# Current Economic Analysis and Observations:

## Insights to Guide Your Financial Planning and Investment Management


Presented by:

**Jeffery A. Acheson, QPFC, AIF®**

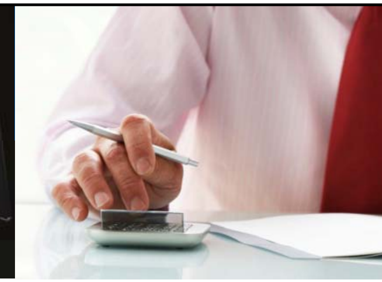
Partner

Schneider Downs Wealth Management Advisors, LP

SD Retirement Plan Solutions Division

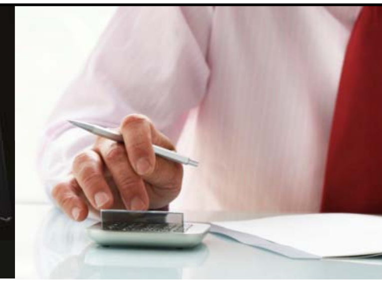

December 3rd 2013

SCHNEIDER DOWNS



# Important Information

The views and opinions expressed are those of the speaker and are subject to change based on factors such as market and economic conditions. These views and opinions are not an offer to buy a particular security and should not be relied upon as investment advice. Past performance cannot guarantee comparable future results.


# Important Information

Performance quoted is past performance and cannot guarantee comparable future results; current performance may be higher or lower.

Results shown assume the reinvestment of dividends.

An investment cannot be made directly in an index.

Investments with higher return potential carry greater risk for loss.

Investing in small companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

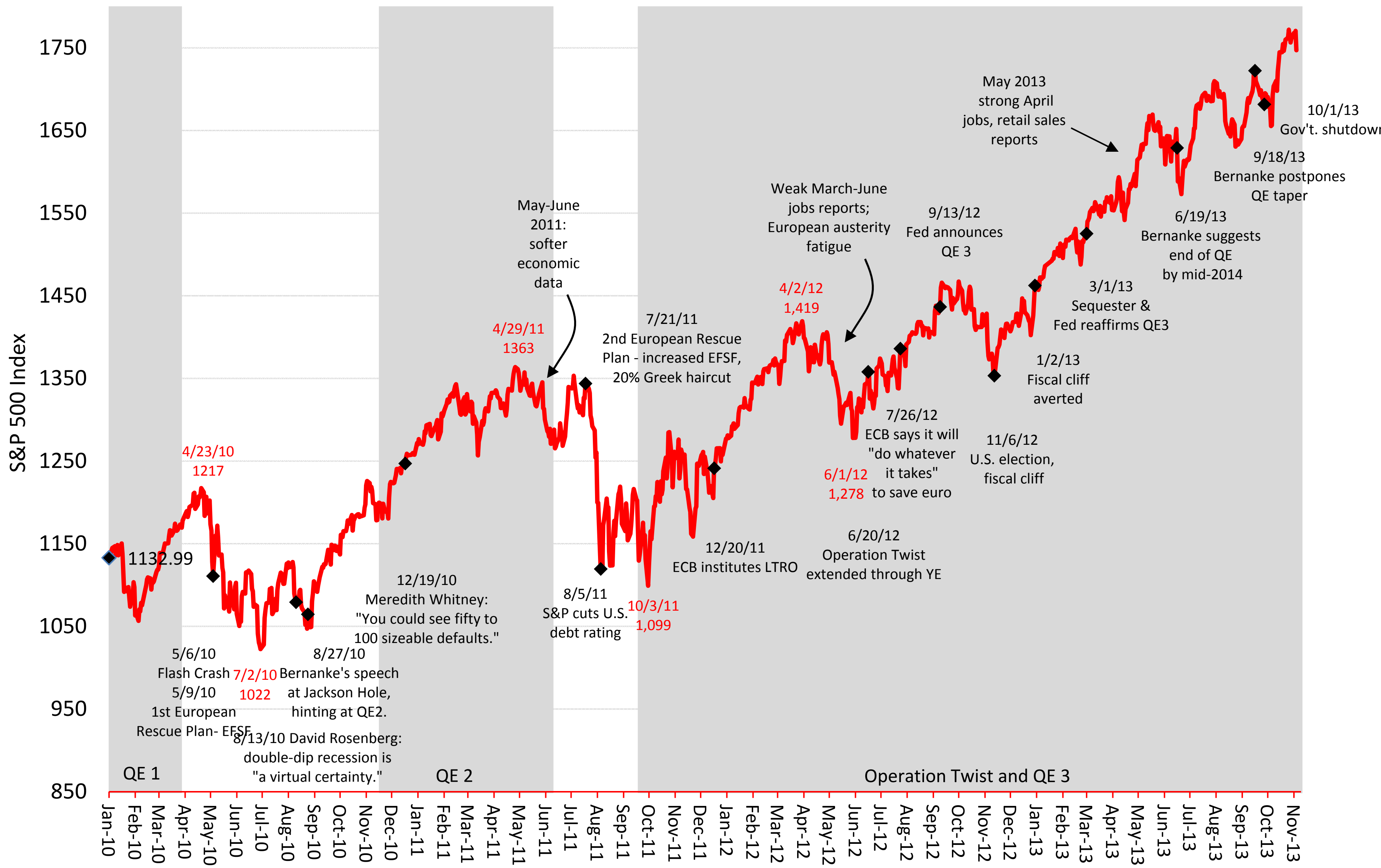
Foreign securities have additional risks, including exchange rate changes, political and economic upheaval, the relative lack of information about these companies, relatively low market liquidity and the potential lack of strict financial and accounting controls and standards.

Investing in emerging markets involves greater risk than investing in more established markets such as risks relating to the relatively smaller size and lesser liquidity of these markets, high inflation rates, adverse political developments and lack of timely information.

Fluctuations in the price of gold and precious metals often dramatically affect the profitability of the companies in the gold and precious metals sector. Changes in political or economic climate for the two largest gold producers, South Africa and the former Soviet Union, may have a direct effect on the price of gold worldwide.

Stock Market

# S&P 500 – relentlessly climbing the Wall of Worry to new highs …

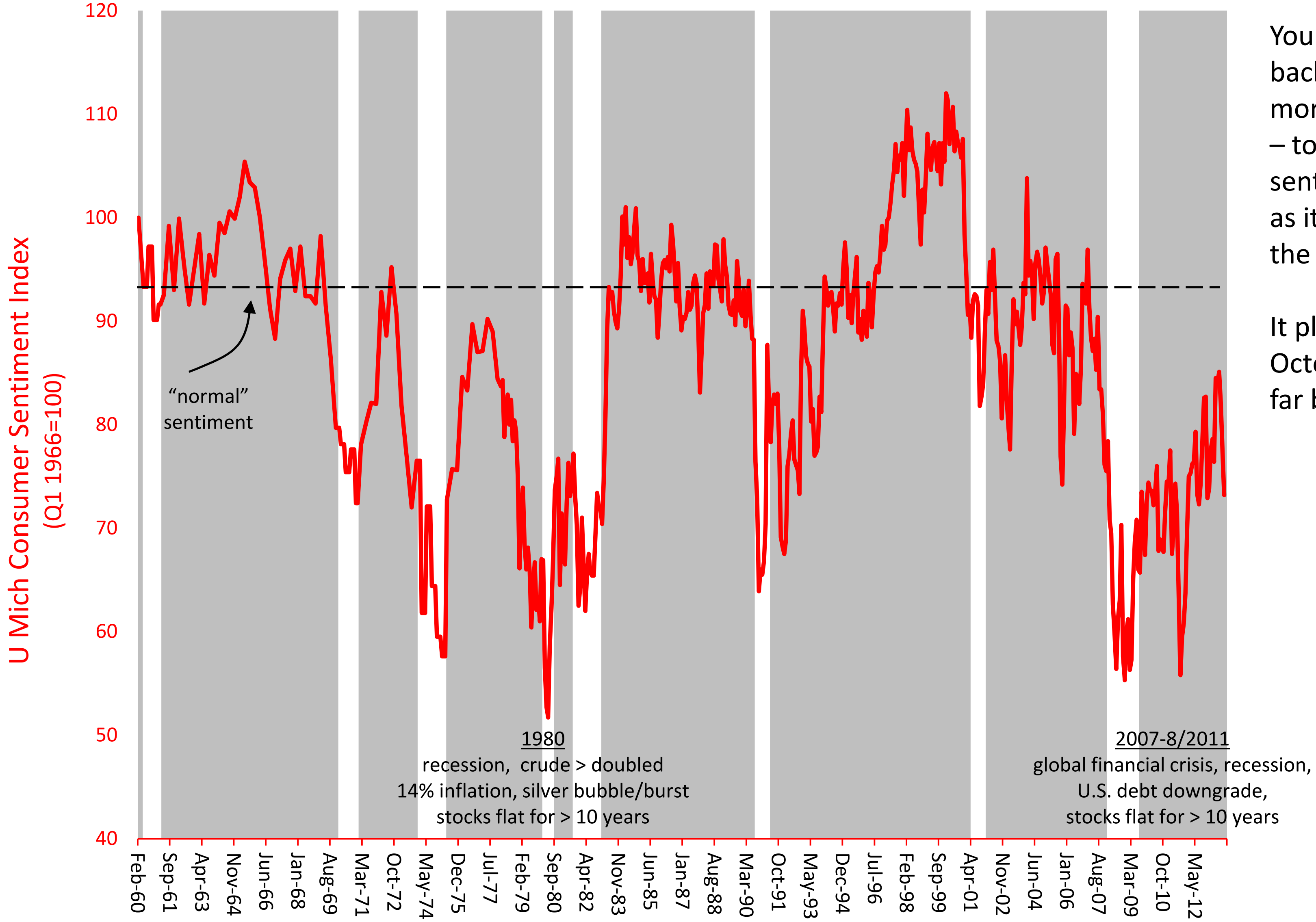





Source: Standard and Poor's. Index data through November 7, 2013.

Consumer Sentiment

# … while Main Street sentiment is stuck in the dumps.

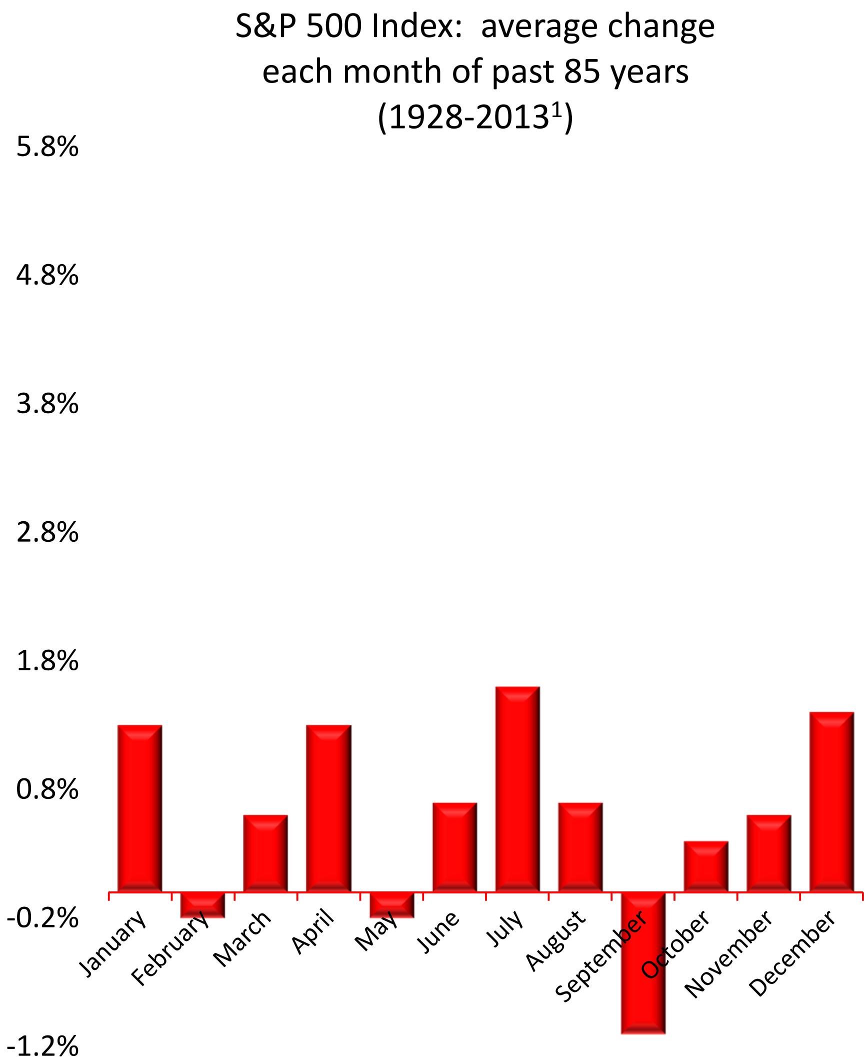


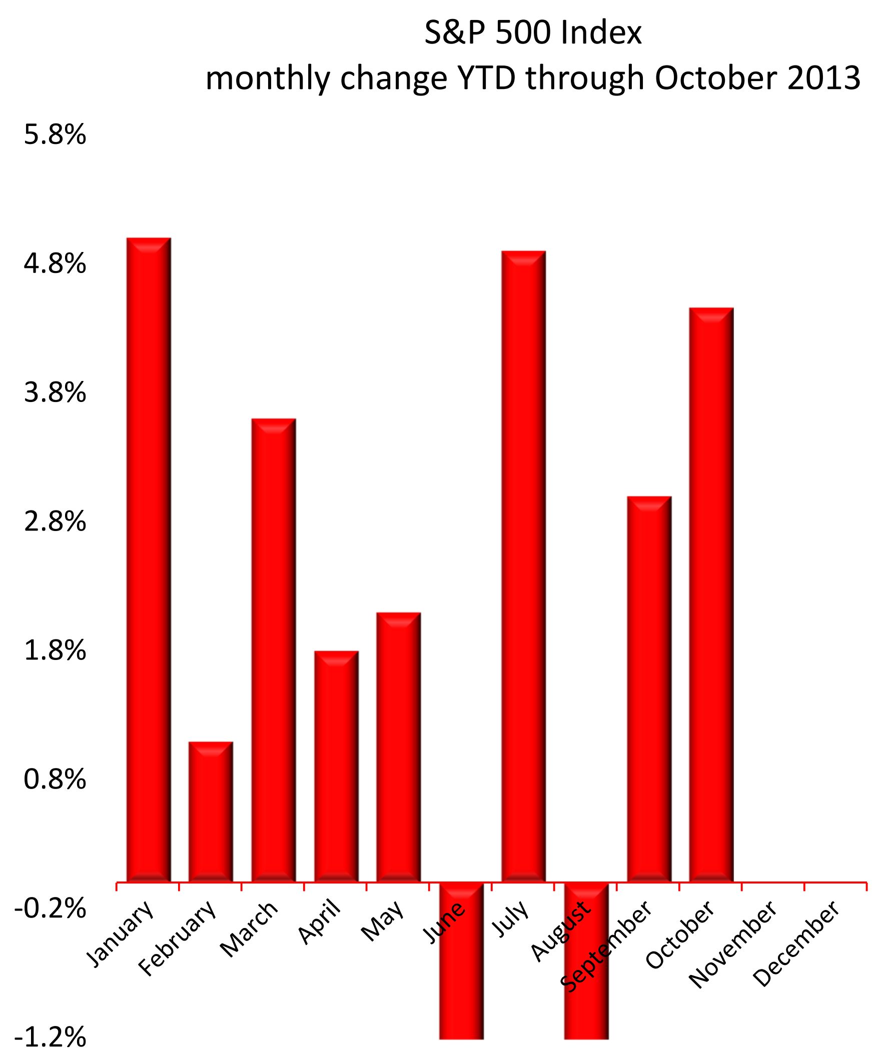

You have to go back a generation – more than 30 years – to find consumer sentiment as low as it got through the recent crisis.

It plunged in October and is still far below normal.

Source: The University of Michigan Survey Research Center, data through October 2013.

# S&P 500 monthly returns – 2013 is extraordinary

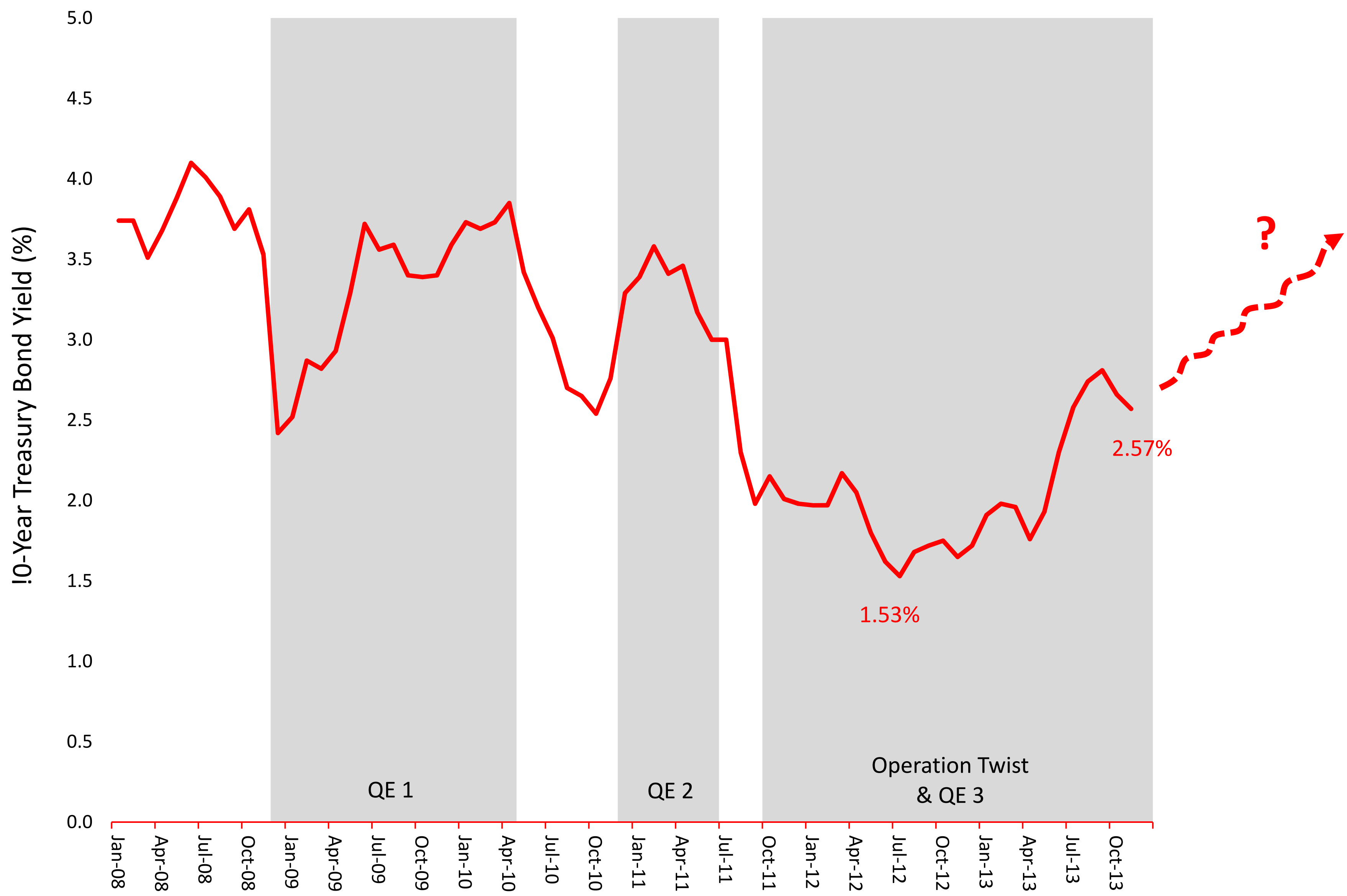



Source: Standard and Poor's. [1] Through July 2013.

The End of QE

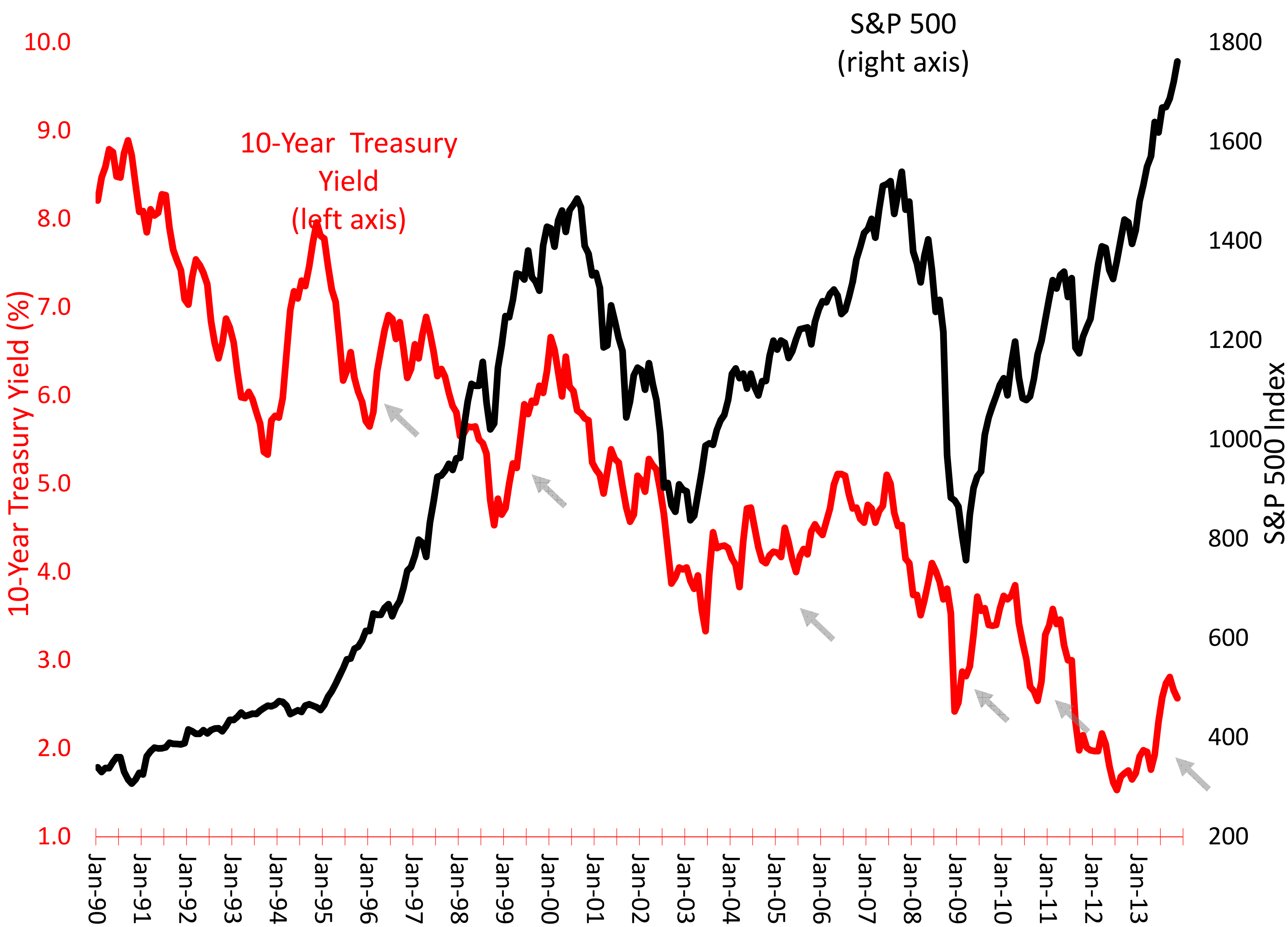
# 10-Year U.S. Treasury bond yield and QE




Source: Federal Reserve. Data through November 1, 2013.

