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Economic and Market Summary
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Macroeconomic data are painting a mixed picture. Over the last 12 months, the average net increase in private nonfarm payrolls was 155,000 while the unemployment rate has been stuck around 8%. Real personal consumption grew at a 2% rate over the last 12 months driven by an increase in personal income of 2%. This is consistent with GDP reports showing 2.1% year-over-year growth. Housing starts continue to be a bright spot with a 6 month average of 733,000 units, a healthy double digit year-over-year increase. Manufacturing and production have weakened recently, while exports to Europe and BRIC countries have continued to grow despite a sputtering global economy. As a result of this data, we're reducing our 2012 U.S. GDP growth forecast to 2% from 2-3%.

Over the last three decades, the U.S. experienced two strong economic growth periods and, more recently, a comparably slower growth period. Market participants' opinion of the current economic expansion, which began in July 2009, is heavily influenced by the prior two expansions. Characterizations of the current expansion as "weak" or "below trend" overlook the efficiencies that have been achieved by the private sector in response to a decade of challenges. We believe the single largest headwind to the current expansion is the absence of long-term, growth-oriented fiscal policy. Our analysis suggests that corporations and consumers have the ability to invest and consume but lack willingness due to incoherent short-term fiscal policies, regulatory uncertainty, and a lack of statesmanship by leaders of both political parties. Our representatives in Washington are not short on ideas; they're short on execution. As a result, corporations are wary toward investing with an outlook too far into the future, especially when considering domestic projects. With a focus on long-term policies that incentivize wealth creation and business expansion, the U.S. economy would realize stronger output gains and job growth.

Late in Q3, the Federal Reserve announced an extension of its program to lower interest rates consistent with the dual mandate of maximum employment and price stability. Chairman Bernanke's comments suggest that the FOMC is currently prioritizing employment. Assuming QE3 is fully executed, the Federal Reserve's balance sheet will grow to a significant portion of the U.S. debt market. With core inflation hovering around 2%, the Fed extended its commitment to maintain low interest rates to mid-2015. We remain bearish on longer term fixed income securities, in general, while continually scrutinizing the market for unique offerings.

An expanding P/E multiple from below-average levels combined with year-over-year earnings growth of 5% has resulted in strong stock market appreciation this year. With the S&P currently trading at 1440 and based upon our 2012 S&P 500 earnings estimate of $100 per share, the market trades at a forward P/E of 14x. For perspective, S&P 500 earnings peaked in September 2000 and again in June 2007 at $56.79 and $91.47, respectively. Concurrent with those peak earnings, the S&P 500 traded at all-time highs of 1520 (P/E multiple 27x) and 1560 (P/E multiple 17x), respectively. Based on modest valuations, steady economic and corporate earnings growth, and continued low investor participation rates as evidenced by over five years of net outflows from domestic equity exchange-traded and mutual funds, we conclude that equities still offer good value.

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