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Economic & Market Summary
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Macroeconomic data support growing consensus that GDP growth is moving towards the +2.5% trajectory, 25% above the +2% rate we've experienced since June 2009. The U.S. consumer remains in good shape with manageable debt service levels and expanding employment, while income growth and confidence remain modest. Lower-priced competition in the global labor force and disjointed domestic immigration policies appear to be dampening income growth prospects for the newer and lower-skilled participants in our labor force. Efficiently educating our workforce with relevant skills should remain a top priority. Q2 GDP growth of 4.6% represents a recovery from -2.1% in Q1 during which severe winter weather and inventory adjustments reduced growth. Year-over-year GDP growth was 2.6% with strong contributions from personal consumption and business investment. Residential investment slipped from its robust pace experienced for several years due to weather and rising mortgage rates. Additionally, consumer preferences have shifted to demanding multi-family/rental properties. We believe this demand shift is transitory and expect the 18-35 year old cohort will naturally move towards full home ownership. 2013 marked the first time in 6 years that the number of babies born increased, albeit modestly, in the U.S. Housing market conditions remain poised for long cycle growth due to aging inventory and household formation. Our 2014 GDP growth forecast remains +2.5% based on consistent contributions from personal consumption, residential investment, modestly higher business investment, and flat or slightly growing government spending.

Outside the U.S., economic conditions have moderated in the last several months. In Europe, growth is slowing, although not far outside of historical norms, and changes to restrictive labor market conditions have been limited. Russia's brazen actions in Ukraine introduce the risk of higher energy prices in Europe which the continent is not well equipped to handle. In Japan, the recently enacted valued-added tax clearly dampened consumption, although it is too early to make conclusions on the long-term growth track. Labor force negotiations have been revived and seek to make Japan's workforce more globally competitive and include higher merit-based wage adjustments. The major emerging markets of Brazil, Russia, India, China, and Mexico have posted weaker-than-anticipated economic growth, excluding India. The main concern in China is a misallocation of banking assets, which could be fueling unhealthy speculation in real estate.

The Federal Reserve confirmed its plan to eliminate QE purchases in October, although Board members' inflation expectations lack consensus. Our belief is that U.S. economic conditions warrant interest rate hikes beginning in 2015. History and intuition tell us leverage is building somewhere in the system. Given the banking sector's strong capital levels and liquidity, it seems logical to conclude that private equity, hedge funds, and non-traditional channels are using low short-term rates to fund higher return long duration assets. Rising interest rates will not allow this situation to conclude quietly. Our fixed income philosophy is focused on quality, prudent duration, and no leveraged positions.

Domestic equities remain on pace for another solid year of returns, up ~8% YTD. S&P 500 earnings estimates seem to reflect somewhat robust expectations. At $135 per share for 2015, EPS would grow 14% compared to 2014. With the backdrop of a stronger dollar and comparably weaker international economic conditions, this estimate could prove aggressive. The 2014 estimate of $118 represents a reasonable P/E multiple of 17x. Flow data for mutual funds and ETFs embolden our rationale for preferring equities over fixed income, as market participants continue to covet fixed income investments over equities. We remain acutely aware that fundamental analysis is critical regardless of overall market valuation and continue to uncover great businesses offering above-average long-term prospects.

Thomas H. Rippl, CFA

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