The End of QE

# Rising bond yields have been good for stocks



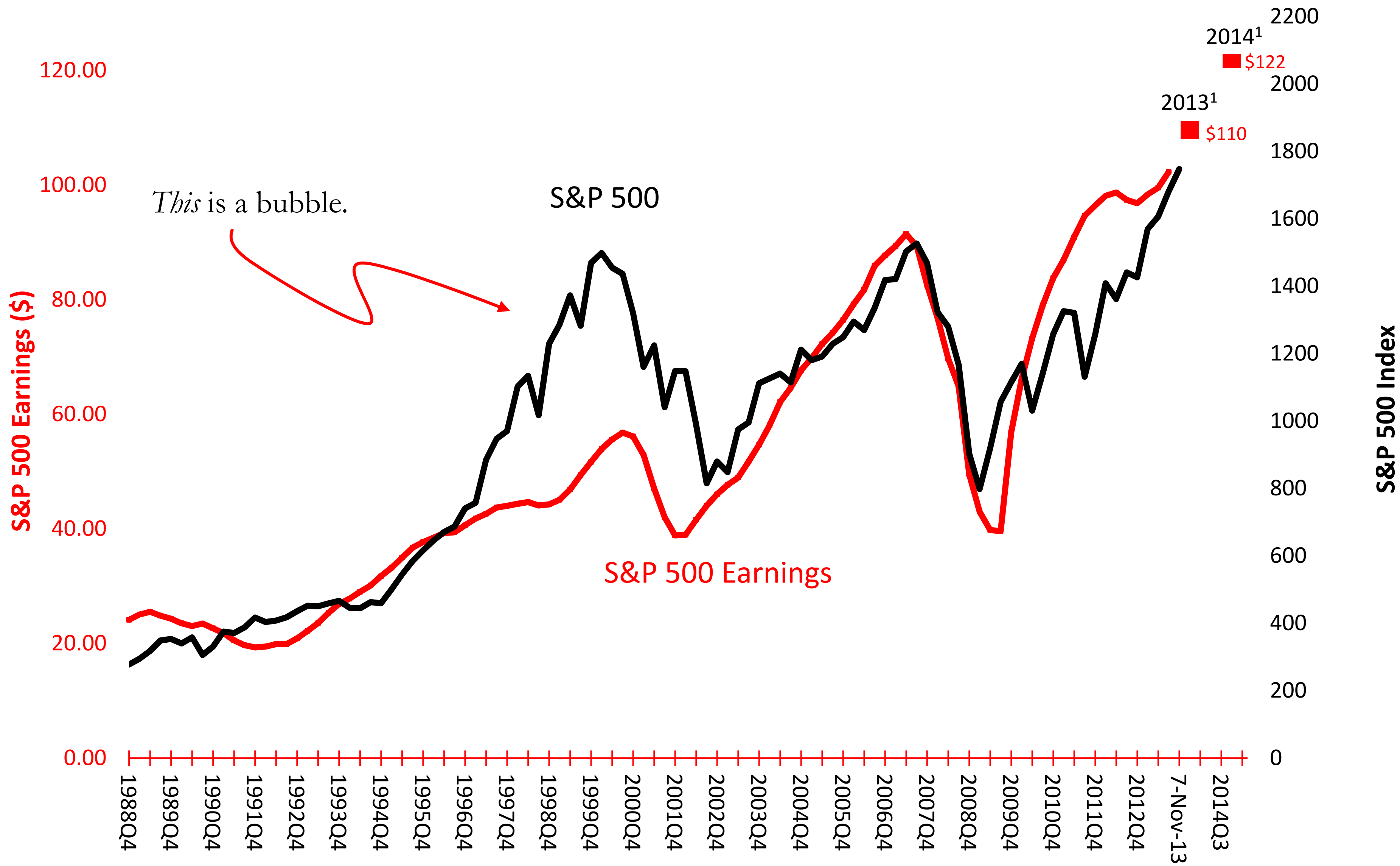

"Higher bond yields are bad for stocks."

It's not so. Bull markets have often been accompanied by rising bond yields.

Sources: Standard and Poor's; Federal Reserve Bank of St. Louis. Data through November 1, 2013. [1] The usual reasons cited are a) higher bond yields provide competition to dividend yields, making stocks less attractive; b) higher bond yields drive down the market's P/E ratio; and, c) higher bond yields will choke off the economic recovery, taking stocks down.

Stock Market

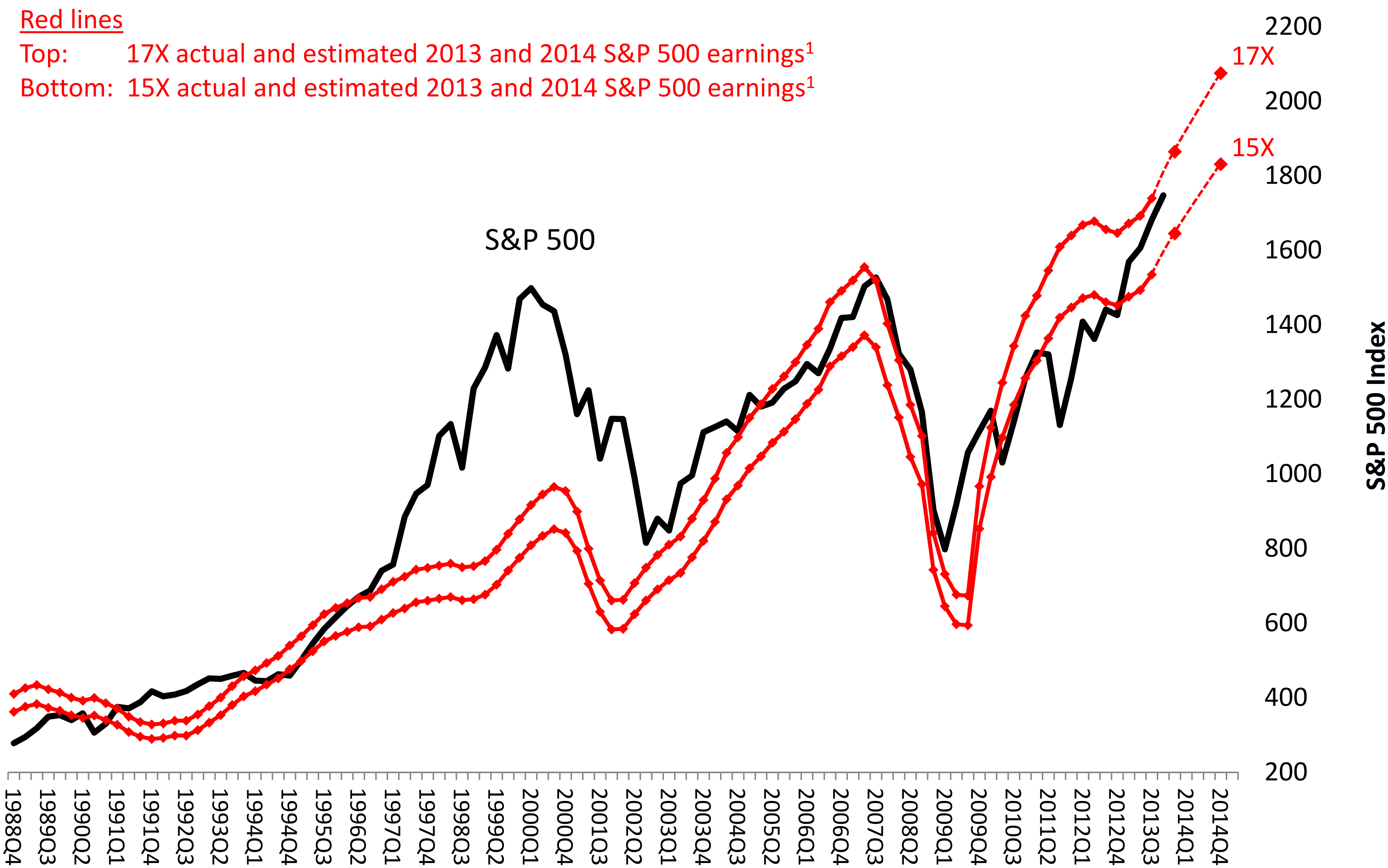
# S&P 500 vs. actual and estimated earnings




[1] Estimated 2013 and 2014 bottom-up S&P 500 earnings per share (left scale) as of October 31, 2013: for 2013, $109.67; for 2014, $122.06. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S survey of consensus estimates. Standard and Poor's for index price data through November 7, 2013; and actual earnings data through September, 2013.

Stock Market

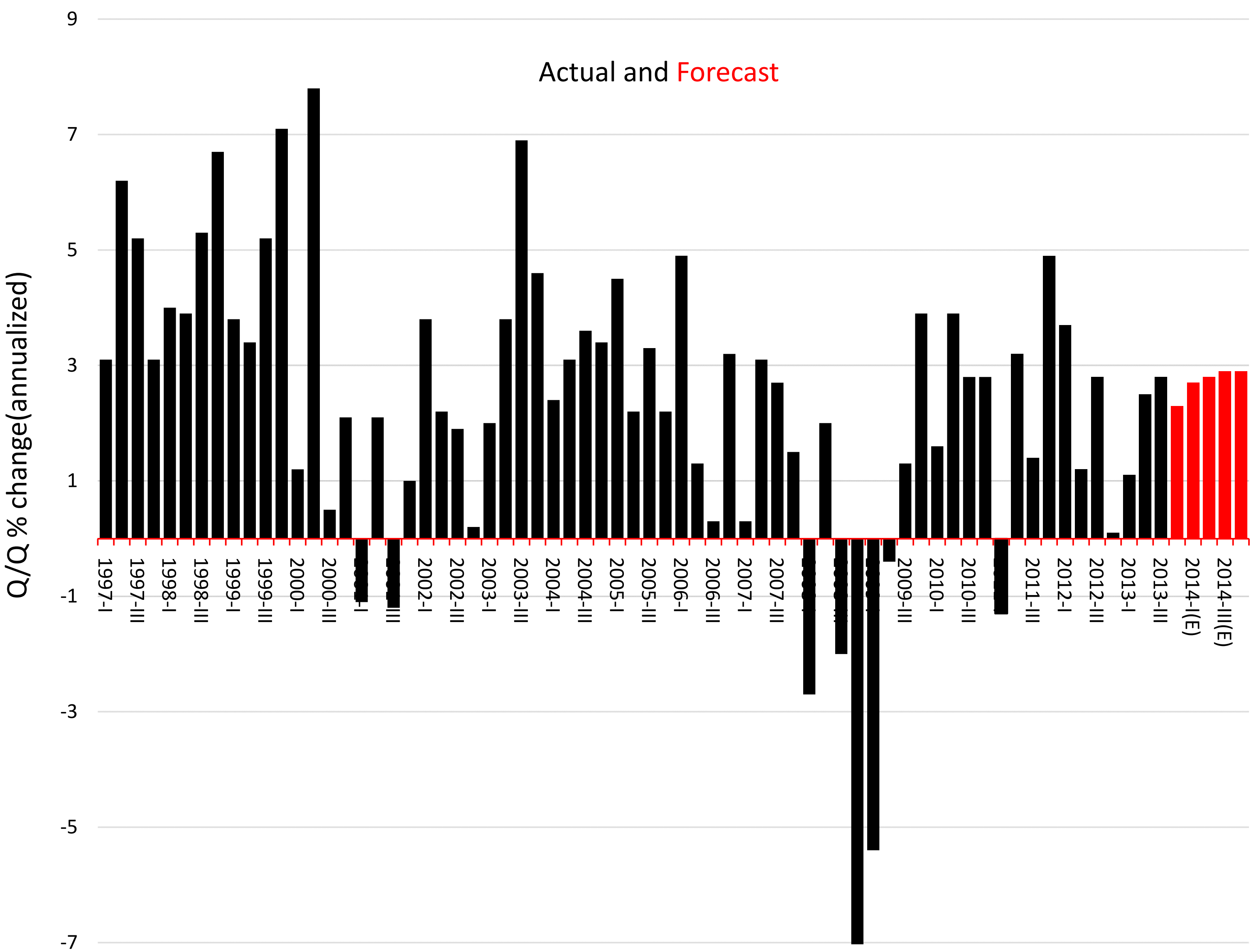
# S&P 500 vs. 15X-17X actual and estimated earnings




[1] Estimated 2013 and 2014 bottom-up S&P 500 earnings per share (left scale) as of October 31, 2013: for 2013, $109.67; for 2014, $122.06. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S survey of consensus estimates. Standard and Poor's for index price data through November 7, 2013; and actual earnings data through September, 2013.

Economic Data

# Gross Domestic Product (GDP) Growth




Economists see continued healthy GDP growth in the quarters ahead.

Sources: Bureau of Economic Analysis, actual data through September 2013; *Wall Street Journal* survey taken October 4-8, 2013.

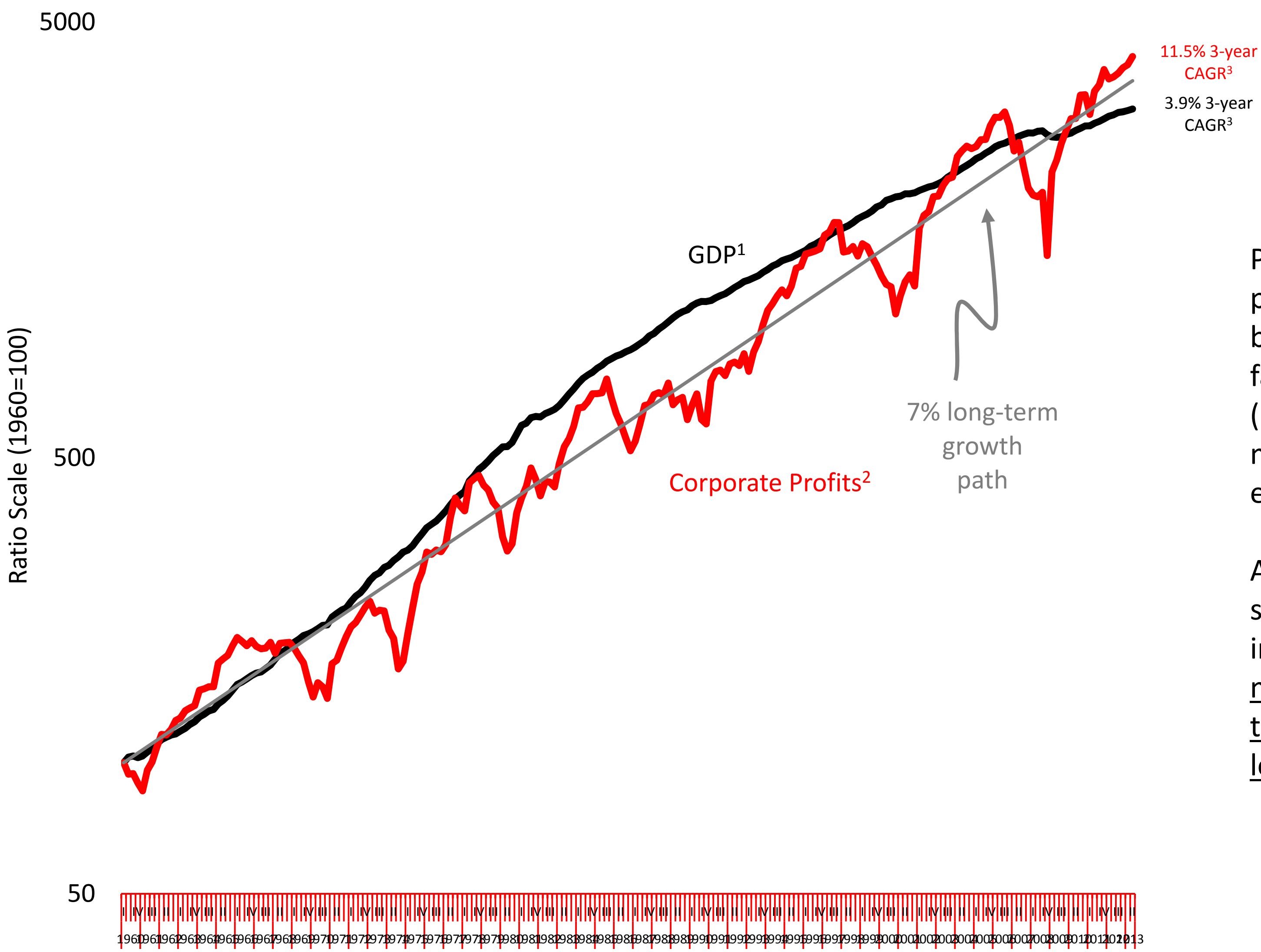
# Projected GDP growth – the case for a downshift


"Revising its previous, 2008 report sharply downward, a recent Census Bureau population projection showed much slower population growth over the next three decades because of less net immigration into the U.S. and a lower-than-expected birth rate."[1]

[1] *Barron's*, October 28, 2013.

Stock Market Arithmetic

# GDP growth and earnings




Post- 2009 recession, profits (red line) have been growing much faster than the GDP (black line), as profit margins have expanded.

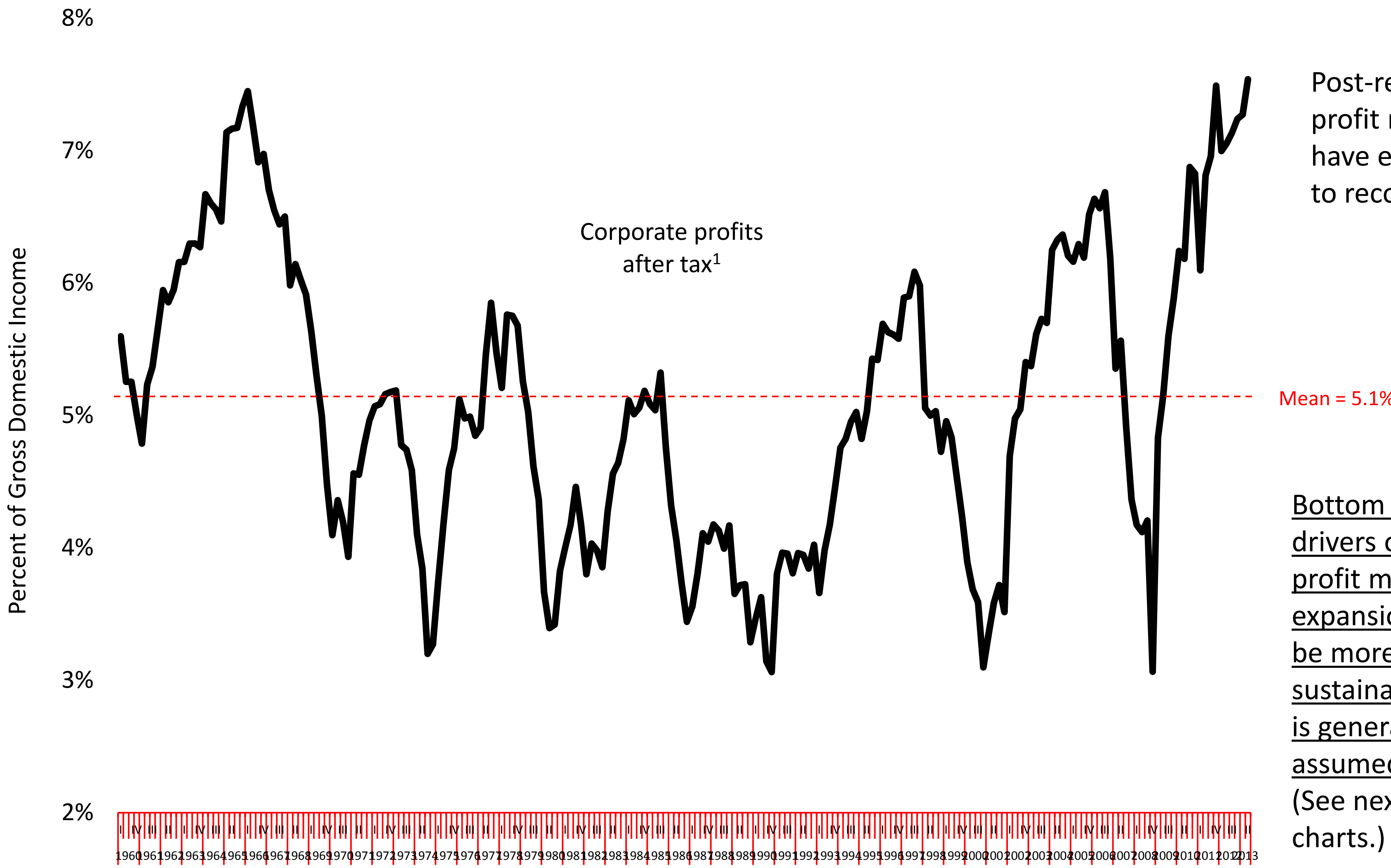
A key question for stock market investors: <u>are profit margins sustainable at these historically high levels?</u>

[1] Nominal GDP.
[2] Corporate profits after tax with inventory valuation and capital consumption adjustments.
Source: U.S. Department of Commerce, Bureau of Economic Analysis. Data through June 2013.

# Stock Market – record profit margins

HULBERT ON INVESTING | By Mark Hulbert

## Lofty Profit Margins Hint at Pain to Come for U.S. Shares




Post-recession, profit margins have expanded to record levels.

<u>Bottom line: the drivers of this profit margin expansion may be more sustainable than is generally assumed</u>. (See next two charts.)

[1] Corporate profits after tax with inventory valuation and capital consumption adjustments.
Source: U.S. Department of Commerce, Bureau of Economic Analysis. Data through June 2013.
Headline: *The Wall Street Journal*, August 24-25, 2013.

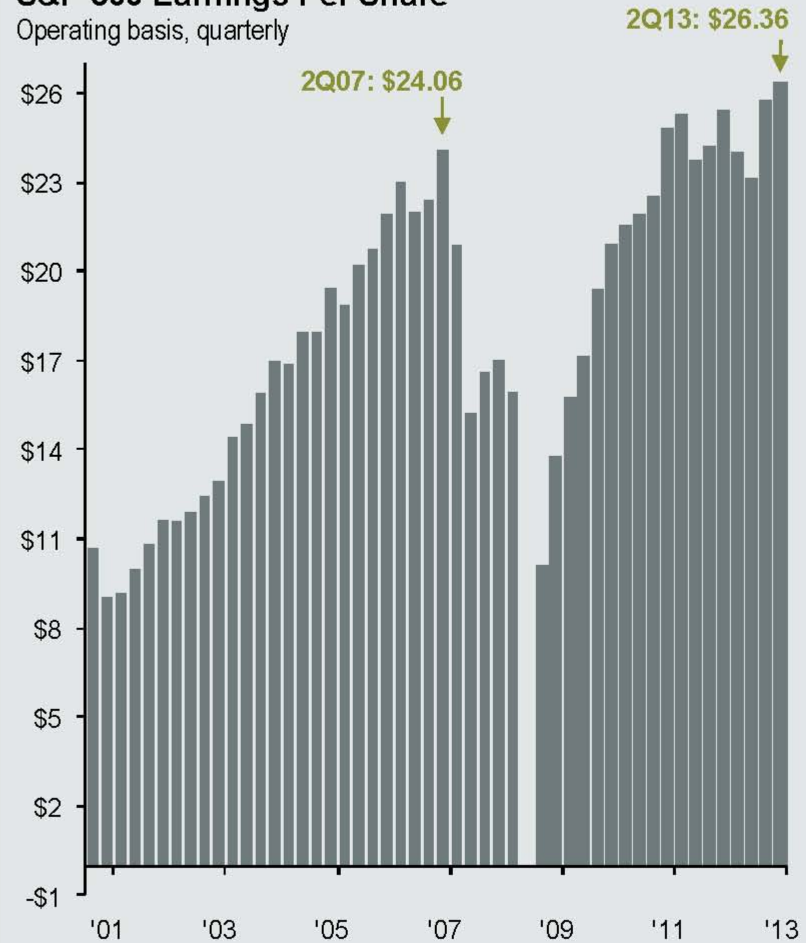
MARKET INSIGHTS

# Corporate Profits and Leverage

Equities

## S&P 500 Earnings Per Share

Operating basis, quarterly




## Adjusted After-Tax Corporate Profits (% of GDP)

Includes inventory and capital consumption adjustments


## Total Leverage

S&P 500, ratio of total debt to total equity, quarterly


Source: Standard & Poor's, Compustat, BEA, J.P. Morgan Asset Management.
EPS levels are based on operating earnings per share. Most recently available data is 1Q13 as 2Q13 are Standard & Poor's preliminary estimates.
Past performance is not indicative of future returns.

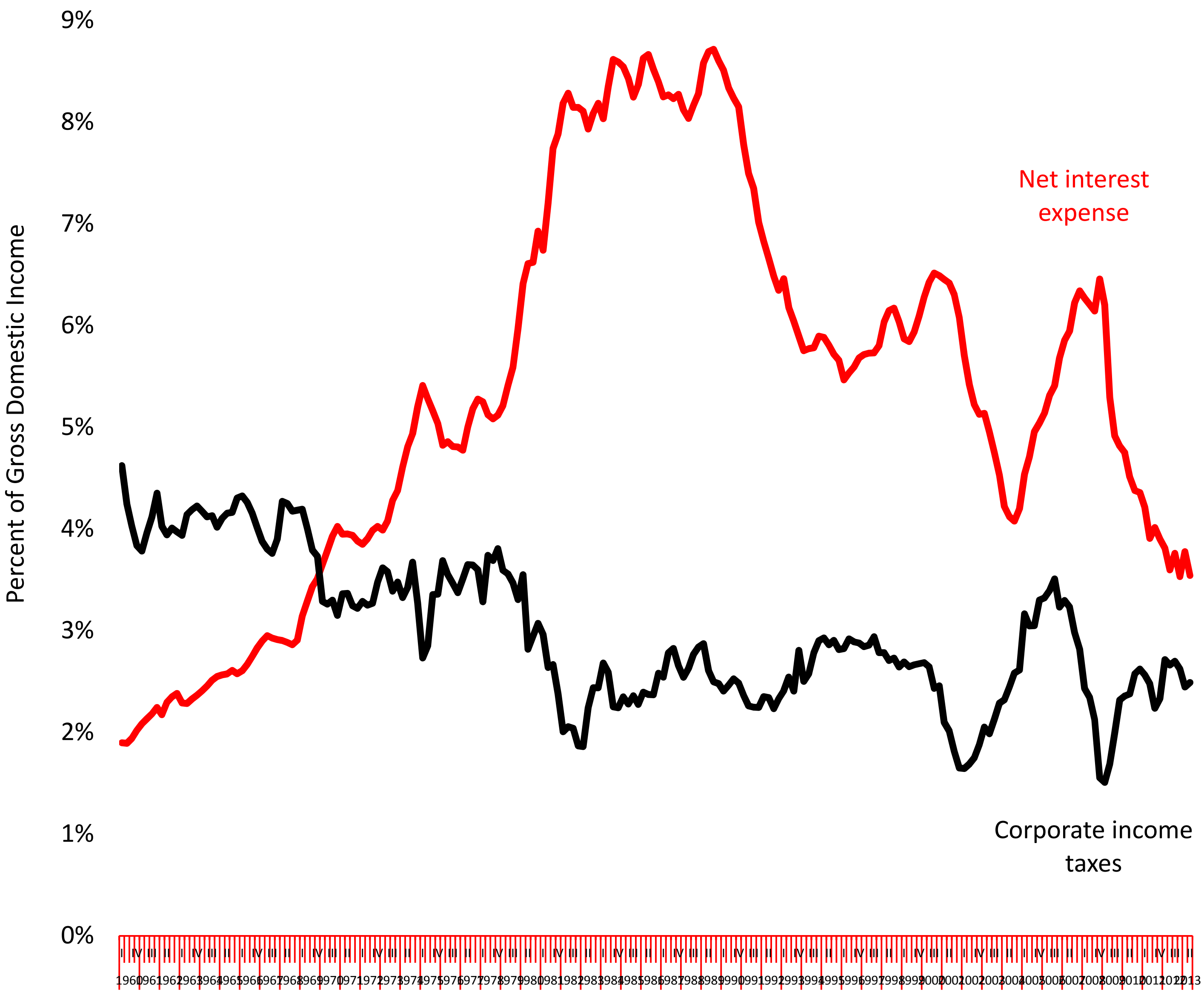
Guide to the Markets – U.S.

