referendum has paved the way for populist and protectionist policies that could undo years of international cooperation and cripple the global economy. In the absence of strong inflationary pressures and broad-based improvement in underlying fundamentals, the economic outlook largely depends on the strength of policy response worldwide to boost business and consumer confidence and to reinforce the global trading order.

International events present ongoing threats to the recovery in the U.S., but on balance, the economy appears to be gaining traction. The ISM manufacturing index has registered improvement five out of the first six months in 2016, signaling steady recovery after a protracted period of weakness. Personal spending rose in the second quarter, signaling a strong rebound in real consumption and suggesting that May’s weaker-than-expected payroll report was an anomaly. Consumers continue to benefit from the lagged effects of low interest rates and low energy costs, and wage growth has shown some signs of picking up. Mortgage applications remain in an uptrend, indicating healthy demand in the housing sector. Provided employment conditions and wage inflation trends remain favorable, the ever-resilient U.S. consumer will likely continue to drive economic growth.

We believe the U.S. economy is positioned for further improvement in 2016. While macroeconomic uncertainty will remain elevated, the diminishing drag from manufacturing, expansionary government spending ahead of the presidential election and low unemployment should provide a solid foundation for growth. Additionally, the profit rebound in energy should support a recovery in global earnings growth as the lagged effects of commodity weakness continue to dissipate. We expect improving profit growth at our portfolio companies and in the S&P 500 overall will create a better environment for capital appreciation in the second half of this year and into 2017.

Key elections in major developed markets have set the stage for political movements to emerge as an important driver of policy over the medium term. Equity markets are likely to remain volatile and highly sensitive to geopolitical developments as the U.S. presidential election approaches and the framework for a U.K. exit from the European Union takes shape. Uncertain economic prospects and unsettled market conditions support a high

quality portfolio bias. Faye Sarofim & Co.'s long-practiced investment approach emphasizes fundamentally sound companies with strong balance sheets, stable demand characteristics, high levels of profitability, and resilient dividend and capital allocation policies. The global industry leaders in our portfolios have the competitive advantages, financial resources and management acumen to sustain growth as the investment landscape changes. Furthermore, we have recently increased our emphasis on companies whose growth plans are more structural and less dependent on the overall level of economic activity. In a volatile market environment, we remain committed to adhering to our time-tested investment philosophy and to delivering superior risk-adjusted returns over market cycles for our clients. (07/16/2016)

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