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Economic & Market Summary
July 2014

Recent economic data as well as company-specific information supports our view that Q1 GDP of -2.9% was an aberration. Q2 GDP growth of 3% would represent a continuation of the modest growth experienced in the current U.S. economic expansion. Personal consumption continues to drive the economy supported by job growth, modestly expanding wages, and manageable debt service levels. Housing hit a speed bump early in the year, but appears to have recovered nicely with starts expanding double-digits in Q2. Conditions supporting housing growth largely remain in place - namely, household formation, low interest rates, and aging inventory. Business investment continues to lag, as it has consistently in this recovery, despite high capacity utilization and plentiful funding options. Slowly receding risk aversion, high relative tax rates, and stifling regulation have kept domestic investment from being the engine of growth we would like to see. Recently, companies have supplemented expansion through mergers and acquisitions, but as prices rise, businesses will ramp organic expansion to fuel their growth objectives. In conclusion, the shape of the domestic expansion has remained homogenous with personal consumption and housing as the main drivers. Our 2014 GDP growth estimate remains ~2.5% as current economic conditions remain consistent with the past several years.

Inflation has been largely dismissed by the Federal Reserve, despite recent trends showing acceleration. Although the Fed has kept to its pace of reducing bond purchases by $10 billion per month, commentary suggests they are not overly concerned with inflation mainly due to labor market slack. Even assuming the Fed is correctly adjusting policy based on inflation, the bond market is mispricing rates. The 10 year U.S. Treasury historically trades 2-4 points above inflation, implying that the rate today should be at least 3.5% compared to the actual rate of 2.5% and supporting our cautious view particularly towards longer-term bonds.

Internationally, we see moderate geopolitical risks and a heavy dose of monetary stimulus. Recently, the situation in Iraq has resulted in rising oil prices, likely affecting international economies more than the U.S. This is not the first geopolitical issue to arise in the economic expansion over the last five years, but it does bear watching. The European Central Bank recently cut interest rates while Japan is in the early stages of unleashing aggressive monetary policy. Based upon valuation gaps, we see opportunities in international markets.

The S&P 500 returned 7% YTD, a robust start to the year and a continuation of a strong and underappreciated bull market. Earnings growth of 6% in Q1 contributed to the performance, along with a modestly expanding P/E multiple. A P/E of 16-17x 2014 earnings is near the long-term average, a point at which bull markets rarely conclude. While market corrections are common occurrences during extended bull markets, we remain constructive on equities because investor allocation into stocks remains near historical lows, P/E multiples are reasonable, and the trajectory of earnings growth is positive. In certain cases we have been trimming stock positions in companies trading above fair value and redeploying into companies trading below our appraisal of fair value.

Thomas H. Rippl, CFA

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