Data are as of 9/30/13.

J.P.Morgan Asset Management

Stock Market – record profit margins

# Shares of gross domestic income




Since 1980, a 4 percentage point decline in interest expense as a percent of gross domestic income has boosted profit margins by a like amount.

Similarly, a gradual decline in corporate income taxes has helped to boost profit margins.

Source: U.S. Department of Commerce, Bureau of Economic Analysis. Data through June 2013.

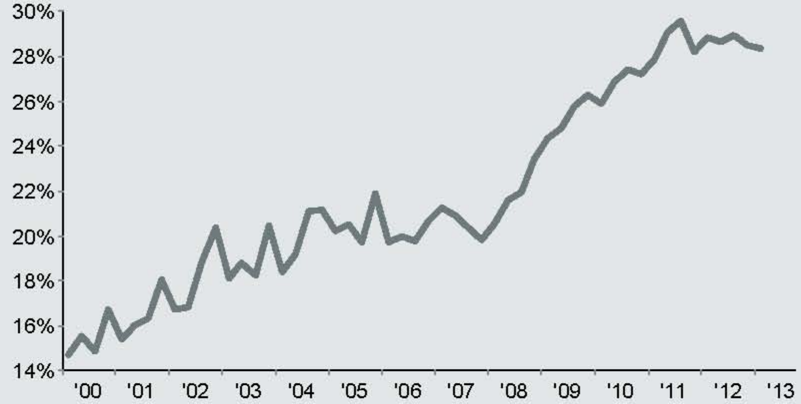
MARKET INSIGHTS

# Deploying Corporate Cash

Equities

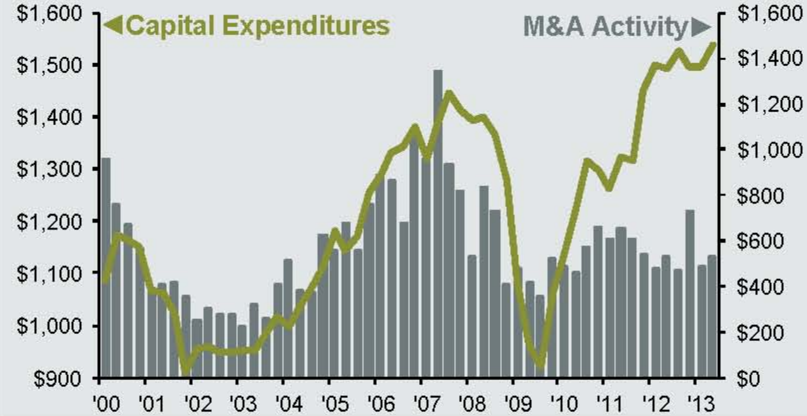
## Corporate Cash as a % of Current Assets

S&P 500 companies – cash and cash equivalents, quarterly



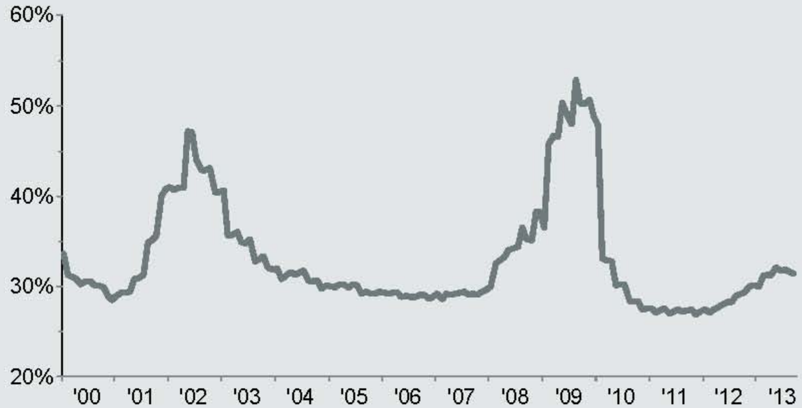

## Corporate Growth

$bn, nonfarm nonfinancial capex, quarterly value of deals completed



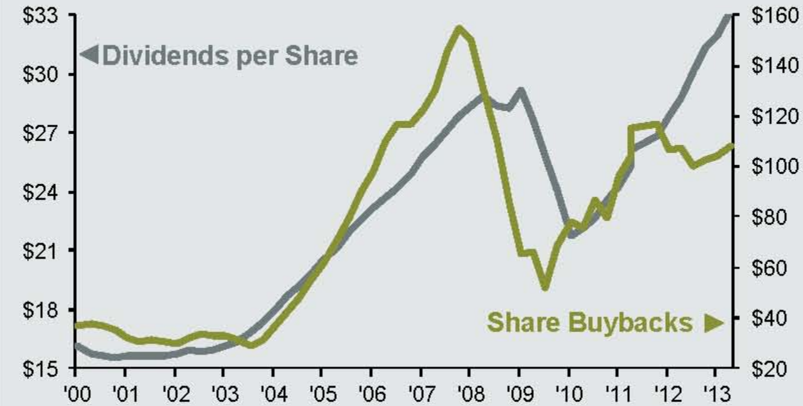

## Dividend Payout Ratio

S&P 500 companies, LTM




## Cash Returned to Shareholders

$bn, S&P 500 companies, rolling 4-quarter averages

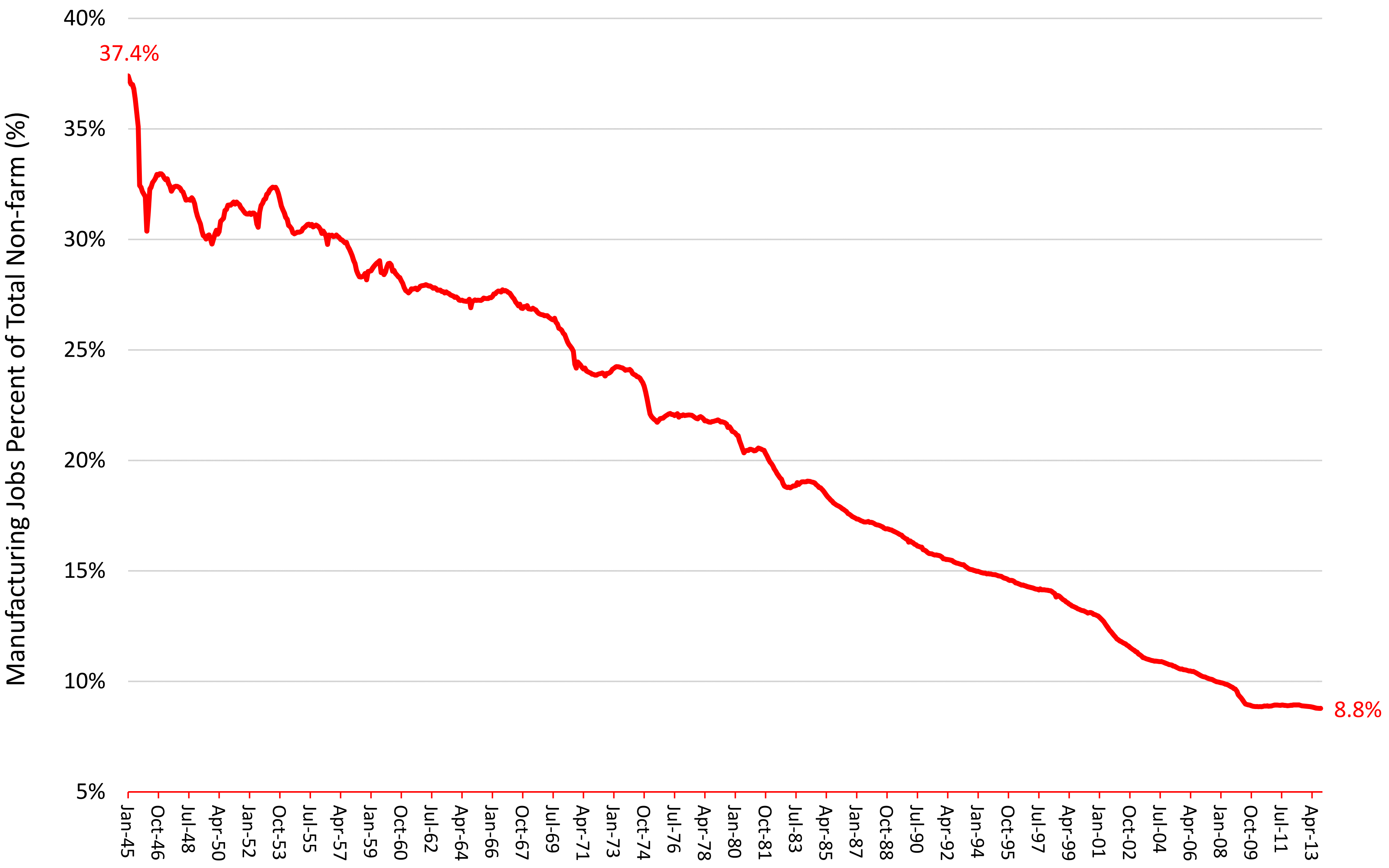



Source: Standard & Poor's, FRB, Bloomberg, FactSet, J.P. Morgan Securities, J.P. Morgan Asset Management. (Top left) Standard & Poor's, FactSet, J.P. Morgan Asset Management. (Top right) M&A activity is the quarterly value of deals completed and capital expenditures are for nonfarm nonfinancial corporate business. (Bottom left) Standard & Poor's, FactSet, J.P. Morgan Asset Management. (Bottom right) Standard & Poor's, Compustat, FactSet, J.P. Morgan Asset Management. Guide to the Markets – U.S. Data are as of 9/30/13.

J.P.Morgan Asset Management

Economy

# Manufacturing jobs % of total non-farm employment

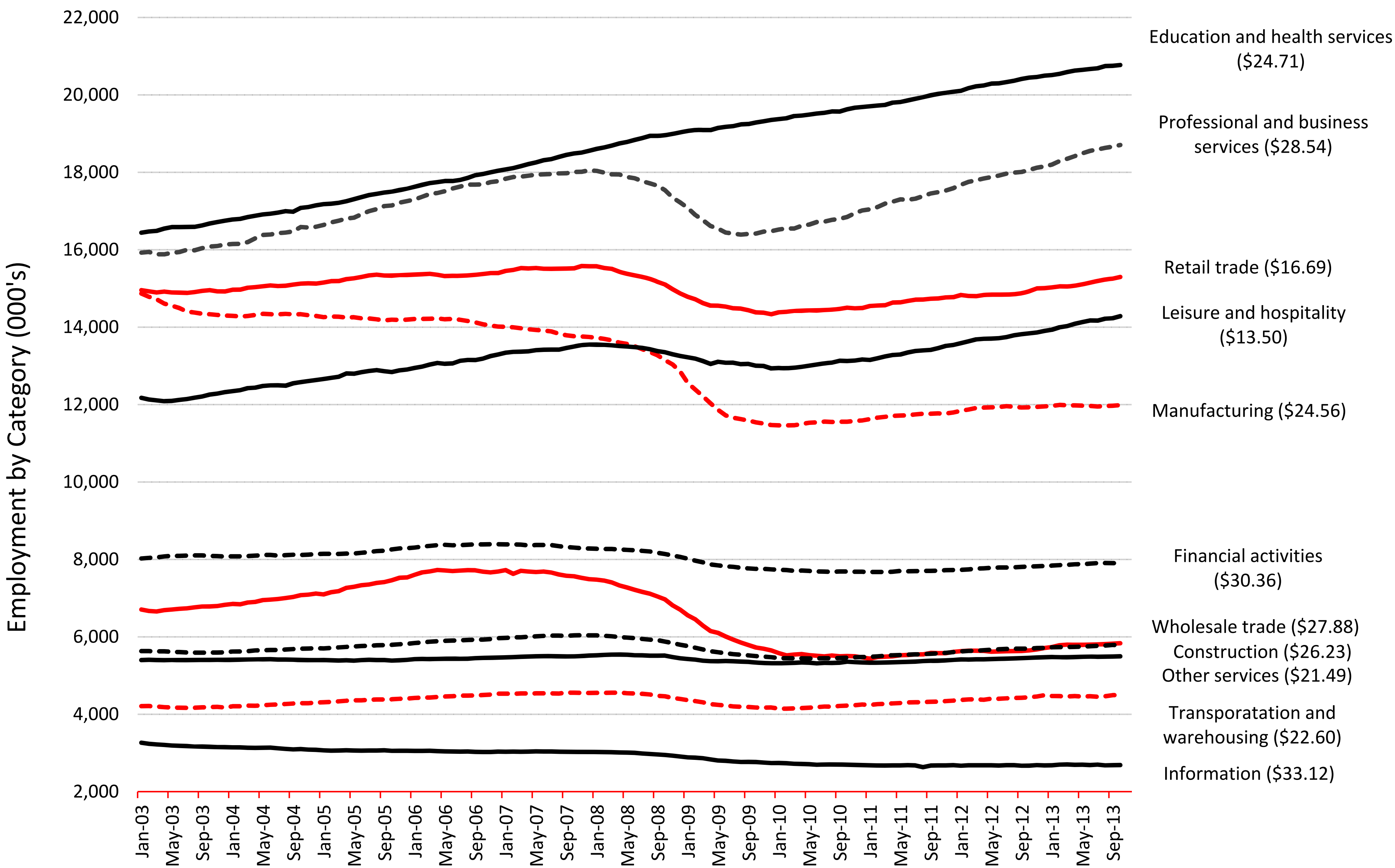





Source: Bureau Labor Statistics, data through October 2013.

Economy

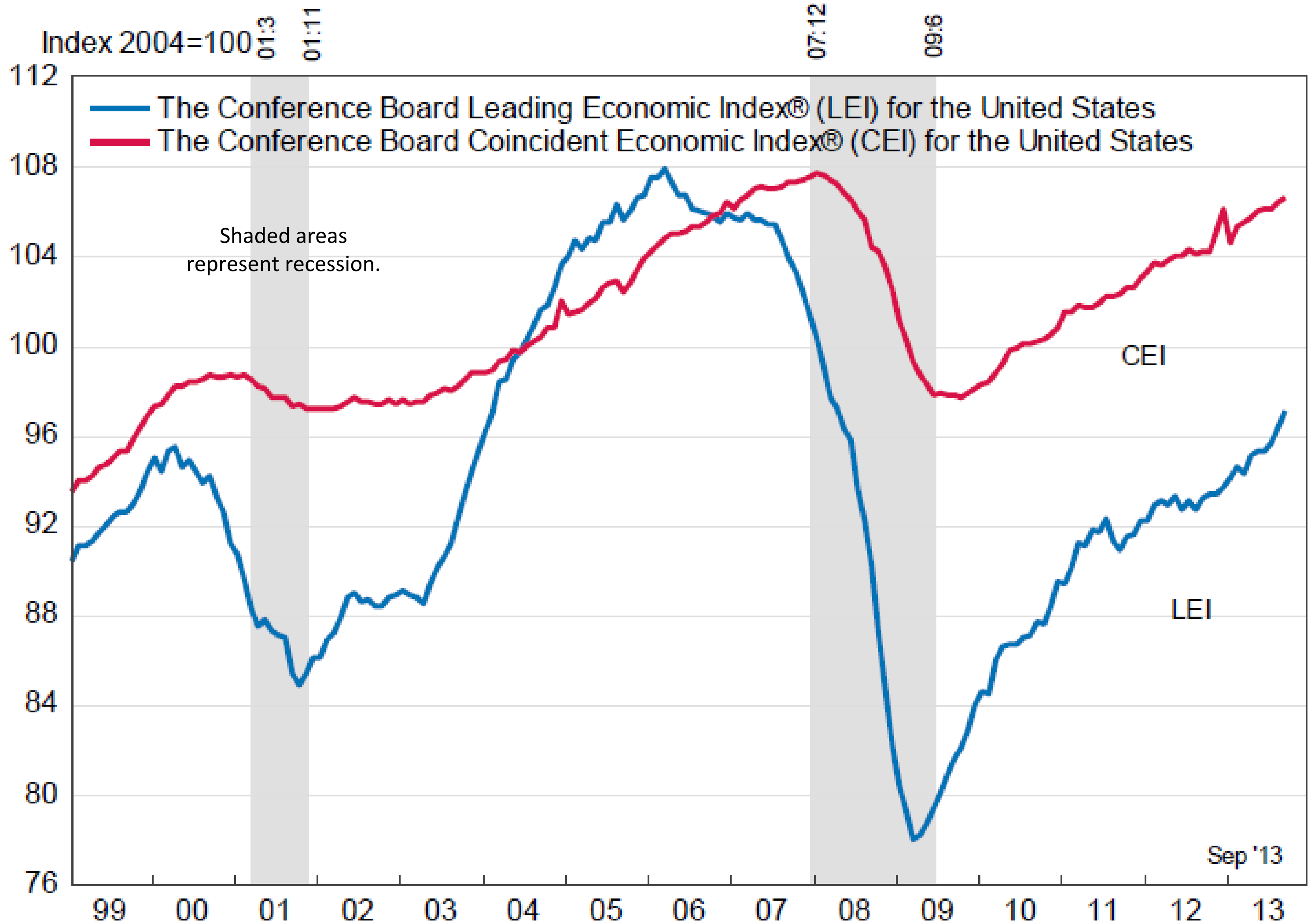
# Employment by Category with Average Hourly Earnings




Source: Bureau Labor Statistics, data through October 2013. These 11 categories constitute 99% of total private non-farm jobs. Remaining categories not included (1% of total private jobs): mining and logging, utilities.

Economic Data

# U.S. Index of Leading Economic Indicators (monthly)




"The September LEI suggests the economy was expanding modestly and possibly gaining momentum before the government shutdown."

The Conference Board
November 6, 2013

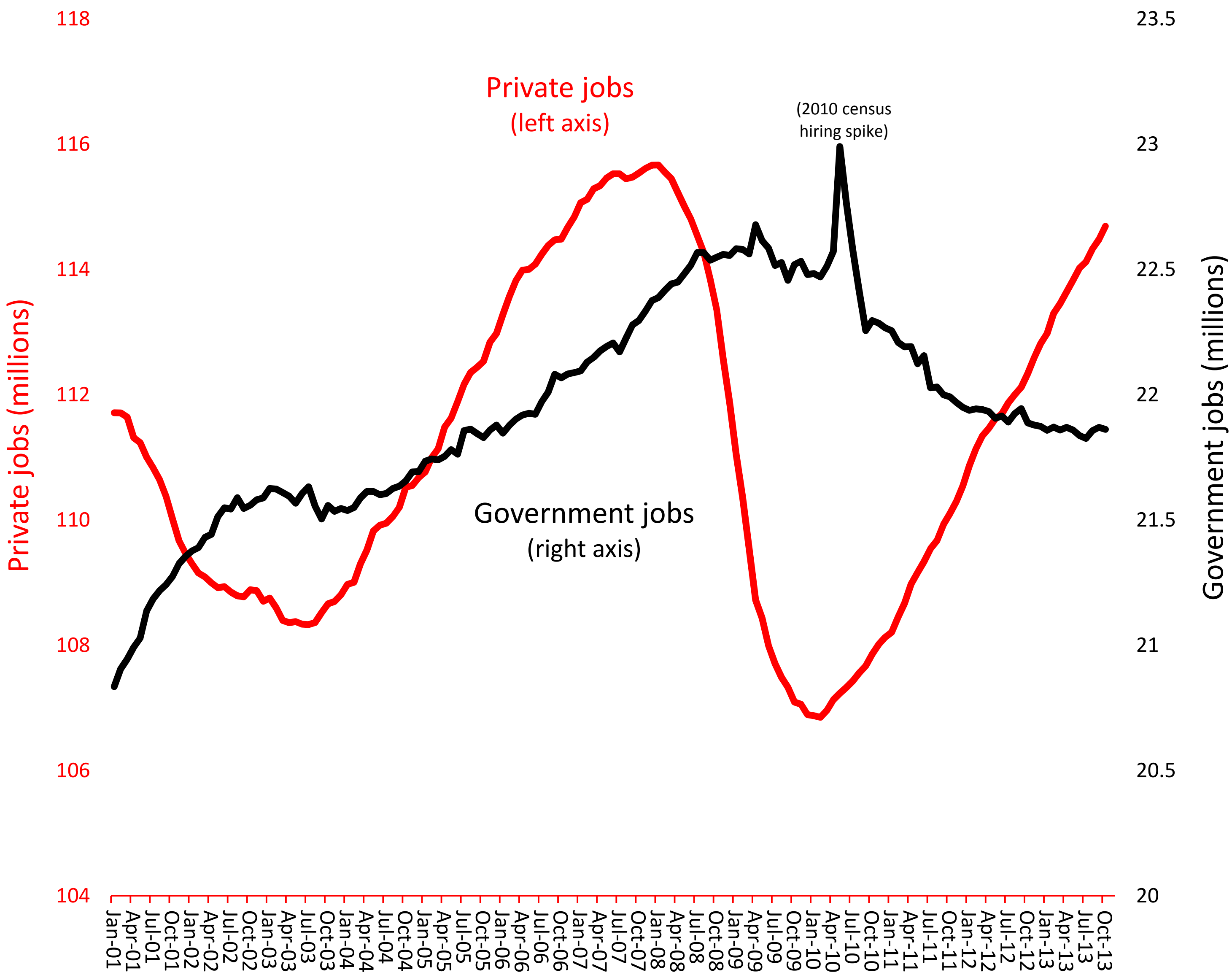
The Conference Board Leading Economic Index® (LEI) components: 1) average weekly hours worked, manufacturing; 2) average weekly initial unemployment claims; 3) manufacturers' new orders – consumer goods and materials; 4) ISM index of new orders; 5) manufacturers' new orders, nondefense capital goods; 6) building permits – new private housing units; 7) stock prices, S&P 500; 8) Leading Credit Index™; 9) interest rate spread; 10-year Treasury less fed funds; 10) index of consumer expectations.



Source: ©The Conference Board. Data through September 2013, released November 6th.

Economic Data - jobs

# Private jobs rising, government jobs contracting




Private sector jobs recovery looking good.

