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Economic & Market Summary
April 2014

Domestic economic growth continues at a modest pace while the highly anticipated acceleration appears somewhat elusive. Consumer spending remains the strongest component of GDP and is poised for additional growth. As of January, personal income grew 4% year-over-year while expenditures increased 3.5%. Debt service ratios have declined each year since 2007 indicating a healthy consumer balance sheet and leaving ample room for continued spending growth. Consumer sentiment also continues to strengthen. Private sector employment has improved since last year as the unemployment rate declined a full point to 6.7%. Unfortunately, labor participation remains weak. Housing starts in January and February were flat compared to last year at 907,000 annualized, but remain below household formation. Moreover, favorable market conditions including interest rates and affordability suggest housing will remain a growth engine in the economy. Business investment has been notably weak during the current expansion but accelerated in the fourth quarter and, based on a sharp increase in year-to-date commercial and industrial loan originations, could be entering a phase of sustained growth. Net exports remain a positive contributor to overall growth which we expect to continue due primarily to booming energy production. Healthy consumer spending, housing and business investment, and net export growth suggest that 2014 will be similar to 2013 GDP growth of 2.6%.

International economic growth has been uneven. In 2013 Brazil grew 2.3%, China +7.7%, Mexico +1.3%, Russia +1.3%, and India +4.5%. The Japanese economy grew 1% in 2013, but could accelerate in 2014 if fiscal and monetary stimuli offset the anticipated negative effect of a higher sales tax rate beginning in April. Europe has returned to modest growth and concerns about debt have been significantly reduced, demonstrated by Ireland's recent 10-year bond auction at a record low yield of 2.9%. The risk of a recession in Russia is growing dramatically as it isolates itself. The degree to which sanctions on Russia affect the European economy will be important to monitor.

Core inflation at 1.6% remains subdued. However, inflation risk has increased due to the Federal Reserve's extraordinary monetary stimulus over the last several years and stronger bank lending more recently. To produce a less accommodative monetary posture, the Fed has begun to reduce bond purchases and at the current pace will conclude the QE program in October. The tapering process remains subject to supportive economic data, particularly more favorable employment conditions. Rising interest rates will likely follow; the Fed Funds rate could actually be increased in 2015 for the first time since 2006. Yields on intermediate and long-term bonds are below historical inflation figures and we remain generally cautious on these securities.

The S&P 500 returned 1.8% in the first quarter. At approximately 16.5x 2014 expected earnings, the P/E multiple is running modestly above the historical average. Consensus 2014 earnings estimates on the S&P 500 have risen to expected growth of ~12% from ~5.5% only six month ago. Note that 2013 estimates were nearly as bullish at one point but drifted lower as the year progressed. The combination of earnings estimate revisions, rising interest rates, and above-average valuation exposes the market to volatility. A review of our coverage universe shows a growing number of companies trading at or above our appraisal of fair value, while fewer are trading below. Select opportunities still exist, emphasizing the point that fundamental research is critical to successful long-term investing.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address above.