Schaper, Benz & Wise
INVESTMENT COUNSEL
Trusted Advisor for Generations

18 Jewelers Park Dr., Suite 200 | P.O. Box 628
Neenah, WI 54957-0628 | 920.727.1137

Economic and Market Summary
July 2012

The U.S. economy has continued to experience moderate growth in the first half of 2012. Personal consumption, business investment, residential investment, and inventories all positively contributed. Detractors from growth were government and net exports. We believe that employment growth, moderating inflation, and debt service payments at 20 year lows are conditions that support continuation of personal consumption growth in 2012. Personal consumption represents two-thirds of U.S. GDP. Annualized housing starts in May were 708,000, an increase of 8% from 2011 and another contributor to domestic economic expansion. With record low interest rates and depleting inventories, the housing market is poised to experience sustained growth. While business investment grew in Q1, we think additional growth in the near-term will be challenging as fiscal and regulatory certainty won't likely come until after the Presidential election. Inventory levels are lean, but growth in this category will require businesses to have more confidence than exists at present. While government spending will reduce GDP growth in the near-term, we view this as positive because shifting services to the private sector tends to increase efficiency over the long-term. We expect net exports to be a modest drag on GDP growth, but lower energy prices will be a benefit. In aggregate, we remain confident that U.S. GDP growth will be around 2-3% in 2012.

Global geopolitical issues continue to dominate the headlines. Slowing growth in BRIC countries and the European debt crisis are risks facing the global economy. Qualitatively, these issues could dampen confidence, leading to lower capital investment and personal consumption. Quantitatively, exports represent only 14% of total U.S. GDP. Through the first four months of 2012, U.S. exports to the European Union increased 3.5% over 2011 while exports to BRIC countries increased 5.9%. In total, the risks highlighted will have some effect on the U.S. economy but not to a significant degree.

With monetary policy already extraordinarily accommodative, it is time for fiscal policy to shift away from politically driven and ineffective government-led stimulus and toward supply side policies that lessen the role of government and incentivize private investment. Consensus is coalescing around the notion that our economic expansion is not strong enough to withstand the effect of tax increases currently scheduled for January 2013. We are in the throes of an election season, however, and don't expect meaningful policy progress until late in 2012 or early 2013.

U.S. equity markets were significantly more volatile in the second quarter compared to the first quarter of 2012, a condition we expect to persist through the remainder of 2012. With an earnings yield (inverse of price-to-earnings multiple) of 7.5% on the S&P 500 compared to the 30 year Treasury yield of 2.7%, we estimate that much of the apprehension is reflected in stock prices. History tells us, however, that markets tend to over-correct. This leads us to construct investment portfolios that feature high-quality investments and liquidity in order to weather periods of time when prices reflect elevated levels of fear. We view corrections as opportunities to purchase high-quality assets at attractive prices.

Thomas H. Rippl, CFA