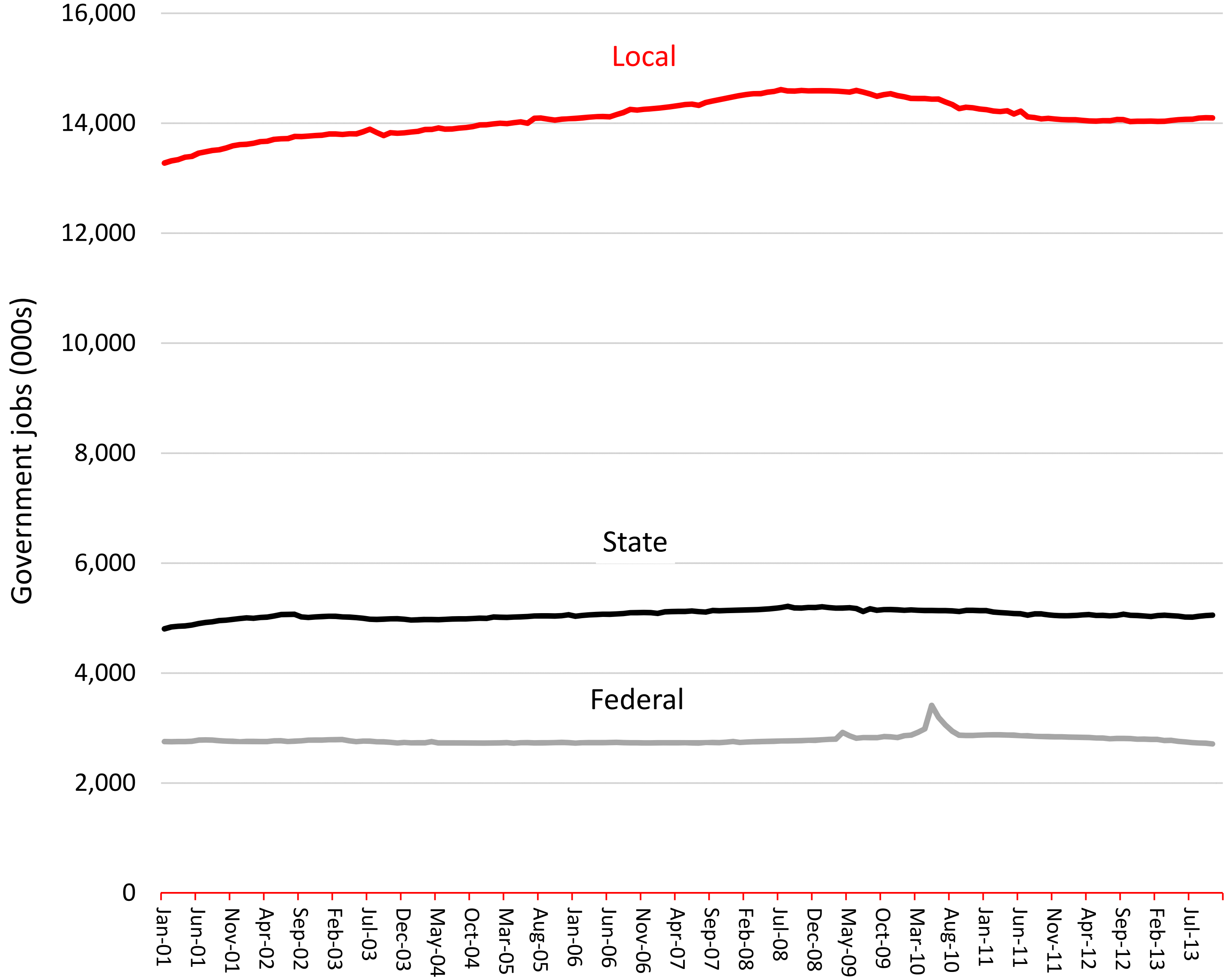
Government jobs decline flattening out.



Source: Bureau of Labor Statistics; data through October 2013.

Economic Data - jobs

# Government Jobs by Category



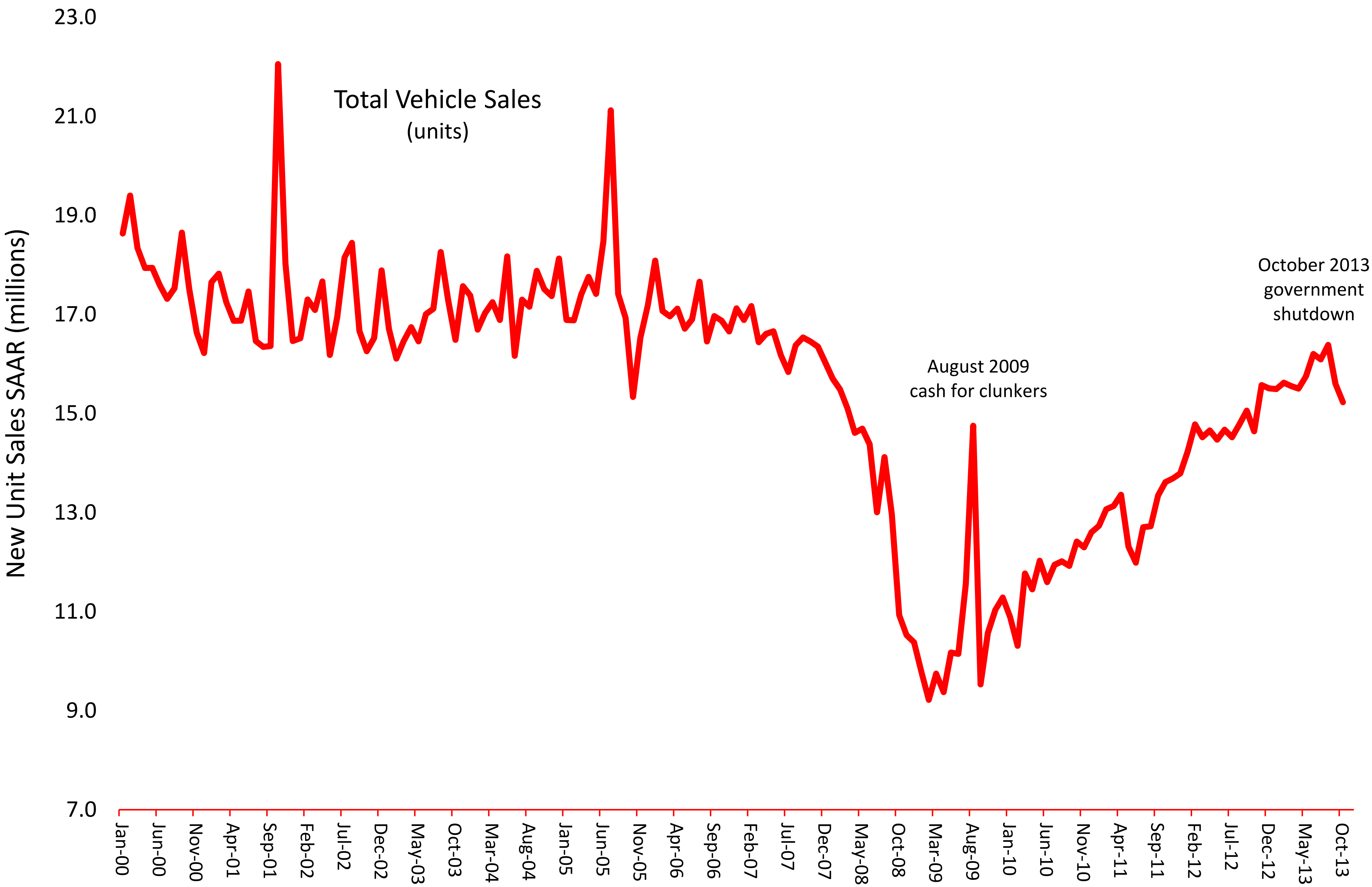

Local government jobs constitute 64% of total government jobs.

Federal government jobs constitute 12% of total government jobs.

Source: Bureau of Labor Statistics; data through October 2013.

Economic Data

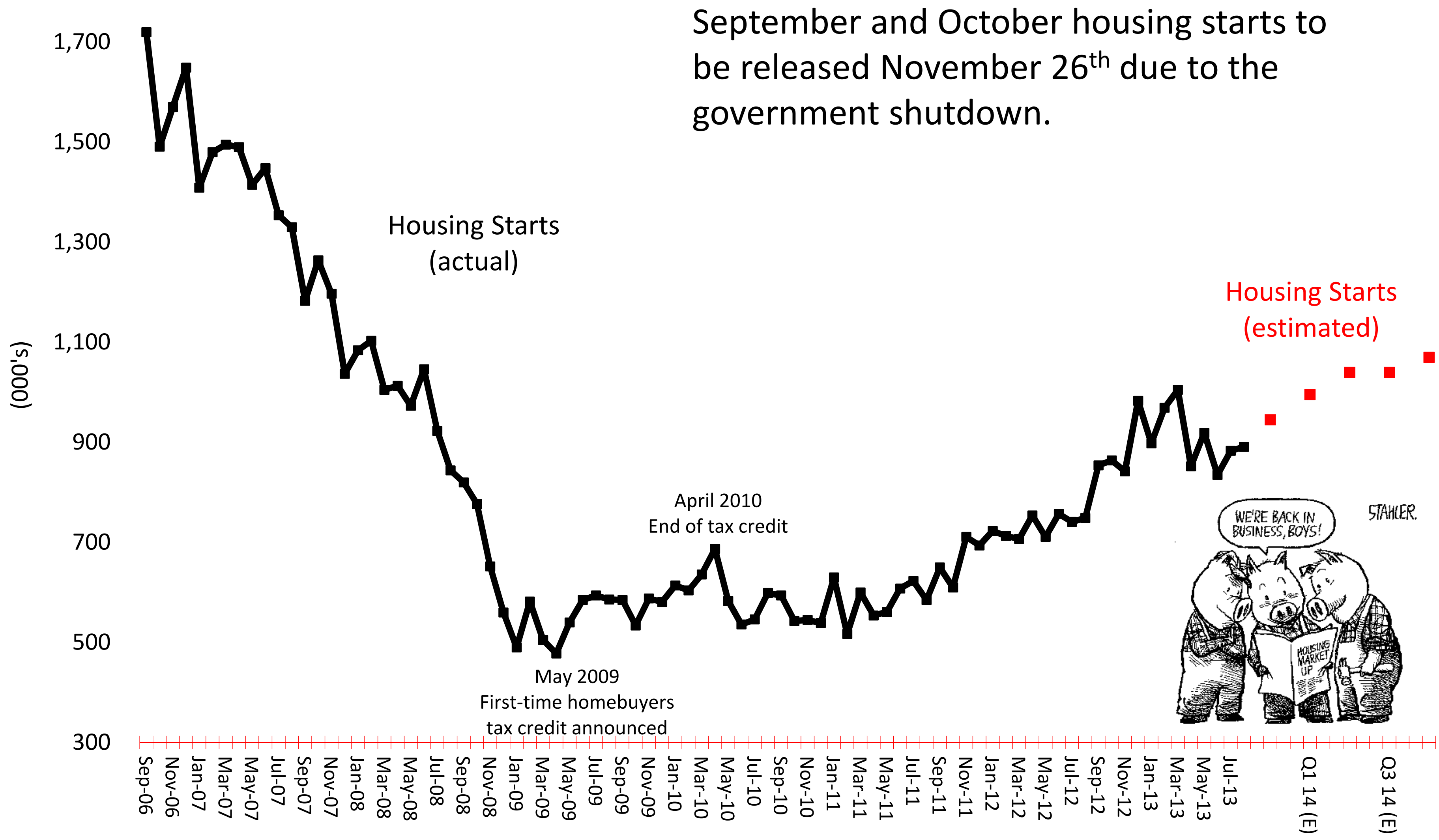
# Vehicle sales – strong recovery






Source: Bureau of Economic Analysis. Data through October 2013.

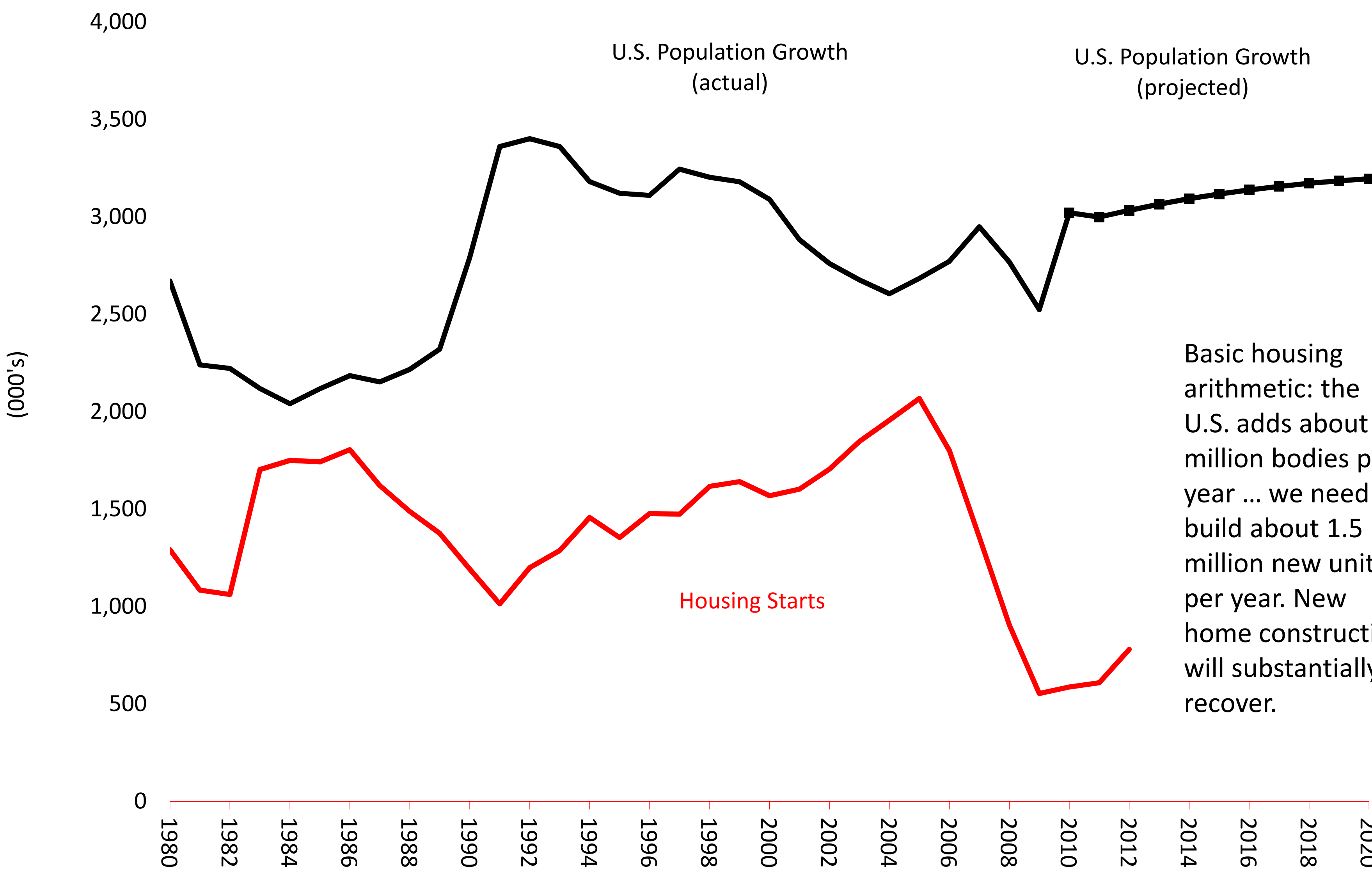
# Housing starts – steady recovery, a lot of headroom




Sources: U.S. Census Bureau, data through August 2013; Mortgage Bankers Association's housing starts forecast dated September 23, 2013.
Cartoon: *Barron's,* June 3, 2013.

Economic Data

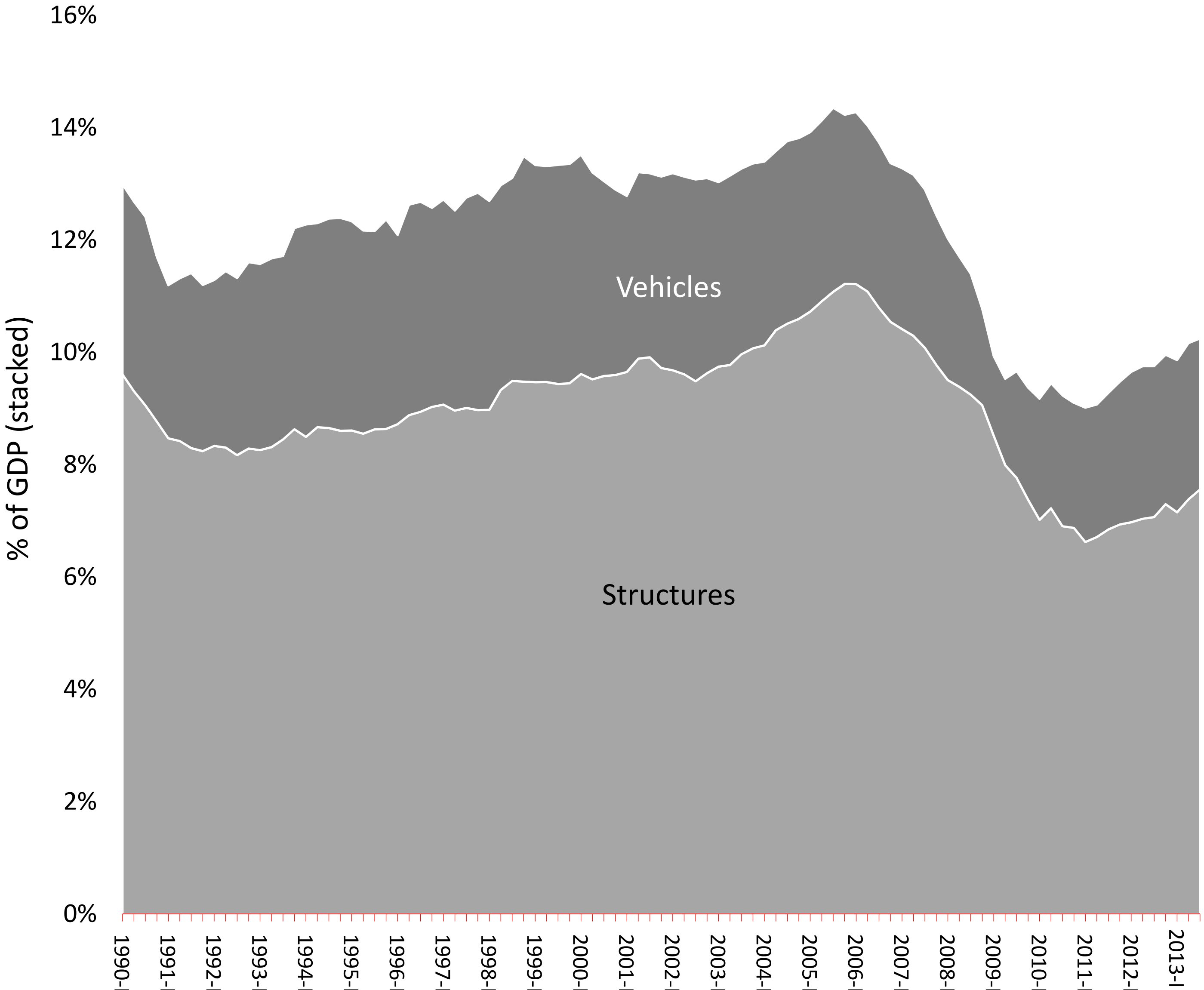
# Housing starts: the big picture – very positive




Basic housing arithmetic: the U.S. adds about 3 million bodies per year … we need to build about 1.5 million new units per year. New home construction will substantially recover.

Source: U.S. Census Bureau. Actual population data through 2008; projections 2009-2020. Actual annual housing starts through 2012.

# Construction and vehicles combined – tailwind for GDP growth



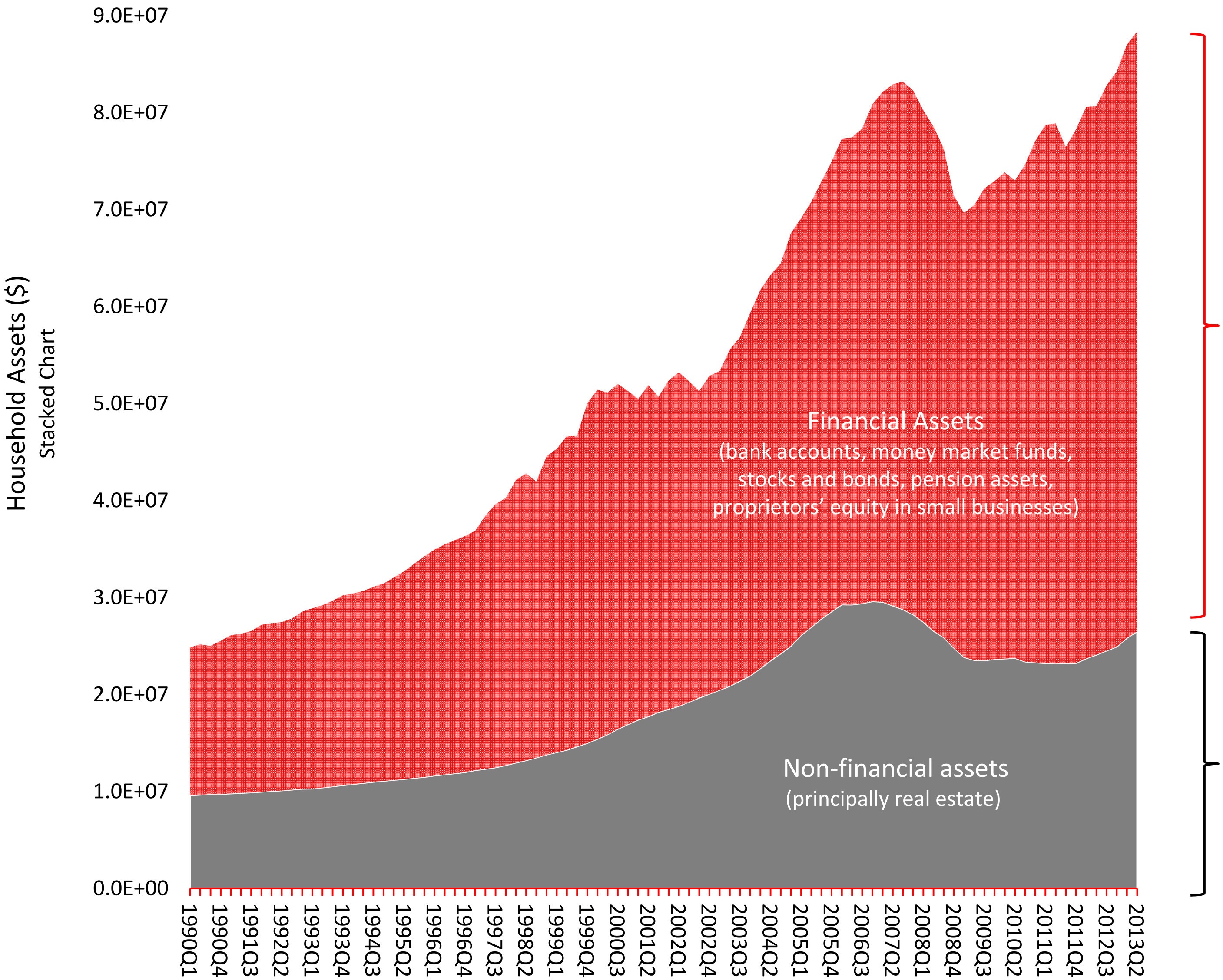

Historically these two categories have contributed >12% of GDP. Today, they are 10%.

There is good reason to think both will continue to recover, providing a lift to GDP in the quarters ahead.

Sources: Bureau of Economic Analysis. Data through September 2013.

Economic Data – consumer spending

# Household assets




The total value of household assets has retaken its pre-recession high.

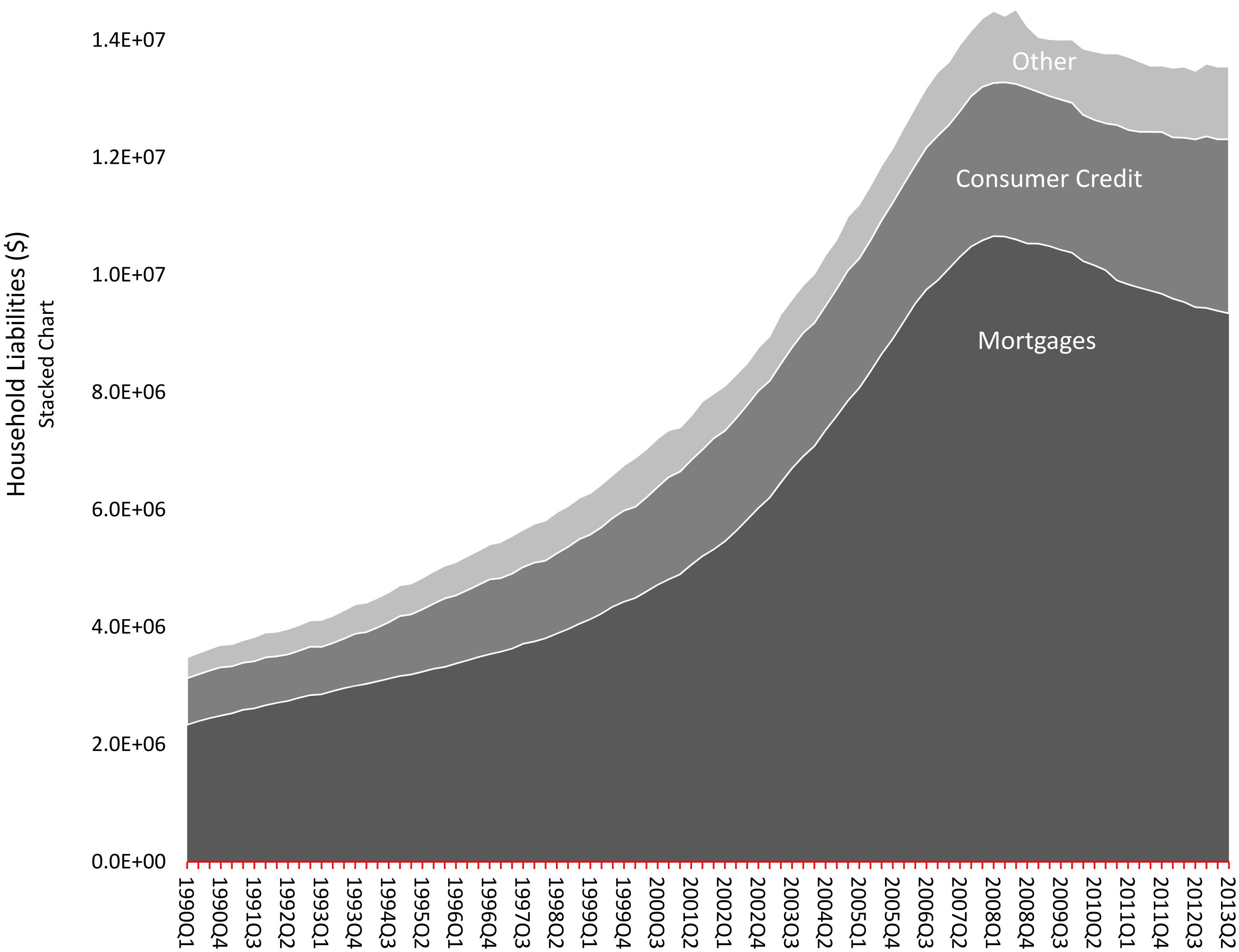
Financial assets = 70% of total household assets.

