<u>Outlook for April, 2014: "Will She or Won't She?…"</u>

With global equity markets appearing to consolidate and even give-up some ground after hitting new highs earlier this month, the natural question remains where are markets headed and whether the Federal Reserve will actually ***tighten monetary policy*** anytime soon? We are convinced that the answer to the latter question could well determine the answer to the former.

A reading of minutes and recent speeches by participants in the Federal Open Market Committee Meetings of the Federal Reserve does suggest a ***significant dichotomy in views*** among policymakers as it relates to the timing of tightening monetary policy. Having said that, it is quite clear that the Fed is unlikely to make drastic moves that would disrupt "normal" functioning of markets.

Indeed, during a press conference immediately following the FOMC meeting, Chairman Janet Yellen seemed to indicate that the FOMC could "tighten within six months" after the end of ***"tapering"***. It doesn't take a rocket scientist to figure out that at its current pace, tapering will likely be completed sometime this fall – which would put the first tightening sometime next spring – a mere twelve months away.

It is not at all clear whether Chairman Yellen's comments were intended to disrupt markets or not, but roil they sure did. Regardless of whether markets interpreted her remarks appropriately, she did get an object lesson in being a central banker – who's every utterance and word is scrutinized and often phrases become unintended fodder for financial journalists and talking heads on what passes for television these days.

Subsequently, the FOMC's minutes – which were released to the public last week – imply that there is still ***considerable debate*** among the FOMC about the timing of tightening. In other words, just because the Fed has concluded its exercise in tapering, does not necessarily imply that the next logical step – a hike in interest rates – will occur by rote within the next six months.

There is no question in our mind that the Fed's management of its exit from Quantitative Easing as well as the required shrinking of its bloated balance sheet is going to be ***critical for markets*** over the near to medium term. ***Our main worry*** remains that there is ***plenty of scope (and opportunity!)*** for central bankers to ***"mess things up"*** and we worry that swooning markets could stay the Fed's hand, thus raising a greater risk in the longer term.

Economic data released recently have been ***quite positive***: The US added 192,000 jobs in March – despite severe winter weather in parts of the Northeast and the upper Midwest during the early part of March. Upward revisions to the jobs added for January and February were also positive (adding a net 37k jobs). The US economy has added a little over 2.0 Million jobs (2,043k to be exact) in the past twelve months – which is a reasonable pace of job growth.

Among sectors of the economy, professional and business services (+57k) along with trade, transportation and utilities (+38k) were the leading sectors while manufacturing (-1k) and government (0k) were the laggards for the month of March. The politically sensitive ***unemployment rate*** stayed unchanged at 6.7% while the more robust U-6 measure of unemployment rose 0.1% to a still high 12.7%. The Labor force participation rate – another indication of the health of the labor market – rose slightly to a still abysmal 63.2%.

Fed Chairman Janet Yellen made ***an impassioned plea*** to look at the human side of joblessness and the difficulty of finding jobs for workers who have been out of work for long periods of time. She tried to put a human face on this story by citing the example of a few workers during a speech in Chicago, IL. In an almost made for television vignette (and we can't really make this stuff up), two of the workers she cited as examples appeared to have criminal records – making them unattractive to prospective employers - thus calling into question her data sources and judgment in using them as examples.

Both the Institute of Supply Management Surveys of the manufacturing sector (with the PMI rising from 53.2 in February to 53.7 in March) as well as the service sector (with the NMI composite rising from 51.6 in February to 53.1 in March) posted gains suggesting that the economy was finding its footing this spring. Also measures relating to retail sales (+3.8% year-on-year) imply that the economy is slowly but surely healing.

Inflation readings in the US as well as around the globe tend to be quiescent suggesting very little in the way of upward pressure on prices: Consumer prices have risen a mere 1.7% (year-on-year) on an ex-food and energy basis for urban consumers in the twelve months ended March. Similarly, producer prices have gained a mind numbing 1.7% (year-on-year) for the twelve months ended in March also on an ex-food and energy basis. Similar readings in many developed European countries are below gains of 1.0% for the past year, thus suggesting little in the way of inflation pressures.

Farther afield, Mario ("whatever it takes") Draghi the head of the European Central Bank has started to make some noise about quantitative easing and further monetary policy accommodation in order to combat a rising Euro currency. It is quite ironic, we think, that the very same Euro which faced an ***existential threat*** a mere three years ago is now regarded as being too strong.

This, in essence, is the ***real problem with Central Banking*** today: Most policy makers would rather see their home currency weaken thus providing a fillip to exports rather than supporting higher interest rates or fiscal rectitude (as both these involve considerable economic pain to be borne by their people). In today's topsy-turvy world, it is often forgotten that a ***currency exchange rate*** is a ***relative price*** and it is therefore impossible (by definition) for every currency to weaken relative to every other currency!

Prime Minister Abe of Japan has promulgated an increase in the consumption tax in that country raising it from 5.0% to 8.0%. This has had the effect of increasing sales of durable goods in the weeks ahead of the increase and a subsequent decline in sales immediately following the date of the consumption tax increase. It remains to be seen whether the Japanese economy will weather this storm with equanimity rather than see another dip in growth.

Over ***812 million people in India are expected to vote*** in general elections in that country – which could lead to a changing of the guard at New Delhi. Given the size of the electorate, voting is being conducted in stages and results will be tallied and ultimately announced only sometime in mid-May – a full five weeks after when initial voting starts.

The Congress Party (a left of center coterie of politicians) has held sway over the central government for over thirty years and appears to be quite weakened as a result of allegations of corruption and economic mismanagement. The country (and its youth in particular) appear to be quite restive and ready for a new and energetic leader who could implement reforms and unleash the entrepreneurial spirit. ***India and its politicians have a real opportunity*** this time around to fulfill the dreams of its teeming millions.

Given the cross-currents with respect to Federal Reserve policy and the consolidating nature of equity markets, we do feel a little cautious in the near term. However, we remain optimistic regarding the medium to longer term outlook for markets. It also goes without saying that our abiding faith in a ***fully diversified portfolio*** - that has a balanced approach to both risk and return - as the main way to attain ***favorable investment outcomes*** over the long haul, remains steadfast.

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