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Economic & Market Summary
March 2015

The U.S. economy grew 2.4% in 2014. While there was ostensibly a modest slowdown in the first quarter of 2015 due to weather and port issues, domestic economic conditions remain favorable. With the unemployment rate at 5.5%, energy prices falling, and confidence growing, consumer spending is poised to continue its positive trajectory. Recently, we have become concerned with aggressive financing terms on automobile purchases and rising underlying debt levels. Additionally, while growth in revolving credit over the last year represents improving risk appetites, it does bear watching closely. We remain bullish on residential investment. Conditions for a continuing housing recovery remain in place despite the fact that activity over the last year has been slower than expected. Annual housing starts of one million units are below expectations at this point in the cycle and household formation. Reasons for this include millennials living at home, high student loan balances, and relatively tight credit conditions; all of which we believe are transitory. Business investment was a solid contributor to 2014 GDP, but the first quarter looks weak. Although confidence has improved and financing is readily available, as evidenced by strong growth in commercial and industrial loans, we continue to observe apprehension among businesses as they focus on cost controls, mergers/acquisitions, and financial engineering. This area of the economy appears ripe for expansion as capacity utilization is relatively high and investment since the recession has been constrained. Within the context of a restrictive regulatory environment, uncompetitive corporate tax policy, and worries stemming from years of unconventional monetary policy and government debt accumulation, the private economy is growing at a reasonable pace. Our 2015 GDP growth estimate remains 2.5%-3%.

Monetary policy is exceptionally accommodative, despite being almost six years into an economic recovery. Employment has recovered, while core inflation of 1.5% is below target. Federal Reserve Board members' dovish bias along with other central banks entering an easing cycle, a strong dollar, and low domestic inflation suggest short-term rates may not be increased until late 2015. This doesn't change our belief that the bond market is richly priced. Strong fund flows and oversubscribed new issues demonstrate the insatiable demand for fixed income investments.

Slow and steady economic growth, low interest rates, and profit growth have created supportive conditions for positive stock market returns over the past six years. In Q1 the S&P 500 returned 1% and based upon a 2015 consensus earnings estimate of $118, the market currently trades at 17.5x. Earnings estimates have come down 10% in just the last 3 months as investors digest a stronger U.S. dollar and weakness in the oil/gas sector. The market's implied equity risk premium today is below the long-term historical average, suggesting equities are poised to deliver average to below-average returns. To be sure, there are valid reasons equities could move higher, including rising P/E multiples consistent with a bull market, persistently low interest rates, and underestimated earnings. Three years ago we wrote, "With a P/E ratio of 12.6x and a dividend yield of 2.2%, stocks look attractive. When compared to bonds (10 year U.S. Treasury yield at 1.9%), stocks look even more compelling. Equity valuations continue to reflect an elevated level of investor apprehension, which typically is the time when above-average returns begin to take hold." Investor apprehension appears to have abated. While our preference for owning equities over bonds endures, equities are no longer in bargain territory.

Thomas H. Rippl, CFA

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