Non-financial assets = 30% of total household assets.

Source: Federal Reserve. Data through June 2013, released September 25,2013.
$9.E+07 = $90 trillion.

Economic Data – consumer spending

# Household liabilities

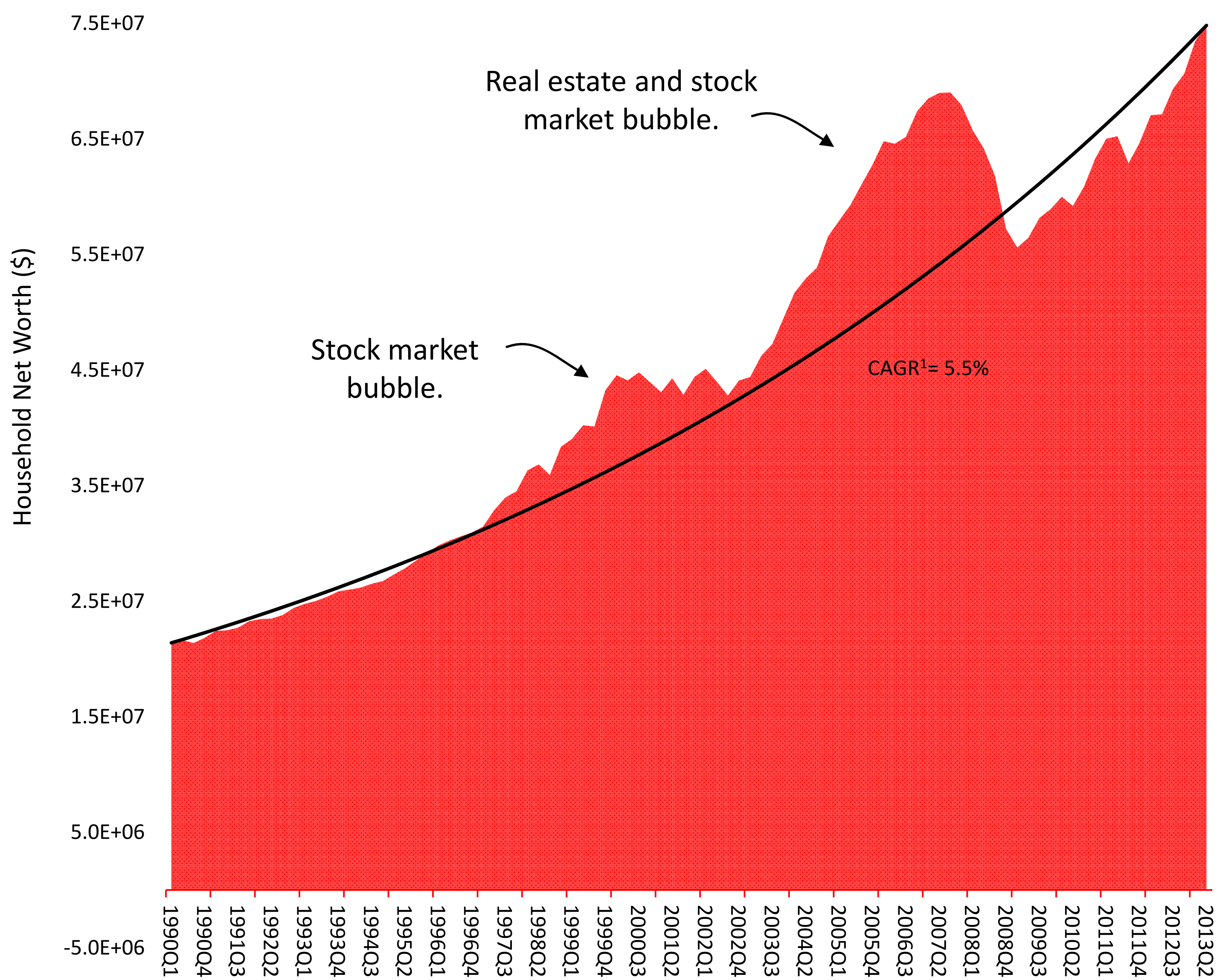



Households have been paying down (including by means of foreclosure) their debts.

Source: Federal Reserve. Data through June 2013, released September 25,2013.
$1.4E+07 = $14 trillion.

Economic Data – consumer spending

# Household net worth



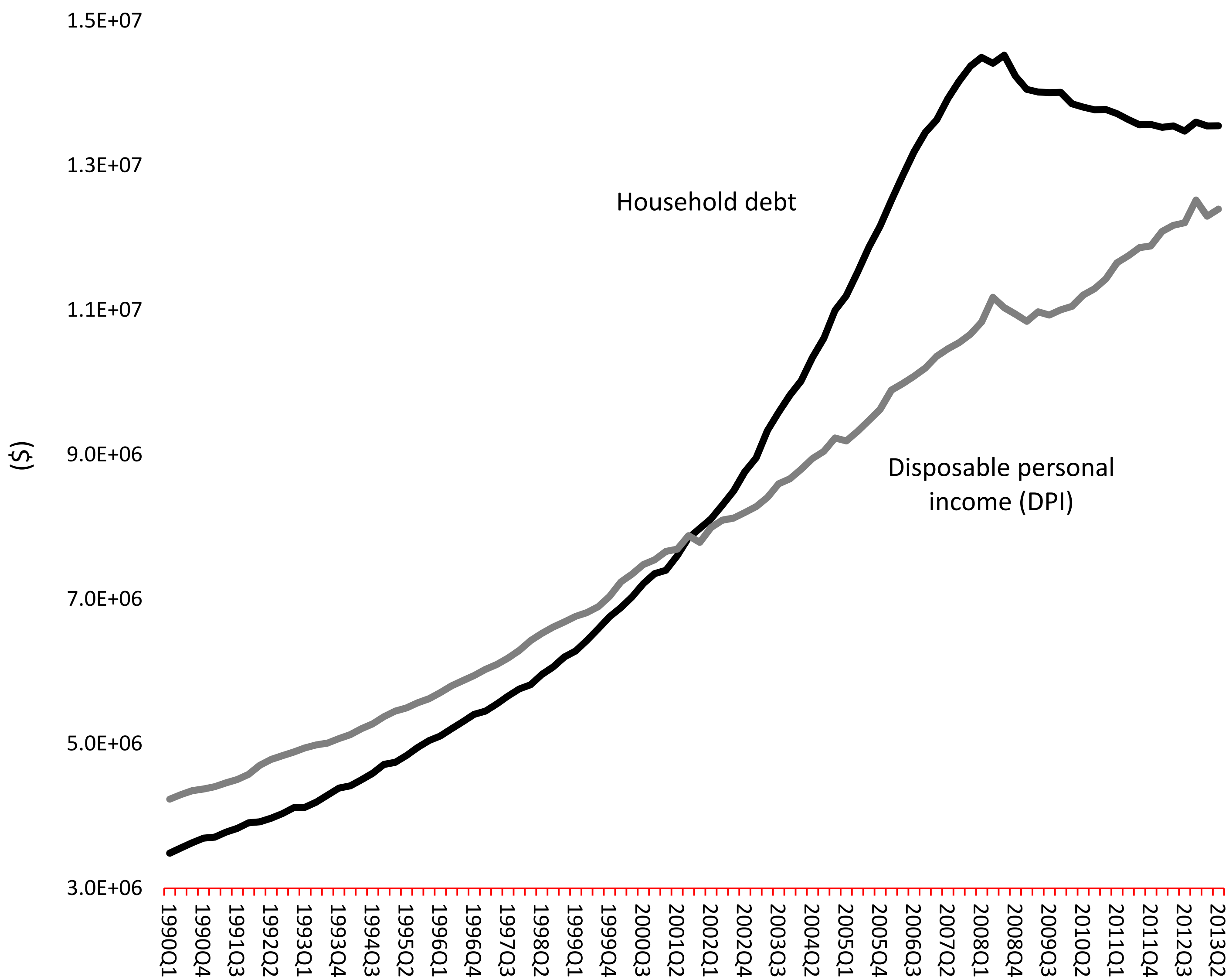

With household assets up and liabilities down, household net worth is at new highs.

Positive wealth effect on consumer spending.

Source: Federal Reserve. Data through June 2013, released September 25, 2013. [1]Compound annual growth rate. $7.0E+07 = $70 trillion.

Economic Data – consumer spending

# Household debt vs. disposable personal income

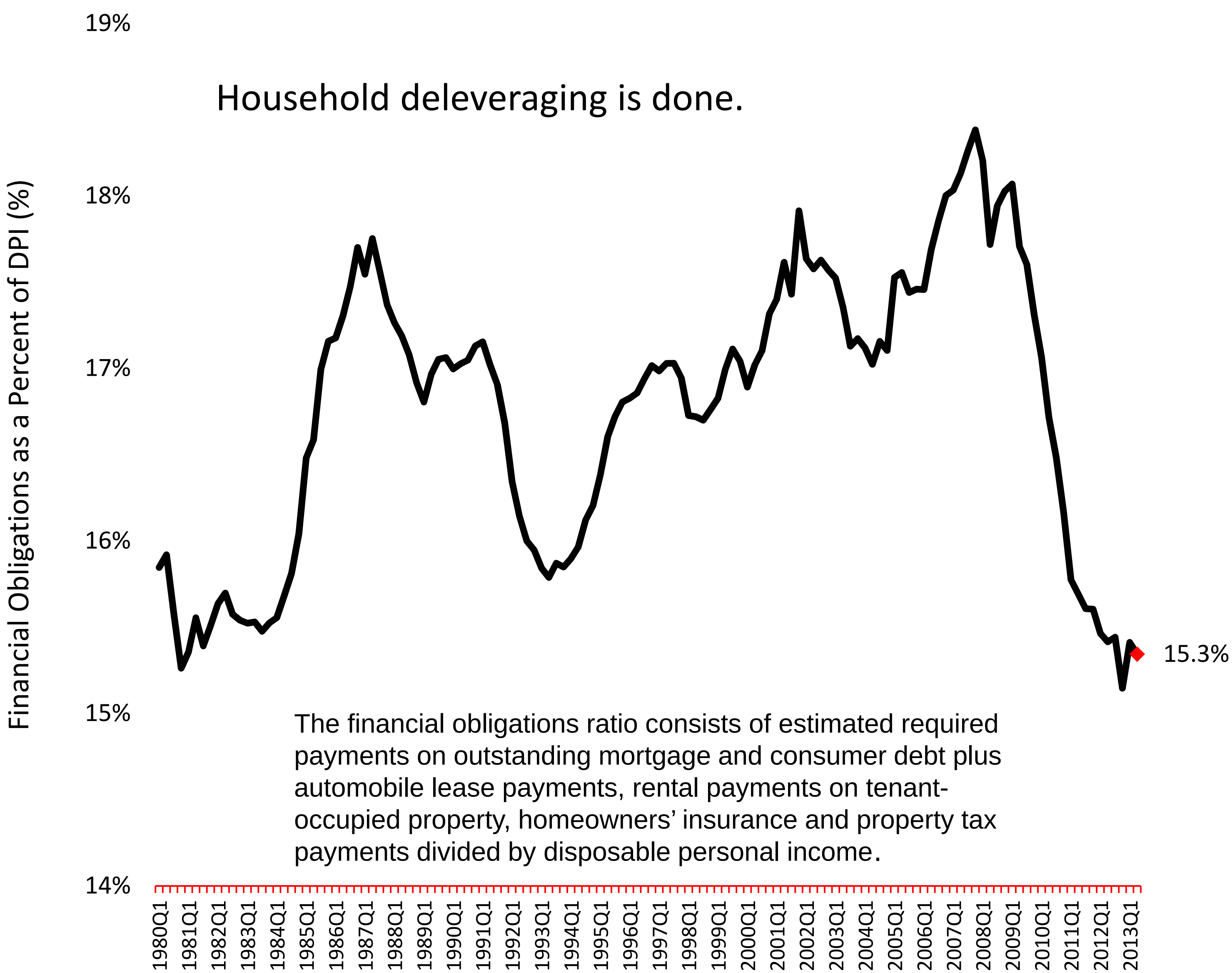



Because DPI has steadily increased and interest rates are far lower than in previous decades, in fact, Americans are in the best shape with respect to servicing their household debt than they've been in a long time. See next slide.

Source: Federal Reserve. Data through June 2013, released September 25, 2013.
$1.4E+07 = $14 trillion.

Economic Data – consumer spending

# Financial obligations ratio – record low



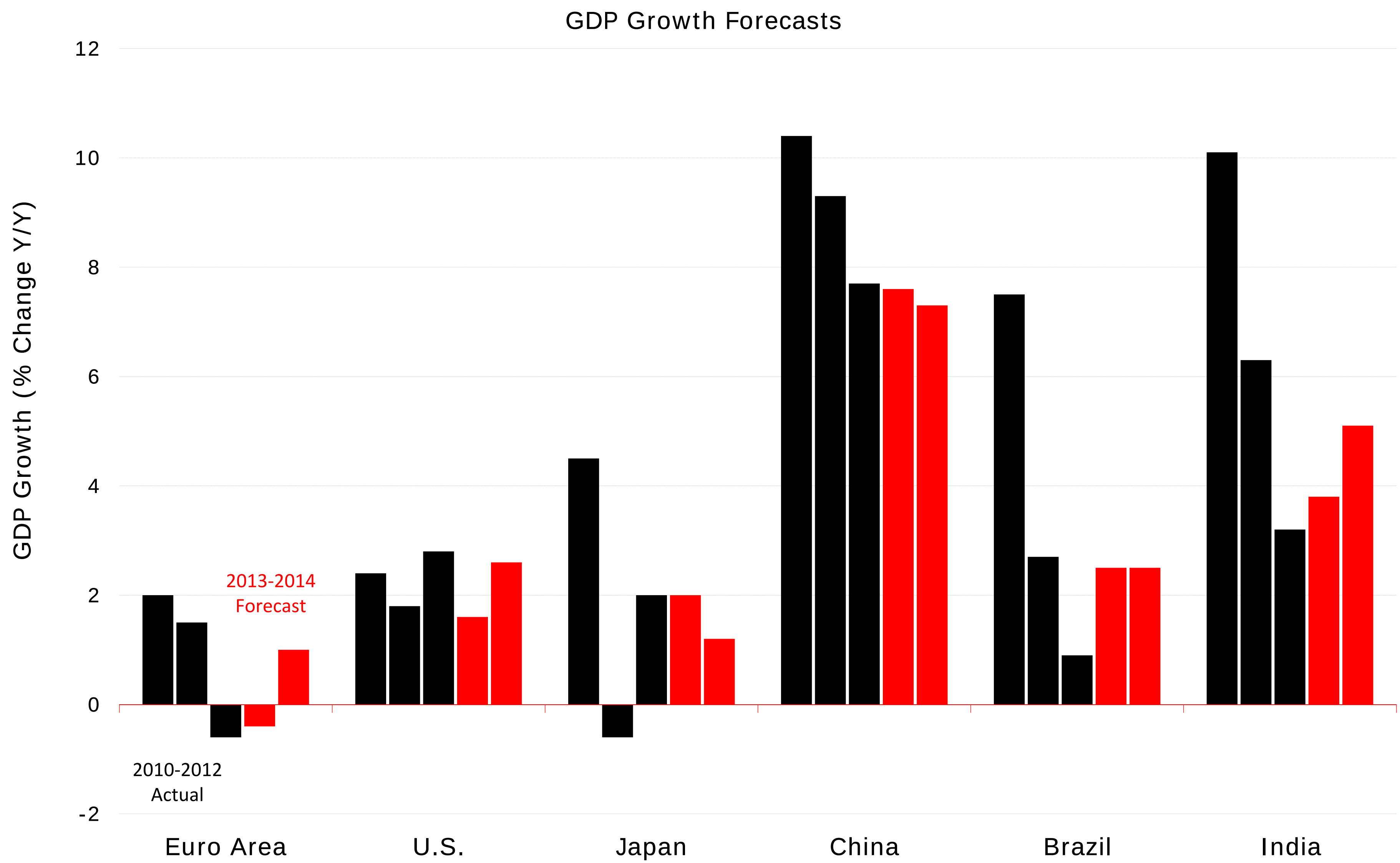

Source: Federal Reserve, data through June 2013; released October 29, 2013.

Comparing consumers' monthly flow of income to their fixed recurring monthly expenses, including debt service, gives a more accurate measure of consumers' financial health.

<u>Here's the stunner: consumers' ability to cover the monthly "nut" has seldom been better</u> as incomes have recovered, household debt has been reduced and interest rates remain low.

Economic Data rest-of-world

# World GDP growth forecasts – better growth expected in 2014




Source: IMF *World Economic Outlook Update*, October 2013.

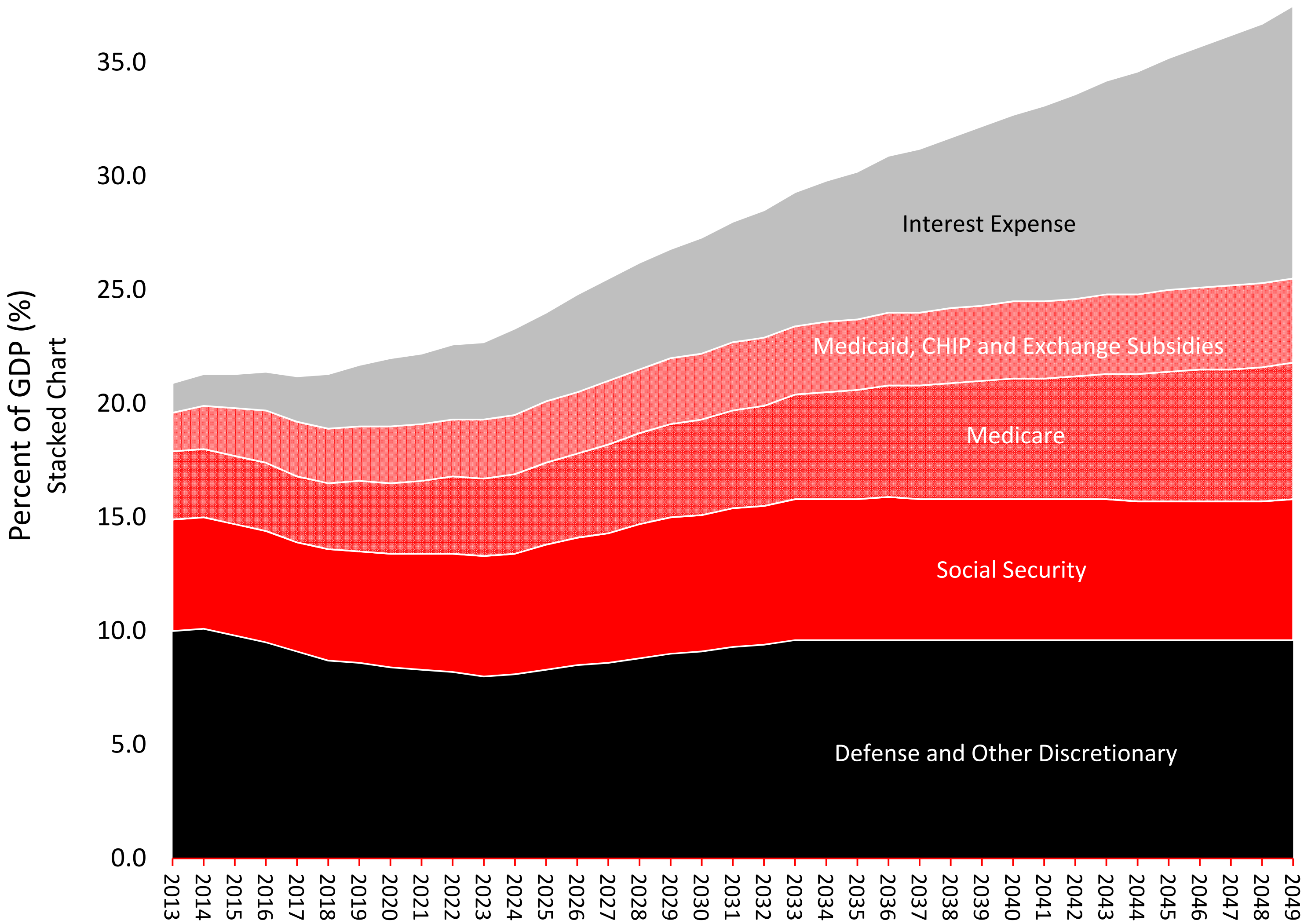
# Projected federal spending – entitlements on autopilot


CBO released its latest long-term spending projections on September 17th.

[1] *The Wall Street Journal*, October 8, 2013.

## Deficit spending

# Projected federal spending[1]

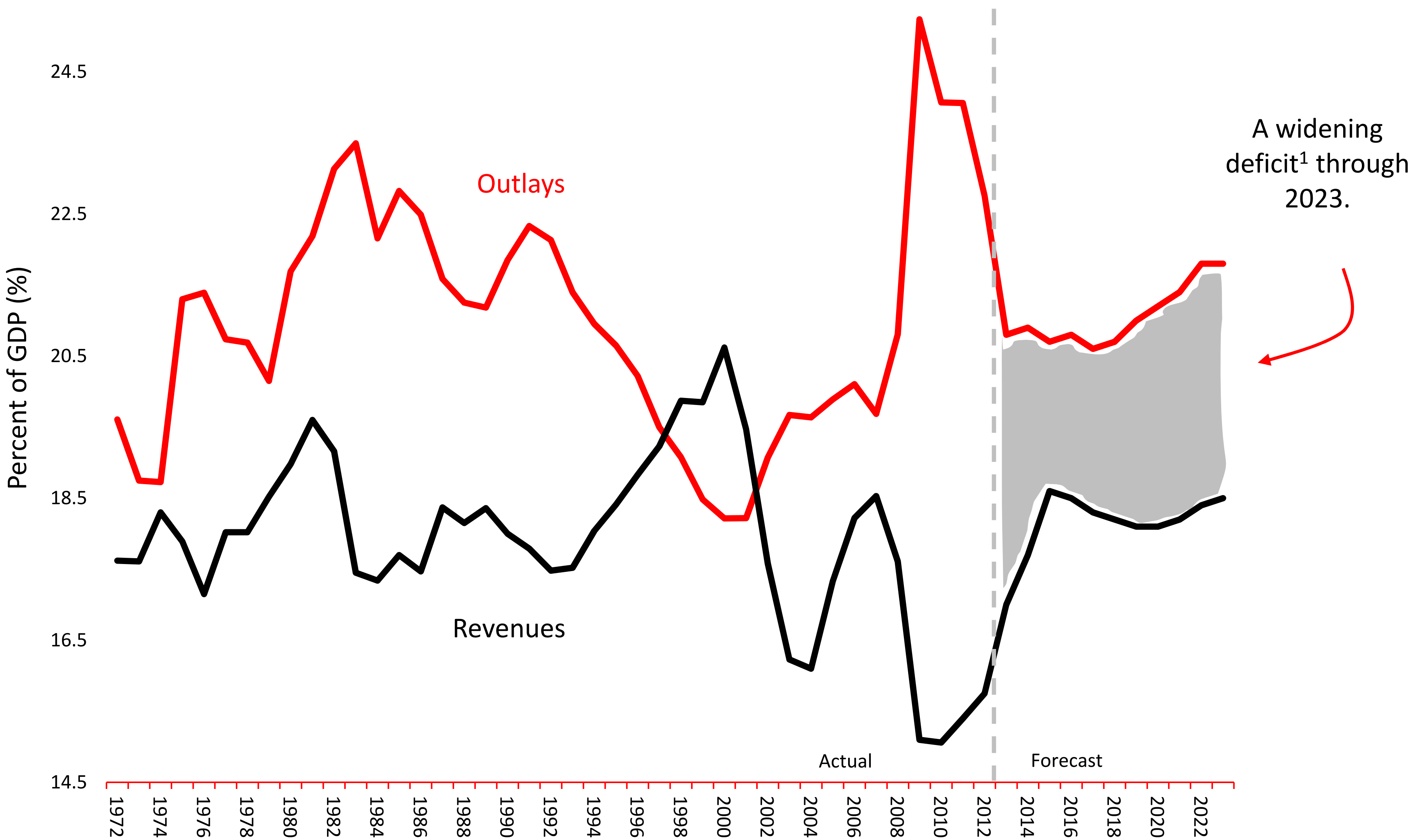



Entitlements are on autopilot and interest expense explodes in the out years.

