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Economic & Market Summary
January 2013

In the face of constant headwinds, the U.S. economy continues to expand. Q3 GDP growth was 3.1% and Q4 should be near 2%. Low debt service payment levels, declining unemployment, low energy prices and improving confidence will drive personal consumption growth in 2013. Residential investment improved markedly in 2012 with housing starts rising to an annual rate of 861,000, up 22% year over year. Conditions are supportive of additional growth in 2013 with declining supply, rising demand, and historically low financing costs. Business investment was growing until Q3. We believe corporations are behaving cautiously, awaiting fiscal policy clarification. Capacity utilization has risen back to its 20 year average indicating we are near the point when growing demand would require capital investment. Government spending detracted from GDP growth over the last four quarters. Spending should continue to decline from elevated levels as the private economy expands. Net exports have historically reduced GDP growth driven primarily by our dependence on foreign sources of energy. Technological advancements are yielding newly discovered domestic sources of energy which could develop into a significant advantage over the next several decades as well as contribute to domestic economic growth. In aggregate, we expect economic growth of approximately 2% in 2013. The probability of a recession appears low, but there is risk of the fiscal cliff outcome dampening confidence and lowering disposable income for a period of time.

Regarding monetary policy, the Federal Reserve announced a continuation of its program to lower interest rates across the yield curve. Importantly, the Fed stated that aggressive policy accommodation will remain in place while unemployment is above 6.5%. Core inflation is ~2% and biased slightly downward in recent months. Central banks across the globe are engaging in massive monetary expansion leaving the potential for inflation to reverse course rapidly and keeping us cautious on fixed income securities, particularly those with longer maturities.

Global macroeconomic conditions are mixed. Europe is stuck in a recession; however, with the European Central Bank offering ample liquidity, the damage is currently contained. China appears to be turning the corner toward higher growth which could have a positive carryover effect on commodity-driven economies in South America, Australia, and Canada. Finally, the newly elected Japanese Prime Minister has expressed a desire to aggressively stimulate the economy. An improving global economy will boost exports and profit growth for U.S. based multinational corporations.

The S&P 500 produced an above-average 16% total return in 2012. Although growth of corporate profits has slowed to 5%, the P/E multiple has expanded. Normally this would be a warning signal but we expect profit growth to improve. With a P/E multiple of 13x estimated 2013 earnings, it is hard to argue that stocks are expensive. Stocks have had a rough, but not unprecedented, 12 year period with a total return below inflation. This has influenced many investors to lower or eliminate their exposure to equities - a mistake in our view. In an environment of 2-3% GDP growth and a reasonable P/E multiple, we believe our investment strategy of owning high-quality consistent growth companies has a high probability of producing results that outpace inflation by a healthy margin over the next 5 years.

Thomas H. Rippl, CFA

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