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Economic & Market Summary
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Fourth quarter U.S. data reveals acceleration in the economy, nearly across-the-board. Housing starts continue to grow at a healthy double-digit pace and in November surpassed 1 million units annualized, bringing supply closer to demand (household formation). Retail sales numbers are strong, which reflects better employment trends and an improving consumer balance sheet. Unemployment ticked down to 7%, from 7.7% last year. Industrial production is robust and capacity utilization is 79%, a level that should lead to faster capital spending growth. Manufacturing and non-manufacturing surveys signal continuing growth. All of this good news has occurred in a period of rising tax rates and increased regulation. Q3 GDP growth of 4.1% included a significant contribution from inventory build; accumulation off lean levels may be signaling increased business confidence. GDP growth over the last four quarters was 2%, with positive contributions from all aspects of the private economy (personal consumption, business investment, residential investment, inventories, and net exports) with only government acting as a drag. The recently passed U.S. budget deal is a welcome compromise. Our economy would benefit greatly from some certainty in longer-term fiscal policy and we are hopeful this agreement is the first step. Corporate taxes, immigration, entitlement reform, and healthcare could all be addressed in a manner which fosters a favorable economic environment. Our 2014 GDP growth estimate remains approximately 2% with an upward bias based upon recent data.

The Federal Reserve recently reduced its asset purchase program (QE) to $75 billion per month from $85 billion. This tapering move comes as the economy appears on stronger footing with both unemployment and the U.S deficit declining, offset by relatively benign inflation data and inflation expectations. Monetary policy remains considerably accommodative. Further tapering of the QE program was signaled but will be data dependent. Core inflation of 1.7% remains below the 2% target. We are skeptical that this figure will remain below-trend and therefore remain cautious on long-term fixed income investments. As the Fed reduces its asset purchase program, long-term rates should continue to move higher. Janet Yellen was confirmed as Fed Chair while Stanley Fischer has been floated to replace her as Vice Chair. Mr. Fischer has been lauded for his service as Governor of Bank of Israel from 2005 to 2013 and would appear to be a positive addition to the Fed's leadership.

At 16x next year's estimated earnings, the S&P 500 is priced for average to slightly below-average long-term returns. Near-term, the market could be susceptible to a correction given very strong recent gains, rising interest rates, and decelerating earnings growth. However, supportive economic data, fiscal accomplishments, and continued underweighting in equities by institutional and retail investors all argue against a sustained downturn. The prodigious amount of "cash on the sidelines" has begun to trickle into the market. Last year was the first since 2006 featuring positive net flows into domestic equity mutual and exchanged-traded funds. The S&P posted a 32% gain in 2013 driven largely by P/E multiple expansion in contrast with performance during 2009-2012 which was driven by earnings and dividend growth. A rising valuation environment requires investment discipline and a focus on high-quality businesses.

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