Source: Congressional Budget Office (CBO), *The 2013 Long-Term Budget Outlook*, September 17, 2013. [1] CBO's alternative fiscal scenario incorporates the assumption that the automatic reductions in spending required by the Budget Control Act for 2014 and later will not occur (although the original caps on discretionary appropriations in that law are assumed to remain in place); and, that lawmakers will act to prevent Medicare's payment rates for physicians from declining.

Deficit spending

# Federal revenues and outlays – it's a spending problem

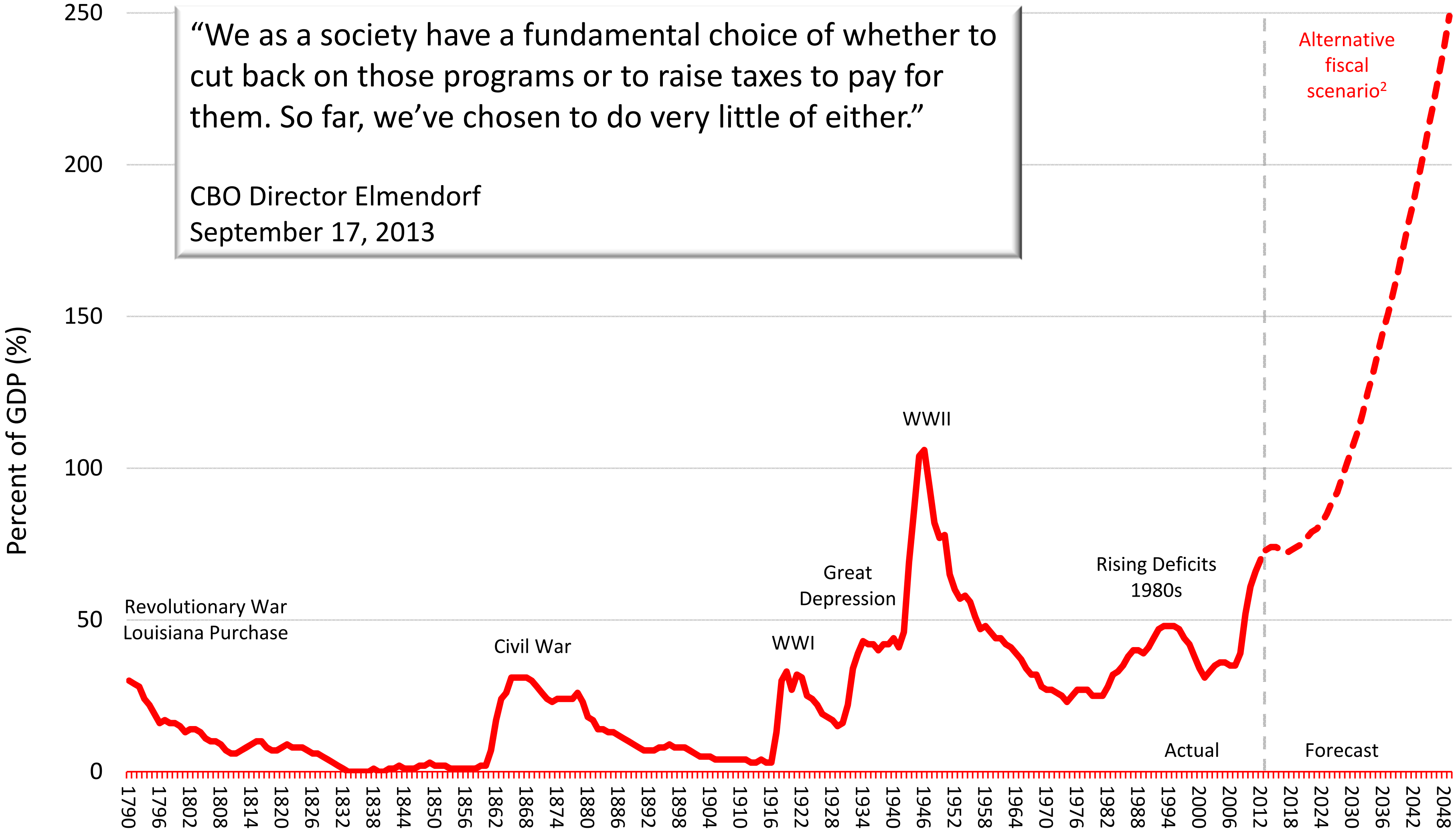





Source: Congressional Budget Office (CBO), *The 2013 Long-Term Budget Outlook*, September 17, 2013. [1] CBO's baseline revenue and spending projections reflect the provisions of current law.

Deficit spending

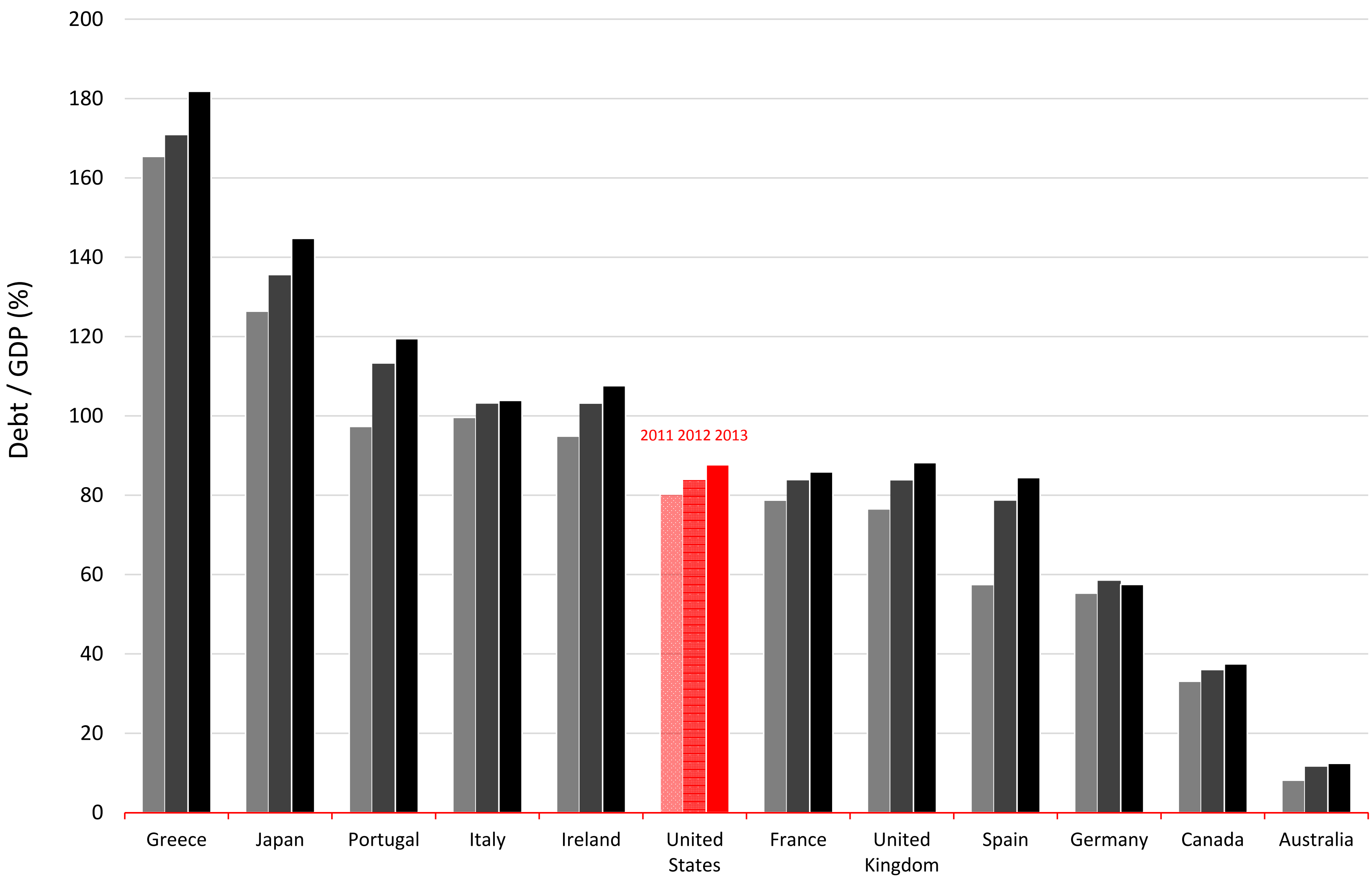
# Federal debt % of GDP




Source: Congressional Budget Office (CBO), *The 2013 Long-Term Budget Outlook*, September 17, 2013. [1] CBO's baseline revenue and spending projections reflect the provisions of current law. [2] CBO’s alternative fiscal scenario incorporates the assumption that the automatic reductions in spending required by the Budget Control Act for 2014 and later will not occur (although the original caps on discretionary appropriations in that law are assumed to remain in place); that lawmakers will act to prevent Medicare’s payment rates for physicians from declining; and, that about 75 expiring tax provisions (including a provision allowing businesses to immediately deduct 50 percent of new investments in equipment) will be extended through 2023.

Deficit spending

# Government debt-to-GDP ratios - comparative

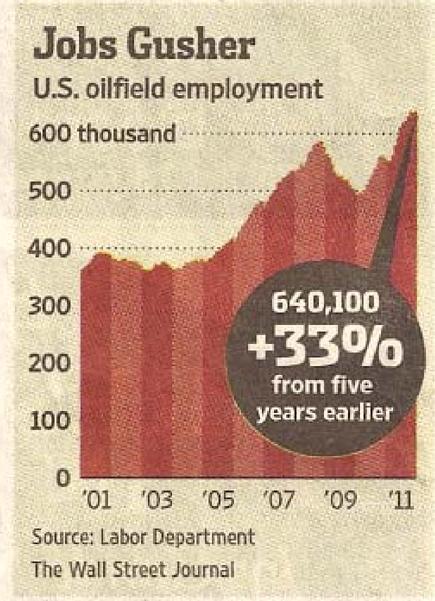



Source: IMF, World Economic Outlook Database, October 2012. For the United States, the IMF is using estimates for all three years. For most other countries the IMF's data is actual for 2011; and estimated for 2012 and 2013.

# This is a big story – shale is re-industrializing America!

## Oil and Gas Boom Lifts U.S. Economy

- The economic benefits of rising energy production are spreading far beyond the traditional oil patch …
- Manufacturing plants are returning to the U.S. to take advantage of cheap natural gas, spurring major investments in petrochemical and steel production in the Gulf Coast and Midwest.
- "We think lower natural gas prices are creating a structural economic advantage for the U.S. … it's a new competitive strength for U.S. manufacturers … Asian companies paying up to six times what their competitors are paying in Texas and Louisiana."
- Consumers throughout the U.S. are paying lower bills for heating and electricity because of cheap natural gas.
- Augusta ME consumers to switch to low-cost gas from high-cost home heating oil, keep local paper mills going.
- The U.S. balance of payments is improving because of the new energy economy.
- For every new job working in the oil and gas sector, another four are supported by the energy supply chain and by workers spending more money on goods and services (one economist's estimate).
- Consumer psychology: "People believe this is a game changer for the region", resulting in more spending on dining out and entertainment.






Source: *Wall Street Journal*, February 8, 2012.

# U.S. manufacturing renaissance

"Why has everybody been surprised by how well the U.S. stock market has done lately? Because they're only beginning to realize the glass is half full again instead of half-empty."

THE INTELLIGENT INVESTOR | By Jason Zweig

## Here Comes the Next Hot Emerging Market: the U.S.

The investment visionary who coined the term "emerging markets" and helped launch the first funds to invest in developing countries thinks he has spotted what you might call the next great emerging market.

It is called "the United States."

Antoine van Agtmael is arguably the founding father of emerging-markets investing. He still is an evangelist for investing in parts of Africa, Asia, Latin America and other less-developed regions, where he thinks the future remains bright. But he believes the U.S. is at the beginning of an industrial revitalization that most analysts only have begun to recognize.

Over the past year, investors have pulled $22 billion from U.S. stock funds and added $339 billion to bond funds, according to Morningstar. If Mr. van Agtmael is right, that exodus is premature.

Mr. van Agtmael, now 68 years old, has been analyzing emerging markets since 1971. In the late 1970s he ran an investment bank in Bangkok as the local stock market boomed and then fizzled. That taught him the enormous potential—and explosive risk—of stocks in developing countries, highlighting the urgent need for diversification.

Later, at the International Finance Corp., an affiliate of the World Bank, Mr. van Agtmael helped create the first database of stock returns and pushed to launch a diversified fund to invest in what was then called the Third World.

After he came up with the catchier term "emerging markets," the first such portfolio was launched by **Capital International** in 1986 with $50 million. Today U.S. fund investors alone have more than $420 billion in emerging markets.

Mr. van Agtmael founded an investment firm, **Emerging Markets Management**, in 1987. It peaked at more than $20 billion in assets before he and his partners sold a 63% stake to **Ashmore Group** in 2011 for more than $126 million.

So when Mr. van Agtmael says he sees an underappreciated investment opportunity, he is worth listening to. When he visited China last year, one manufacturing executive after another complained to him about American competition, "something I had never heard in 40 years in Asia," he says.

Mr. van Agtmael points out that labor costs in China have been rising roughly 15% annually while stagnating in the U.S. Meanwhile, oceans of cheap oil and natural gas are flowing from American shale.

The U.S. is well ahead of China in cellphone infrastructure, he says; it also is advancing faster in three-dimensional printing and the use of robots in factories. At least 200 companies have relocated plants from offshore to U.S. locations, estimates Mr. van Agtmael.

"A decade ago, nine out of 10 companies would tell you they were thinking about building their next plant in China," he says. "Today it's more like three out of 10, and maybe five out of that 10, say they want to build in the U.S."

Some of these emerging advantages haven't shown up in higher profits for American companies—yet. "U.S. manufacturing is becoming more competitive than you would think, and China's less," Mr. van Agtmael says. "And the idea that manufacturing is old-fashioned is itself old-fashioned."

Christophe Vorlet

These ideas aren't a secret, of course. Stock-market bulls have been snorting over shale gas and 3-D printing for a couple of years now. Mr. van Agtmael outlined his message in Foreign Policy magazine last year and has recently been presenting it to sovereign-wealth funds, family offices and other investment audiences. Nonetheless, he thinks investors have underestimated the rate and importance of these changes.

"When I first started talking about emerging markets 30 years ago, people knew it made sense but they didn't quite believe it," he says. "This is the same kind of thing: They get the message on one level, but they haven't yet rationally absorbed it, and it hasn't changed their behavior yet."

Mr. van Agtmael, now a senior adviser at the consulting firm Garten Rothkopf in Washington, is writing a book about the resurgence of manufacturing in the U.S. and Northern Europe. But he still is bullish on many emerging markets, including Mexico, Peru and Colombia; Indonesia and South Korea; Turkey; and much of sub-Saharan Africa.

He thinks Americans should have up to 25% of their equity exposure in emerging-market stocks, well above the 6% average among fund investors.

Still, his most surprising message is that the U.S. is back.

"My belief is that markets are not efficient, but they are emotional," Mr. van Agtmael says. "They are driven by raw feelings. Why has everybody been surprised by how well the U.S. stock market has done lately? Because they're only beginning to realize the glass is half-full again instead of half-empty."

*intelligentinvestor@wsj.com; twitter.com/jasonzweigwsj*

Source: *Wall Street Journal*, April 20-21, 2013.

# U.S. manufacturing renaissance


"Labour costs are growing less and less important: a $499 first-generation iPad included only about $33 of manufacturing labour, of which the final assembly in China accounted for just $8. Offshore production is increasingly moving back to rich countries not because Chinese wages are rising, but because companies now want to be closer to their customers so that they can respond more quickly to changes in demand. And some products are so sophisticated that it helps to have the people who design them and the people who make them in the same place. The Boston Consulting Group reckons that in areas such as transport, computers, fabricated metals and machinery, 10-30% of the goods that America now imports from China could be made at home by 2020, boosting American output by $20 billion-55 billion a year."

Source: *The Economist*, April 21, 2012.

# U.S. manufacturing renaissance

# America's Toilet Turnaround

## *After Years of Moving Work Overseas, Remaining Factories Ramp Up U.S. Output*

BY JAMES R. HAGERTY

PERRYSVILLE, Ohio—In previous management jobs, Jim Morando watched Chinese imports engulf the U.S. market for vinyl tiles, wood flooring and window blinds.

Now, as president of **Mansfield Plumbing Products**, a toilet manufacturer here, Mr. Morando says he has decided to "stand and fight."

After decades of losing out to foreign rivals, U.S. manufacturing of toilets is making a surprising, if modest, comeback—mostly under foreign ownership.

Mansfield Plumbing, owned since 2004 by **Organizacion Corona** of Colombia, is spending $9 million to expand the capacity of its Perrysville plant by nearly 50%. Another toilet maker, **Toto** Ltd. of Japan, is installing new casting machinery to raise capacity at its Morrow, Ga., plant about 5%.

**American Standard** Brands, bought earlier this year by **Lixil** Corp. of Japan, is installing a new kiln and refurbishing other parts of its Nevada, Mo., plant, boosting capacity 5% to 10%.

The toilet turnaround is a microcosm of U.S. manufacturing trends.

"The days of chasing cheap labor around the world are coming to an end," said William Strang, who heads the operations division for Toto in the Americas. Toto is reducing trans-Pacific shipments and relying more on U.S. and Mexican plants for its sales in North America.

Making toilets requires lots of manual labor—"very much like making pottery," as one industry executive puts it. That is why most production moved over the past two decades to lower-cost countries, mostly China and Mexico.

The work is demanding, requiring muscles to lift bowls and tanks, as well as a delicate touch to smooth surfaces.

"You need the strength of a football player and the hands of a sculptor," Manfield's Mr. Morando said as workers in muscle shirts hoisted newly baked porcelain on a recent afternoon.

Three-quarters of the 10.6 million residential and commercial toilets sold in the U.S. last year were imports, estimates Victor Post, vice president of GMP Research Inc., a research firm based in Mount Pleasant, S.C.

There are just seven toilet plants in the U.S. today, down from 48 in the late 1970s, Mr. Morando said.

Much of that capacity may never return, but industry exec-

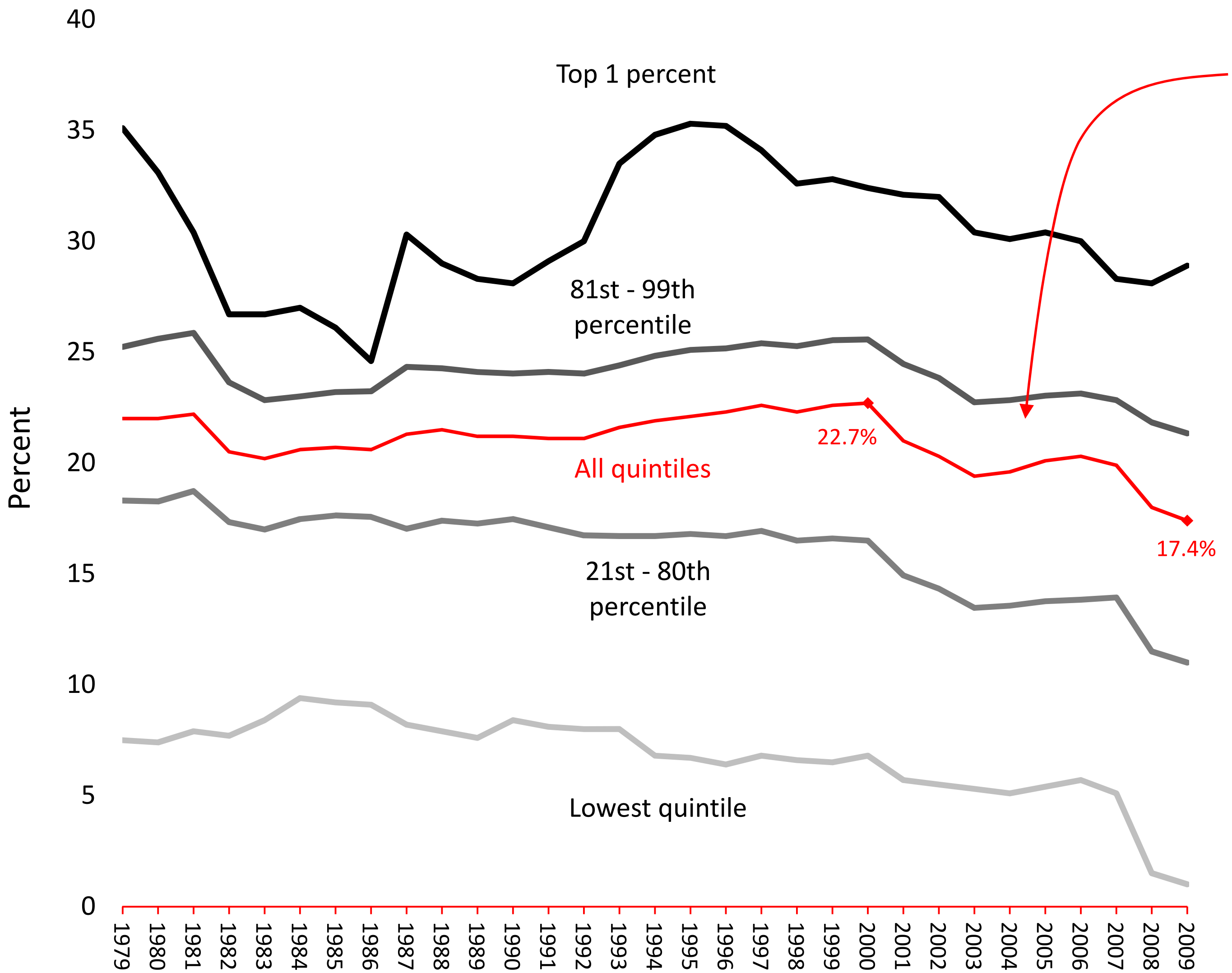
*Please turn to page B8*

**Online>>**

**See photos and learn more about the toilet-making process, at WSJ.com/Business.**

Source: *Wall Street Journal*, September 25, 2013.

# Average federal tax rates[1] by income quintile




The CBO's latest study shows a > 5 percentage point decline in average tax rates from the 2000 peak, <u>suggesting room for a tax increase to revert to the historic norm.</u>

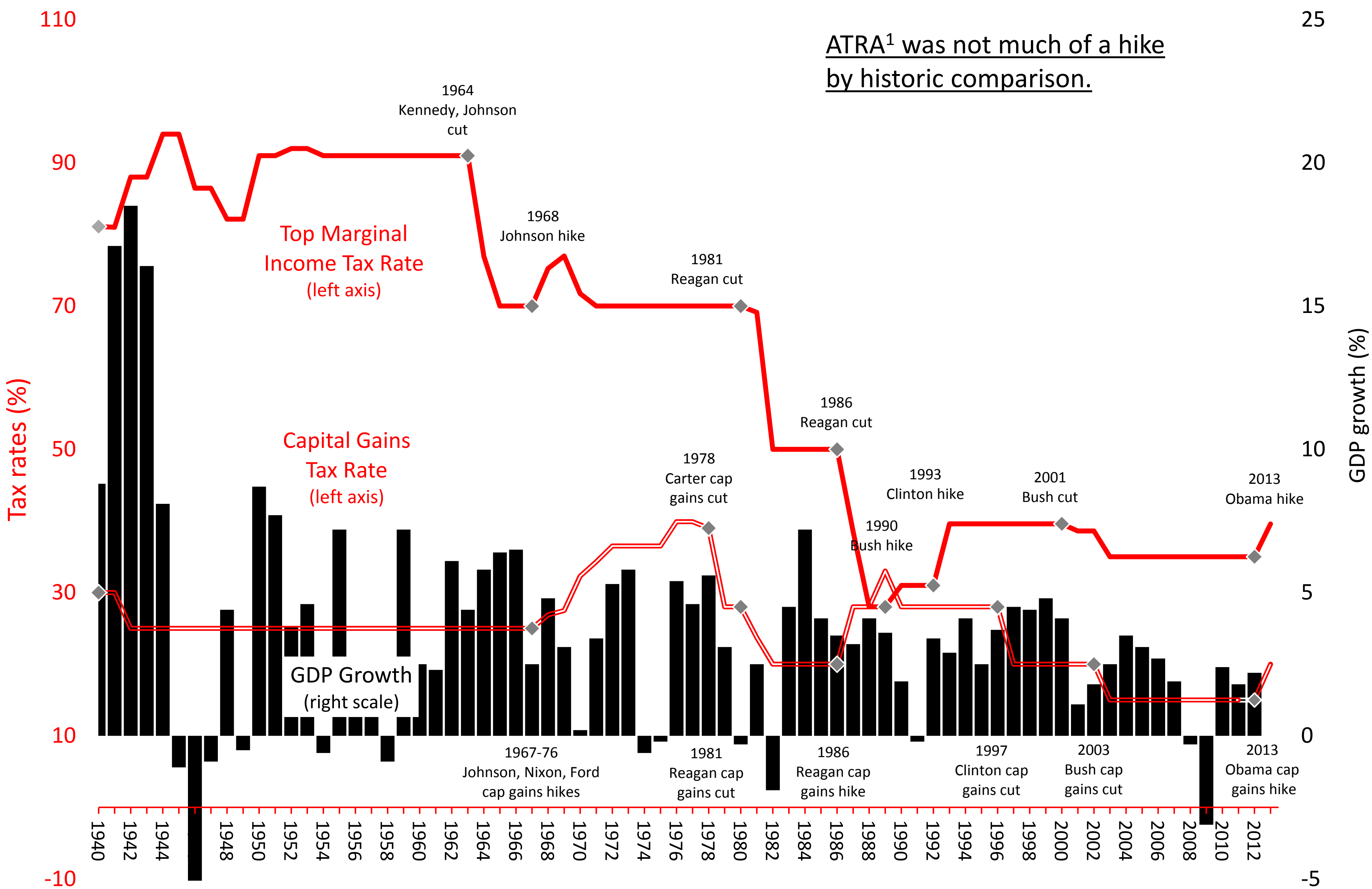
The political debate is centered on *who* should pay more taxes.

| | Average 2009 pre-tax income ($) |
|---|---|
| Top 1 percent | 1,219,700 |
| Highest quintile | 223,500 |
| Fourth quintile | 93,800 |
| Middle quintile | 64,300 |
| Second quintile | 43,400 |
| Lowest quintile | 23,500 |

Source: Congressional Budget Office, *The Distribution of Household Income and Federal Taxes, 2008 and 2009*, published July 10, 2012. [1] Market income is composed of labor income, business income, capital gains, capital income (excluding capital gains), income received in retirement for past services, and other sources of income. Government transfers are cash payments and in kind benefits from social insurance and other government assistance programs. Quintiles, or fifths, are created by ranking households by their before-tax income. Quintiles contain equal numbers of people. Federal taxes include individual and corporate income taxes,social insurance (or payroll) taxes, and excise taxes. Average tax rates are calculated by dividing tax liabilities of each type by total income for each income group.

American Taxpayer Relief Act of 2012

# Top marginal tax rates and GDP growth

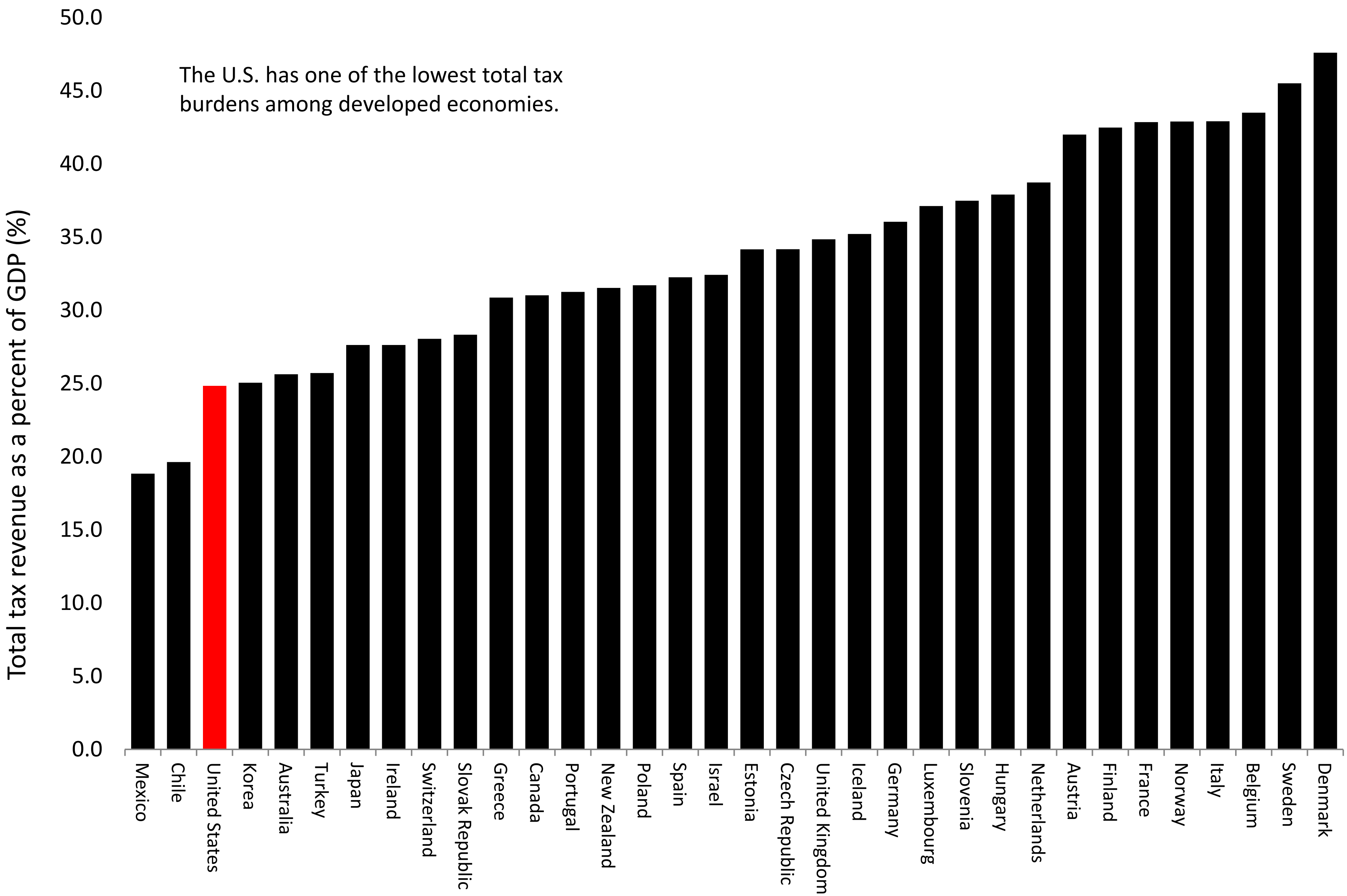





Source: BEA, Tax Policy Center Urban Institute and Brookings Institution. GDP data through 2012, tax rates through ATRA January 2013.

[1] American Taxpayer Relief Act of 2012.

# Taxes % of GDP – comparison

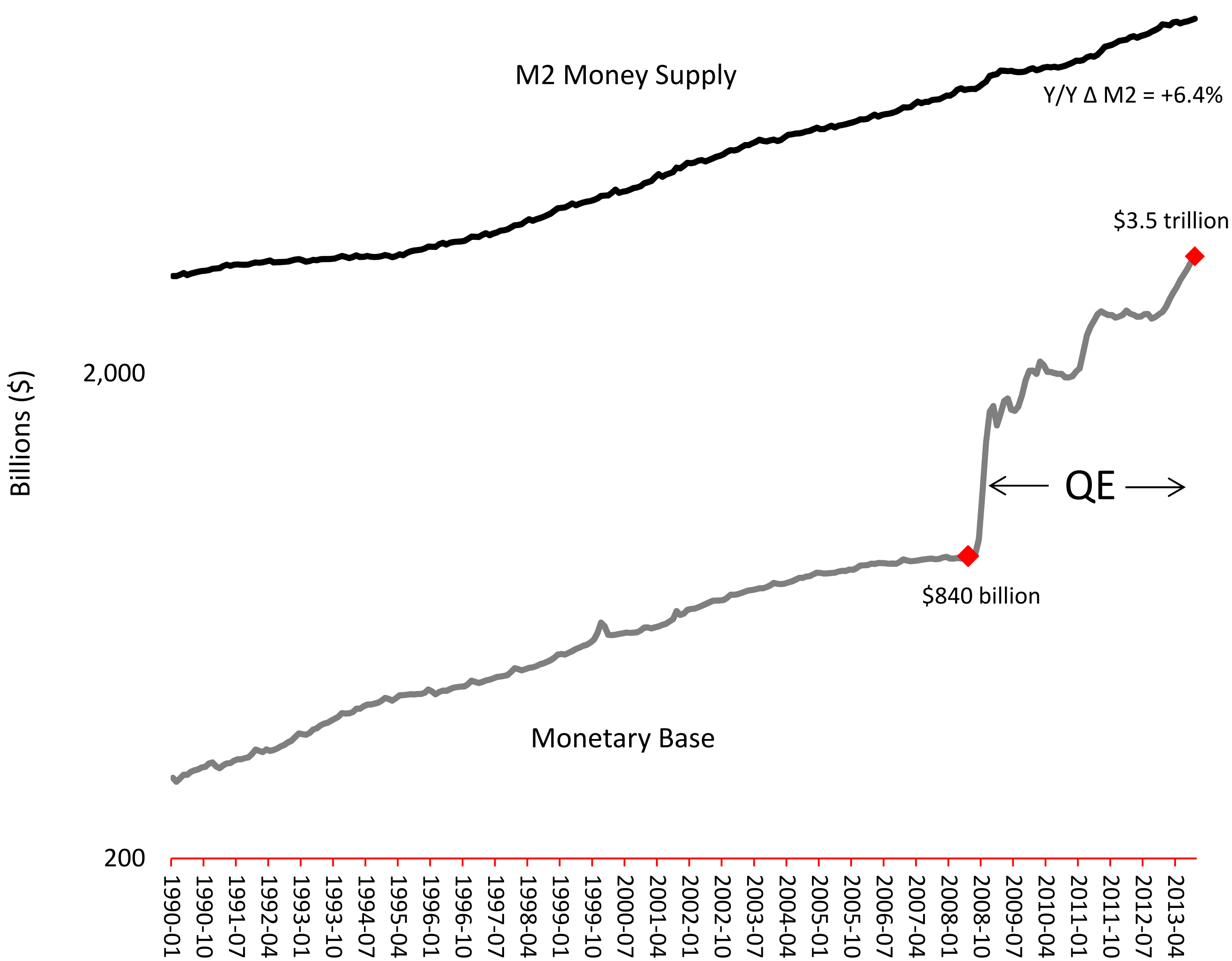



Source: OECD, Revenue Statistics, 2012 Edition. Data for 2010. Does not include non-OECD countries such as China, Brazil, India and Russia.

Economic Data

# "The Fed is printing money." Key distinction between money supply and monetary base.

The Federal Reserve has engineered an explosion in the Monetary Base — reserves that commercial banks keep on deposit at the Fed — in an effort to restore confidence in banks and stimulate the economy. M2 — which is a function of both supply *and* demand for funds — is responding sluggishly.




The Fed's money-printing has increased the money supply. Banks have parked at the Fed about $1.5 trillion more than their required reserves. Inflation-phobes predict those reserves will someday turn into loans, flooding the economy with credit and triggering inflation.

Mr. Bernanke says that won't happen because, unlike his predecessors, he has the legal authority to boost the interest rate (now 0.25%) the Fed pays banks on those reserves. Raising that rate would encourage banks to leave money at the Fed instead of lending it. It also would lead banks to charge higher rates on loans, discouraging borrowing. "We have all the tools we need to undo our monetary-policy stimulus and to take that away before inflation becomes our problem," Mr. Bernanke insists.

That is plausible, though untested.



Source: Federal Reserve. Data through September 2013, released November 7, 2013. *The Wall Street Journal,* January 16, 2013.

# Stock Market – gurus

MARKETBEAT | Market Insight from WSJ.com

## Bill Gross: Stocks Are Dead

### *And Operate Like a 'Ponzi Scheme'*

By Steven Russolillo
And Kirsten Grind

The bond king says stocks are dead.

Bill Gross, co-founder and co-chief investment officer of **Pacific Investment Management** Co., says stock investors should rethink the age-old investing mantra of buying and holding stocks for the long run. He says consistent, annual returns from stocks are a thing of the past.

"The cult of equity is dying," Mr. Gross wrote on Tuesday in his investing outlook column, a monthly note that has become a forum for his colorful, and occasionally inflammatory, market musings. "Like a once-bright-green aspen turning to subtle shades of yellow then red in the Colorado fall, investors' impressions of 'stocks for the long run' or any run have mellowed as well."

Stocks, he says, operate much like a Ponzi scheme, showing returns that have no real bearing on reality.

That may not seem like such a surprise from the man who made his name, and his fortune, in the bond market—and currently runs the largest bond fund in the world.

But Pimco, a unit of **Allianz** SE, has recently made a big push into stocks. The firm made a splash in December 2009 with the hiring of Neel Kashkari, then a top Treasury Department official, to start its equity business. Of the $1.8 trillion Pimco has under management, only about $6 billion is in active equity assets under management.

Mr. Gross points out stocks have averaged a 6.6% annual gain on an inflation-adjusted basis since 1912. But he labels that rate of return as a "historical freak" that isn't likely to be duplicated soon, due to slowing economic growth around the globe.

He says that return has "belied a commonsensical flaw much like that of a chain letter or yes—a Ponzi scheme."

His point: Economic growth ran at about 3.5% over that time, meaning stockholders were "skimming 3% off the top each and every year."

"If an economy's GDP could only provide 3.5% more goods and services per year, then how could one segment (stockholders) so consistently profit at the expense of the others (lenders, laborers and government)?" he asks.

Mr. Gross says he wonders how stocks can keep appreciating at a 6.6% annual rate with such low growth.

He says it can't "absent a productivity miracle that resembles Apple's wizardry."

Reached after Mr. Gross's missive, Mr. Kashkari said the firm is still committed to stocks. "We believe that investment returns across asset classes are going to be lower in the future than in the past, but we think equities still have a very important role to play in clients' portfolios," he said.

*Read the continuously updated look inside the markets, free online at* **wsj.com/marketbeat**

This was such a grossly uninformed missive from such a high profile "expert" that I think it deserves to be tracked.

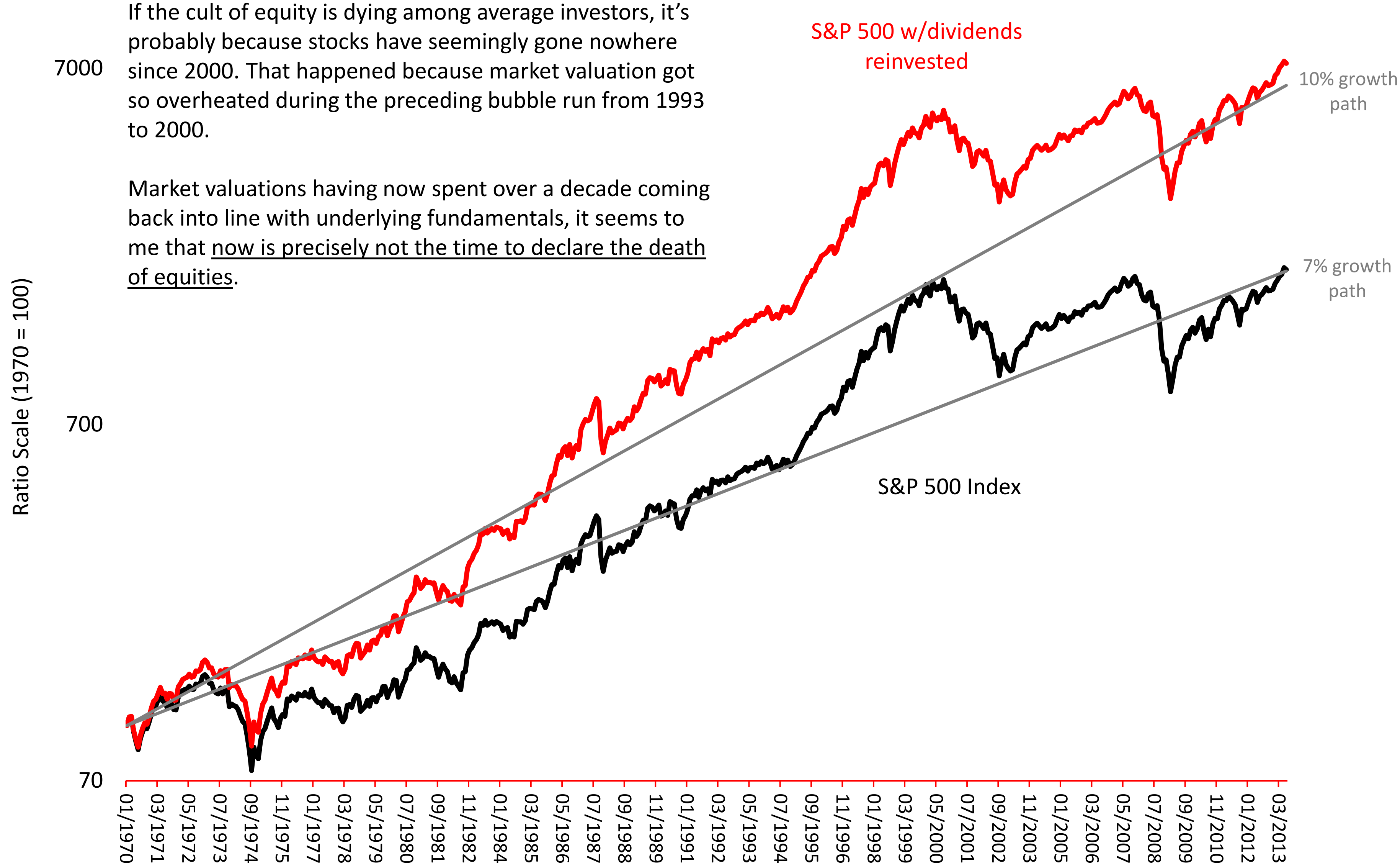

Source: *Wall Street Journal*, August 1, 2012; Dow Jones Inc.; DJIA data through October 4, 2013.

Stock Market Arithmetic

# Total Return = 7% earnings-driven price + 3% dividends reinvested

If the cult of equity is dying among average investors, it's probably because stocks have seemingly gone nowhere since 2000. That happened because market valuation got so overheated during the preceding bubble run from 1993 to 2000.

Market valuations having now spent over a decade coming back into line with underlying fundamentals, it seems to me that <u>now is precisely not the time to declare the death of equities</u>.




Source: Standard and Poor's. Data through June 2013.

**March 8, 2013**

## Nouriel Roubini: Brace for Market Correction Later This Year

CNBC · Text Size

Published: Friday, 8 Mar 2013 | 2:47 AM ET

By: Reported by Ross Westgate; Written by Shai Ahmed

Recommend 72 · Twitter 126 · +1 6 · LinkedIn 21 · Share

Tax increases on wealthy Americans and reduced government spending will have a severe impact on economic growth in the United States this year, wiping out the positive effects of a revival in the housing market and cheaper energy, Nouriel Roubini told CNBC on Friday.

*Article Continues Below*


### Roubini Warns on US Economy

Nouriel Roubini, co-founder and chairman of Roubini Global Economics, warns that the benefits of QE and a boom in shale gas will not be able to outweigh the negative effects of the sequester on the US economy.

**June 3, 2013**

## 'Dr. Boom'? Roubini Sees Two Years of Stock Gains

CNBC · Text Size

Published: Monday, 3 Jun 2013 | 4:42 PM ET

By: Jeff Cox | CNBC.com Senior Writer

Recommend 92 · Twitter 94 · +1 15 · LinkedIn 20 · Share


### Dr. 'Realist' Roubini on Fed Tapering, Markets

Monday, 3 Jun 2013 | 4:10 PM ET

Discussing opportunities in the global market, and how the Fed's tapering might impact the economy, with Nouriel Roubini, Roubini Global Economics.

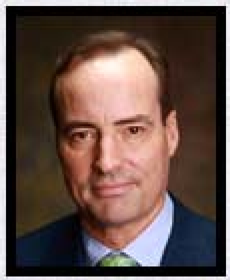
Stock market prices will continue to rise for the next two years until the wealth gap between Wall Street and Main Street gets too high and reality sets in, economist Nouriel Roubini told CNBC.

Source: CNBC.com.

SURVIVE & PROSPER

Learn to Capitalize on the Predictive Power of Demographics!

# 2013: THE YEAR THE NEXT FINANCIAL MELTDOWN BEGINS



Harry S. Dent is a world renowned economist who studies demographic and historic trends to see major events unfolding long before the mainstream media's even has them on their radar. He accurately predicted the 1990-92 recession, foresaw the biggest Bull Market run in US history as well as Japan's Lost Decade and, most recently, sounded the early warnings about the 2008 financial crash.

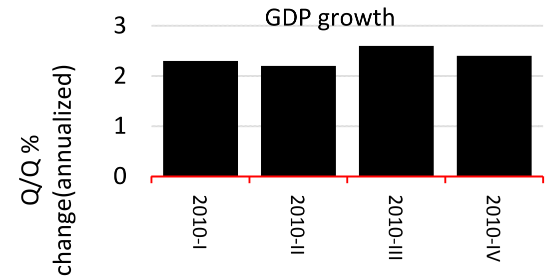
**Now, it's your chance to get ahead of the curve and find out about the dubious future of gold, the DOW dropping to 3300, real estate declining another 30% and other shocking 2013 predictions that can help you make the right decisions for your family and your business.**

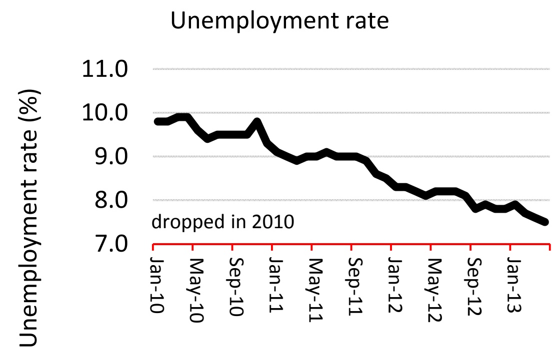
Source: Harry Dent website June 6, 2013.

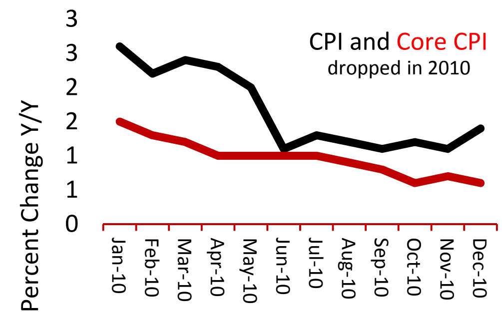
## 2010 Actuals


***Remarkably*** **terrible predictions in January 2010 – yet he was on CNBC again May 16, 2013.**

**1/4/2010 Peter Schiff On Fast Money: Dollar Collapse By 70% In 2010?**

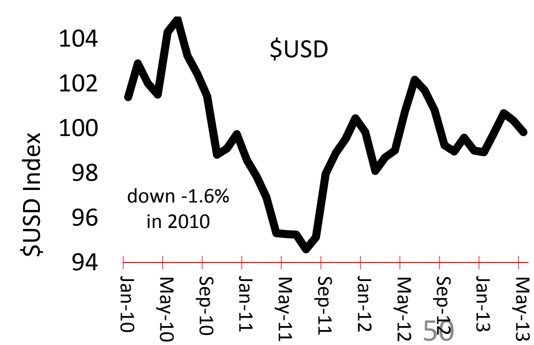



<u>Peter Schiff, January 4, 2010</u>

"The U.S. economy is in terrible shape now and it's only going to get worse."
" … unemployment, interest rates and inflation higher by year-end."
"I'm talking dollar collapse of 50%, 60% 70% …"
"Americans are going to stop spending, we're broke …"
"… windfall profits taxes coming on all types of exporters …"




Source: YouTube.

# Conclusions

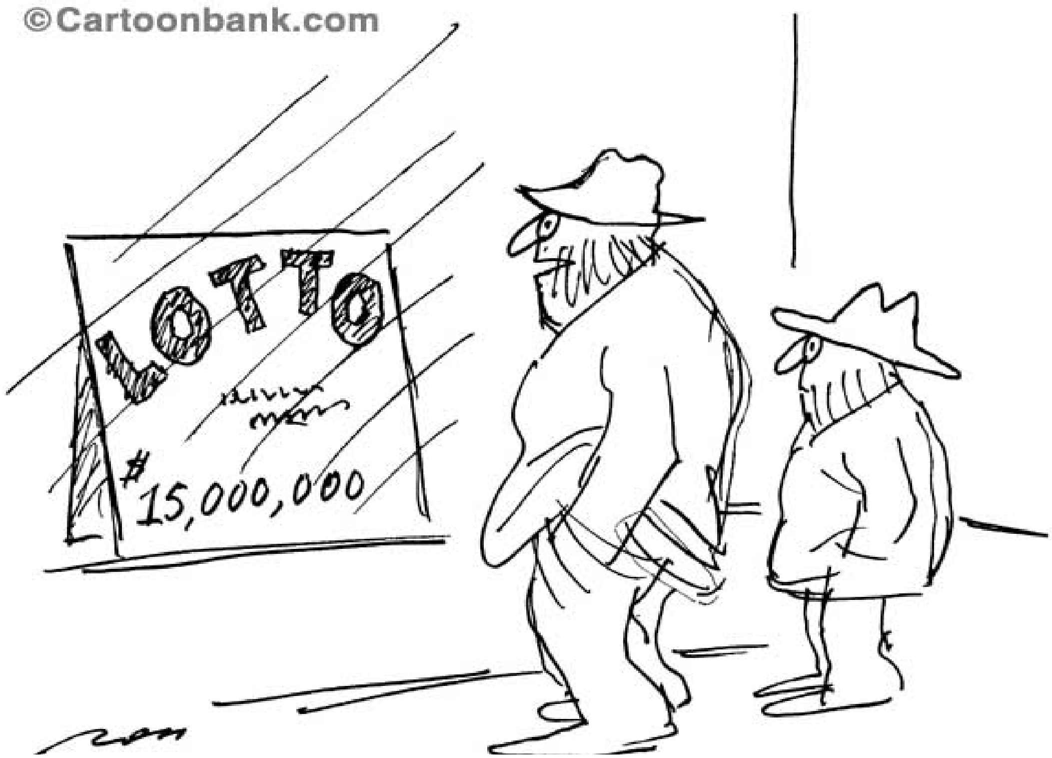

**"It's just a correction.
The fundamentals are still good."**

Economic data:

- Economists see continued economic expansion.
- Slow but steady progress on new job formation.
- Consumers' savings and liquidity have risen substantially.
- Household net worth has recovered – deleveraging is done.
- Significant skew in income, spending is relevant to economic recovery. Retail sales have come roaring back.
- The U.S. economy is positioned to continue a +2 to +2½% long-term trend rate of growth.
- Positive changes in manufacturing.
- Inflation is subdued and will probably remain so until there are signs of wage inflation – which may be a ways off.
- The CBO projects massive budget deficits if current revenue and spending policies continue.

Market data:

- Better, and better-than expected, U.S. economic news has been a catalyst for stocks.
- Stocks climbed the Wall of Worry to new highs even as consumer sentiment has remained depressed.
- Stocks are still reasonably valued on estimated earnings.
- Fed is poised to ratchet down QE.
- Total return on bonds cannot continue recent years' returns.
- Municipal bonds are attractive.



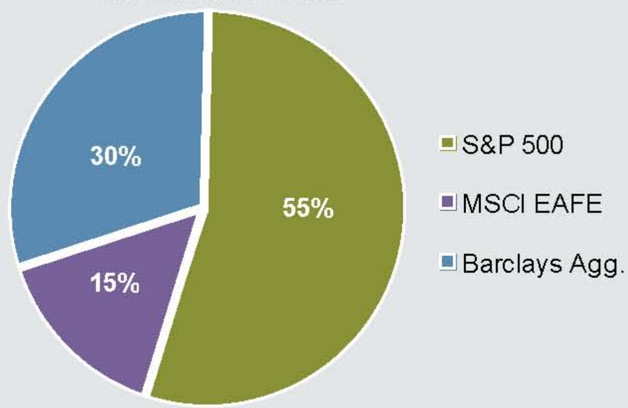

**"Winning is crucial to my retirement plans."**

MARKET INSIGHTS

# Diversification and the Average Investor

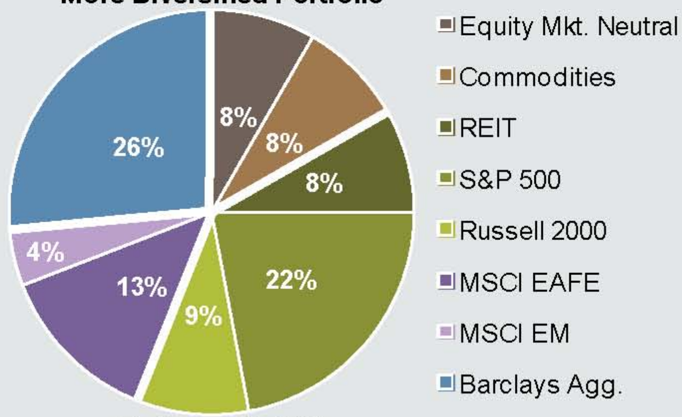
## Maximizing the Power of Diversification (1994 – 2012)

### Traditional Portfolio



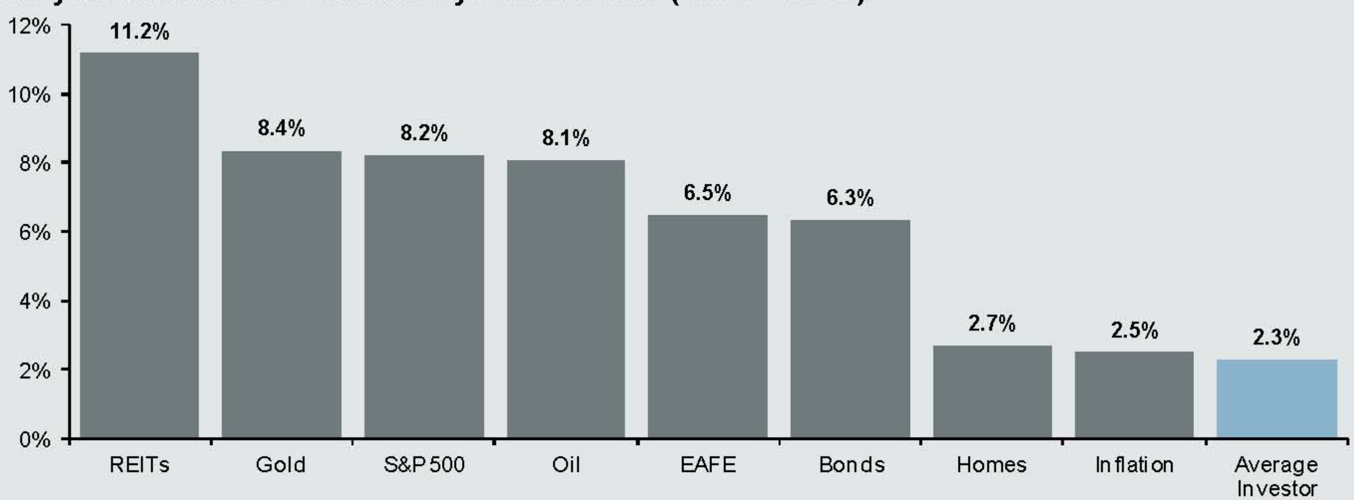

**Return: 7.43%**
**Standard Deviation: 10.80%**

### More Diversified Portfolio




**Return: 7.72%**
**Standard Deviation: 9.87%**

## 20-year Annualized Returns by Asset Class (1993 – 2012)




Asset Class

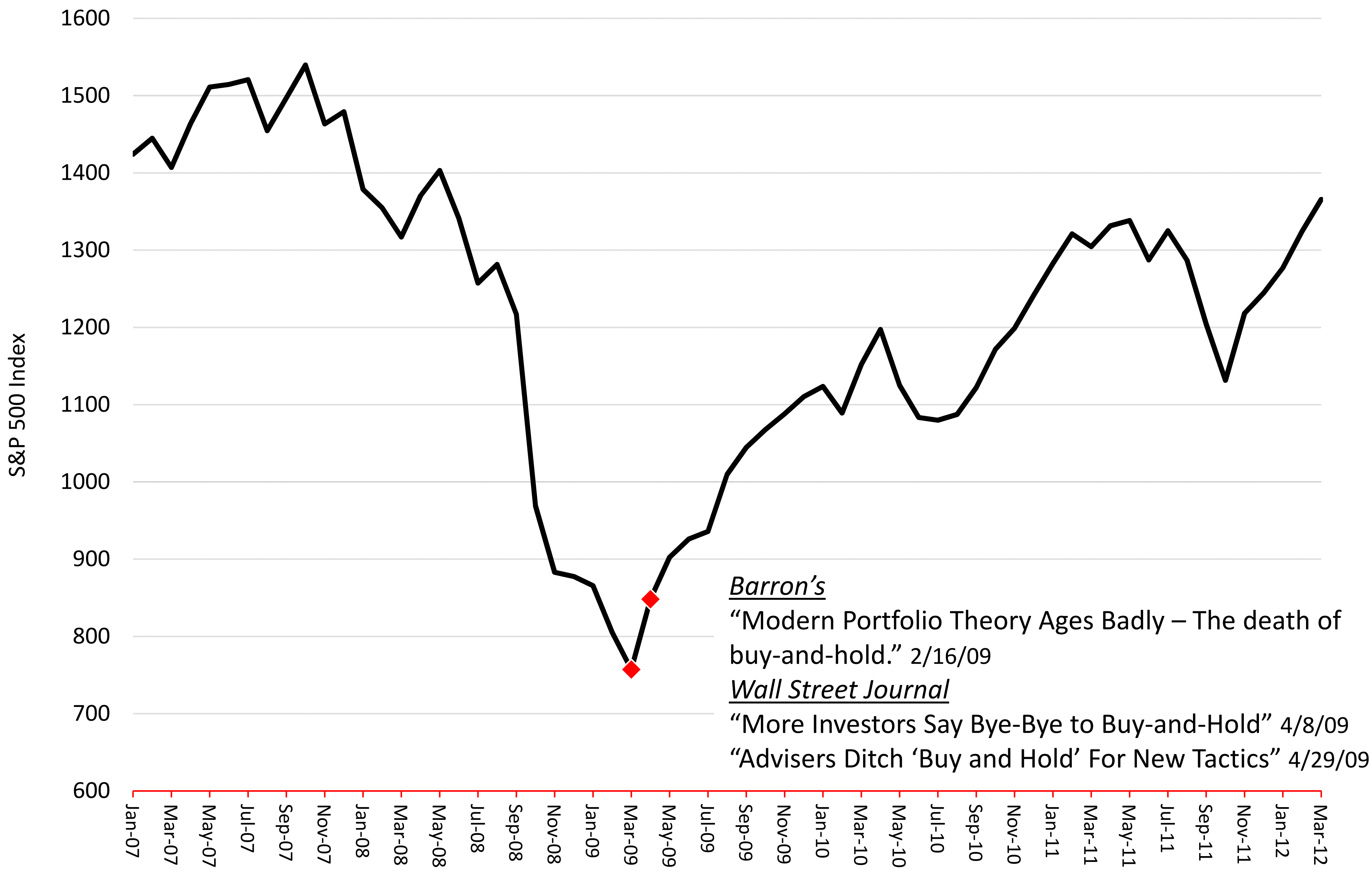
(Top) Indexes and weights of the traditional portfolio are as follows: U.S. Stocks: 55% S&P 500; U.S. Bonds: 30% Barclays Capital Aggregate; International Stocks: 15% MSCI EAFE. Portfolio with 25% in alternatives is as follows: U.S. Stocks: 22.2% S&P 500, 8.8% Russell 2000; International Stocks: 4.4% MSCI EM, 13.2% MSCI EAFE; U.S. Bonds: 26.5% Barclays Capital Aggregate; Alternatives: 8.3% CS/Tremont Equity Market Neutral: 8.3%, DJ/UBS Commodities: 8.3% NAREIT Equity REIT Index. Return and standard deviation calculated using Morningstar Direct.

Charts are shown for illustrative purposes only. Past performance is not indicative of future returns. Diversification does not guarantee investment returns and does not eliminate risk of loss. Data are as of 9/30/13. Guide to the Markets – U.S. J.P. Morgan Asset Management.

(Bottom) Indexes used are as follows: REITS: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays Capital U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/12 to match Dalbar's most recent analysis.

J.P.Morgan Asset Management

# Investors' classic capitulation – "Modern Portfolio Theory is dead"



# Modern Portfolio Theory = Asset Allocation

Modern portfolio theory was introduced by Harry Markowitz with his paper "Portfolio Selection," which appeared in the 1952 *Journal of Finance*.

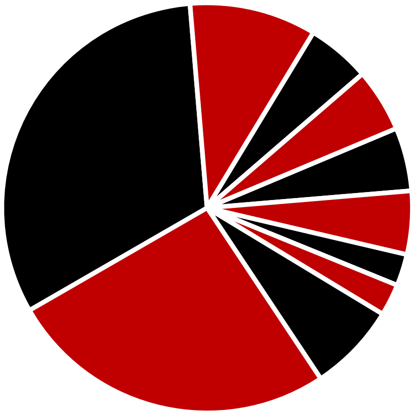
Thirty-eight years later, he shared a Nobel Prize with Merton Miller and William Sharpe for what has become a broad theory for portfolio selection.

## Modern Portfolio Theory

Diversify

Optimize

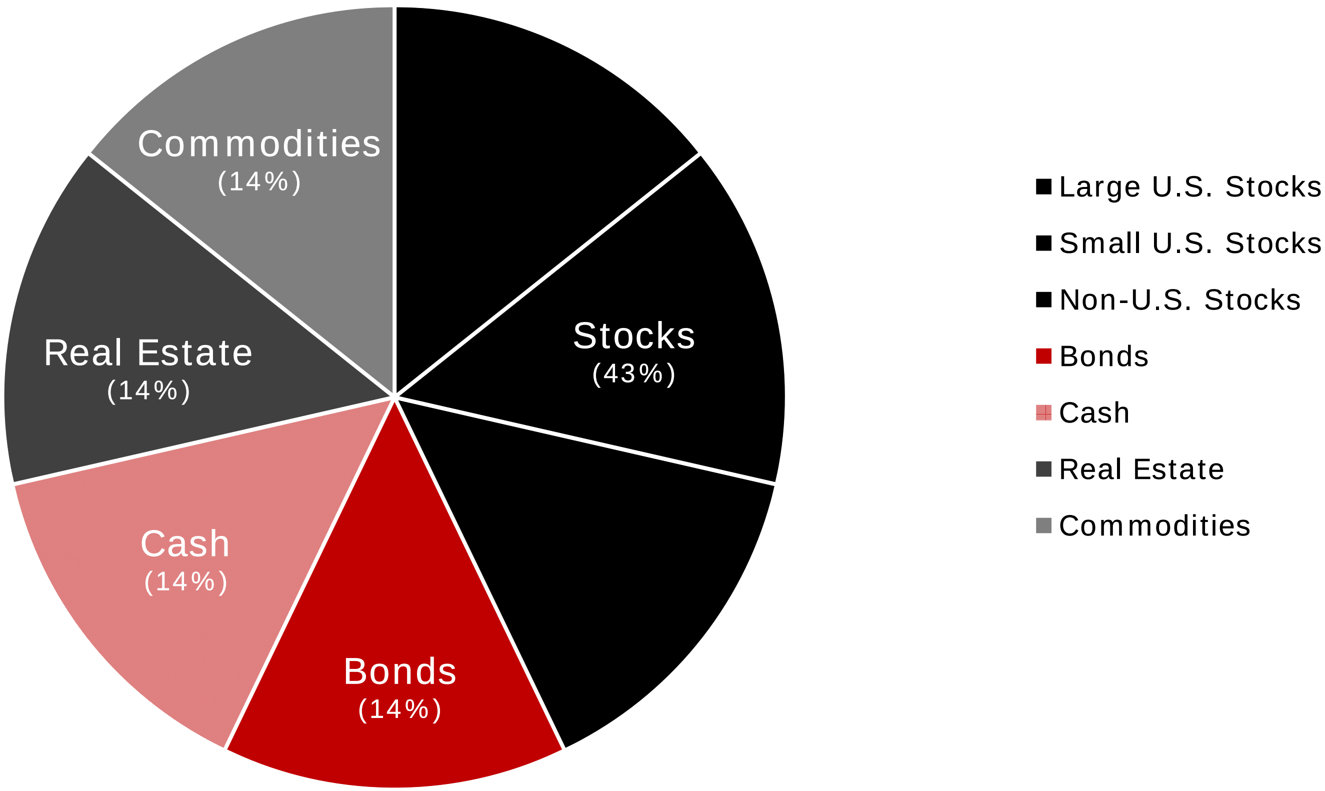
Rebalance



Asset allocation and diversification do not guarantee a profit or eliminate the risk of loss.
Source: Riskglossary.com

# Asset Allocation — An Example

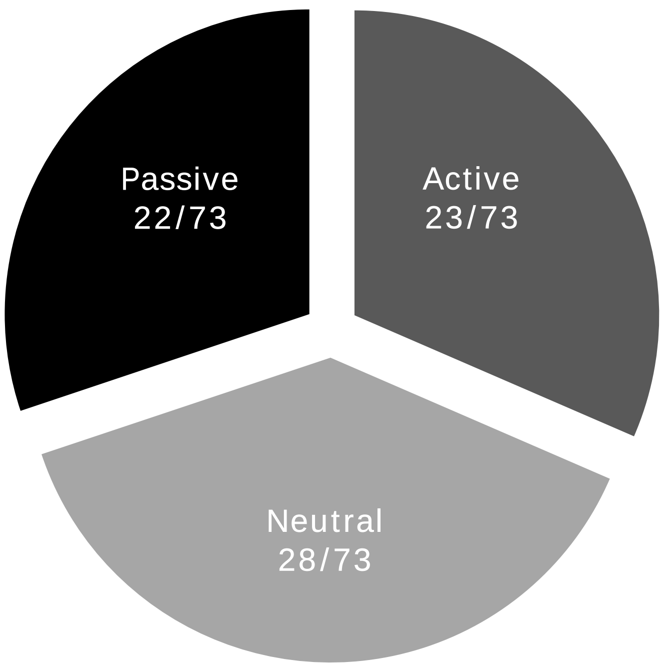
## Let's construct a global balanced portfolio using 7 asset classes …




Source: ©2012 The 7Twelve ™ Portfolio powerpoint presentation, by Craig Israelsen. Used with permission. Indexes used in this illustration: Large-cap US equity represented by the S&P 500 Index. Small-cap US equity represented by the Ibbotson Small Companies Index from 1970-1978, and the Russell 2000 Index starting in 1979. Non-US equity represented by the MSCI EAFE Index. Real estate represented by the NAREIT Index from 1970-1977 and the Dow Jones US Select REIT Index starting in 1978.Commodities represented by the Goldman Sachs Commodities Index (GSCI). As of February 6, 2007, the GSCI became the S&P GSCI Commodity Index.U.S. Aggregate Bonds represented by the Ibbotson Intermediate Term Bond Index from 1970-75 and the Barclays Capital Aggregate Bond index starting in 1976. Cash represented by 3-month Treasury Bills.

# FundQuest BNP Paribas Study[1]

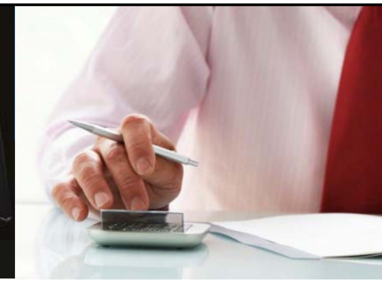
"Out of the 73 categories in our study, we recommend a bias to active management in 23 categories and a bias to passive management in 22 categories. Twenty-eight (28) categories were deemed neutral."



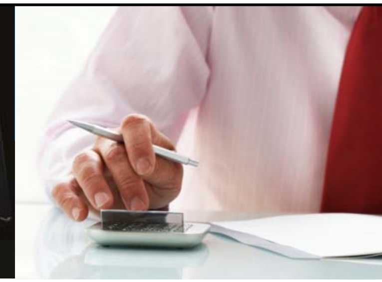

## 73 Fund Categories Analyzed

Bank Loan, Bear Market
Commodities Broad Basket, Communications
Conservative Allocation
Consumer Discretionary, Consumer Staples
Convertibles, Currency, Diversified Emerging Mkts
Diversified Pacific/Asia, Emerging Markets Bond
Equity Energy, Equity Precious Metals
Europe Stock, Financial
Foreign Large Blend, Foreign Large Growth
Foreign Large Value, Foreign Small/Mid Growth
Foreign Small/Mid Value, Global Real Estate
Health, High Yield Bond, High Yield Muni
Industrials, Inflation-Protected Bond
Intermediate Govt' Bond
Intermediate-Term Bond, Japan Stock, Large Blend
Large Growth, Large Value, Latin America Stock
Long Government, Long-Short, Long-Term Bond
Mid-Cap Blend, Mid-Cap Growth, Mid-Cap Value
Miscellaneous Sector, Moderate Allocation Multisector Bond
Muni National Interm, Muni National Long
Muni National Short, Muni Single State Interm
Muni Single State Long, Muni Single State Short
Natural Resources, Pacific/Asia ex-Japan Stk, Real Estate
Retirement Income, Short Government Bond
Short-Term Bond, Small Blend, Small Growth
Small Value Target Date 2000-2010
Target Date 2011-2015; 2016-2020; 2021-2025
Target Date 2026-2030; 2031-2035; 2036-2040
Target Date 2041-2045; Target Date 2050+
Technology, Ultrashort Bond, Utilities, World Allocation, World Bond, World Stock

[1] ©FundQuest BNP Paribas Group study dated June 2010, Jane Li, author. "When Active Management Shines vs. Passive – Examining Real Alpha in 5 full market cycles over the past 30 years."


| Sample Index Portfolio Returns With Monthly Rebalancing Compared Against Individual Indexes | | | | | |
|---|---|---|---|---|---|
| Sample Index Portfolio | Trailing Returns (%) Through 09-30-2013 | | | | |
| | 3 Months | 1 Year | 3 Years | 5 Years | 10 Years |
| MSCI EAFE Index | 11.56 | 23.77 | 8.47 | 6.35 | 8.01 |
| S&P 500 Index | 5.24 | 19.34 | 16.27 | 10.02 | 7.57 |
| MSCI U.S. Broad Market | 5.80 | 18.99 | 14.48 | 8.44 | 6.29 |
| Aggressive Growth Model* | 6.06 | 15.91 | 11.74 | 9.17 | 8.10 |
| Growth Model* | 5.40 | 13.63 | 10.56 | 8.76 | 7.73 |
| Moderate Model* | 4.71 | 11.49 | 9.42 | 8.28 | 7.28 |
| Balanced Model* | 3.94 | 9.45 | 8.47 | 7.82 | 6.77 |
| Conservative Model* | 3.25 | 7.37 | 7.31 | 7.26 | 6.27 |
| Very Conservative Model* | 2.60 | 5.39 | 5.98 | 6.55 | 5.70 |
| BarCap U.S. Aggregate Bond | 0.57 | -1.68 | 2.86 | 5.41 | 4.59 |
| 3 Month Treasury Bill | 0.01 | 0.07 | 0.08 | 0.12 | 1.67 |


| Portfolio Returns Using Indexes and Monthly Rebalancing Compared Against Various Indexes | | | | | | |
|---|---|---|---|---|---|---|
| Sample Portfolio | Performance Volatility From 10-01-2003 Through 09-30-2013 | | | | | |
| | Best 3 Month | Worst 3 Month | Best 1 Year | Worst 1 Year | Best 3 Year | Worst 3 Year |
| MSCI EAFE Index | 34.14 | -35.41 | 54.58 | -50.22 | 23.94 | -15.30 |
| S&P 500 Index | 25.83 | -29.65 | 53.62 | -43.32 | 25.56 | -15.11 |
| MSCI U.S. Broad Market | 25.92 | -31.64 | 53.21 | -44.54 | 24.27 | -16.83 |
| Aggressive Growth Model * | 24.59 | -27.18 | 47.73 | -37.88 | 22.28 | -10.86 |
| Growth Model * | 21.77 | -24.16 | 42.39 | -33.78 | 20.36 | -8.88 |
| Moderate Model * | 18.84 | -20.95 | 36.99 | -29.36 | 18.33 | -6.89 |
| Balanced Model * | 15.68 | -17.50 | 31.58 | -24.48 | 16.32 | -4.93 |
| Conservative Model * | 12.85 | -14.12 | 26.51 | -19.59 | 14.28 | -2.94 |
| Very Conservative Model * | 10.15 | -10.68 | 21.50 | -14.58 | 12.03 | -0.89 |
| BarCap U.S. Aggregate Bond | 6.16 | -3.17 | 13.79 | -2.47 | 8.87 | 2.58 |
| 3 Month Treasury Bill | 1.31 | 0.00 | 5.27 | 0.04 | 4.40 | 0.08 |

*** Models are built with Indexes. Past performance is not indication of future results.**

**Performance was calculated using Morningstar Advisor Workstation and does not reflect any advisory fees.**

**Please see page 3 for additional disclosures.**

Investment Strategy

# Asset Allocation — MPT has delivered

# And Don't Believe Everything You Hear




**"We were wondering if <u>now</u> would be a good time to panic?"**

A study by Media Research Center of a year's worth of economic coverage on ABC, CBS and NBC found more than twice as many stories and briefs focused on negative aspects of the economy (62%) compared to good news (31%).

Source: Media Research Center, "Bad News Bears," October 2006.

# Important Information

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This is not to be construed as an offer to buy or sell any financial instruments and should not be relied upon as the sole factor in an investment making decision. As with all investments there are associated inherent risks. Please obtain and review all financial material carefully before investing.

The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice.

These materials may contain statements that are not purely historical in nature but are "forward-looking statements." These include, among other things, projections, forecasts, estimates of income, yield or return or future performance targets. These forward-looking statements are based upon certain assumptions, some of which are described herein. Actual events are difficult to predict and may substantially differ from those assumed. All forward-looking statements included herein are based on information available on the date hereof and Fritz Meyer assumes no duty to update any forward-looking statement. Accordingly, there can be no assurance that estimated returns or projections can be realized, that forward-looking statements will materialize or that actual returns or results will not be materially lower than those presented.

Note: Not all products, materials or services available at all firms. Advisers, please contact your home office.