<u>Outlook for July, 2013: "An Extended Period…."</u>

Both the European Central Bank and the Bank of England (now under the leadership of Mark Carney, a Canadian) appear to be borrowing a page from the Federal Reserve's playbook by using the language ***"an extended period of time"*** to provide ***forward guidance on administered interest rates***. While this is a new tactic for the Europeans, the Fed appears to be fighting its own battle on "tapering" of quantitative easing amidst differing interpretations by market participants.

Economic data released in the US has, on balance, had a ***better tone lately***: The US economy added a seasonally adjusted ***195,000 jobs in June***. Coupled with upward revisions to the figures for both May (+20k) and April (+50k) the labor market appears to be slowly but surely continuing the process of healing over time. Among the sectors, leisure and hospitality (+53k) and trade, transportation and utilities (+45k) added the most jobs, but government (-7k) and manufacturing (-6k) shed the most jobs during the month.

The much watched ***unemployment rate stayed unchanged at 7.6%*** for the month, although the more appropriate measure of unemployment, the so called U-6 measure posted an outsized jump to 14.3% (from 13.8%) for the month of June. Measures relating to weekly hours (unchanged at 34.5 per week) and average hourly earnings (+10 cents to $24.01) as well as average weekly earnings (a paltry gain of $3.45 per week to $828.35) suggest that despite the gains in jobs, ***wages appear to remain stagnant.***

The Commerce Department's Bureau of Economic Analysis pegged the final revision to ***1Q GDP at 1.8%*** (seasonally adjusted annual rate). Personal Consumption Expenditures rose 2.6% during the quarter (saar), gross private domestic investment posted a large gain of 7.4% (primarily supported by an outsized 14.0% gain in residential investment), while government expenditures declined a sizable -4.8% for the quarter.

In terms of ***inflation readings***, there appear to be very little inflation in the way of inflation pressures in the system: The latest reading on ***consumer prices*** imply a gain of 1.4% for urban consumers in the US with the ex-food and energy measure (core) posting a gain of 1.7% for the previous twelve months. ***Producer price*** increases have also remained fairly benign rising 1.7% for the twelve months ended in May and the ex-food and energy measure has also risen an identical 1.7% in the past year.

Monday kicks off the 2Q2013 earnings season in earnest. Earnings ***pre-announcements*** have been mostly ***negative.*** The ratio of "misses" to "beats" among the pre-announcements at 6:1 is the worst we have seen since Summer 2009 (when the world as we knew it did not quite end)! It will be interesting to see how the earnings numbers pan out, but it is quite obvious that ***corporate managements*** have gotten adept at ***telegraphing their results*** well before earnings are due.

This past week also brought news that the Obama Administration was ***delaying the implementation*** of the employer mandate to provide health insurance under Obamacare (in cases where the company had 50 or more employees) by one year to 2015. Chalk one more up for the good guys, as it was increasingly becoming clear that the ***onerous requirements*** were causing more companies to hire part time workers rather than full time employees. While this is indeed a reprieve, we do expect many of the provisions of this legislation to come into force.

The Federal Reserve's Federal Open Market Committee chose to leave ***the size of quantitative easing*** at the previous level of $85 Billion per month despite much talk of "tapering" by Chairman Bernanke as well as many Regional Federal Reserve Bank Presidents. The minutes of the FOMC meeting held in mid June do suggest that members of the FOMC were slightly less positive about the outcome for growth and inflation over the next six to twelve months.

However, in response to questions as part of the press conference at the conclusion of the FOMC meeting Chairman Bernanke appeared to indicate that the FOMC could well ***begin its tapering later this year*** as long as the labor market continued to heal. Chairman Bernanke did make it quite clear that the decision to "taper" was very much ***"data dependent"*** and not necessarily a foregone conclusion.

Our own opinion has a slightly different (***and perhaps jaundiced***) take on the decision to "taper": While the data might be supportive, the real reason for the tapering might well be Chairman Bernanke's interpretation of his own ***legacy***. Having innovated in the use of ***unconventional policy tools*** to pull the economy out of its deep funk after the global financial crisis, Chairman Bernanke would not like to end his term without charting the course of exit from the use of these unconventional tools.

It is quite obvious that Chairman Bernanke is ***likely to "retire"*** at the end of his term as Chairman next January, even though his term on the Board of Governors does not expire until January 2020. Clearly, Chairman Bernanke would like to be viewed as not only the central banker that "saved the world", but one that used his considerable skills to also chart an ***exit from unconventional policies*** for his successor. This is why beginning the process of tapering later this year is critical from a hand over standpoint.

Overseas data have been mixed: Factory activity figures in Europe have generally been downbeat suggesting further troubles and pain ahead: German Industrial production is up a mere 1.0% (y/y), while that in France is -0.5% (y/y). Similarly, retail sales in Germany have risen 2.5% while those in the Netherlands, on a volumetric basis have shrunk -4.2% (y/y).

The use of the phrase "an extended period of time" by the ***European Central Bank*** in providing forward guidance on administered interest rates is a tactic right out of the Bernanke Fed's playbook. Chairman Bernanke has used this phrase to describe the FOMC's ***reluctance in raising interest rates*** even if the economy appeared to be healing. The FOMC then went on to providing a specific date until which the Fed Funds Target would be held at 0.0%, thus allowing for further healing in the economy through ***higher asset prices***. We suspect that the ECB is at a similar juncture in its conduct of monetary policy as is the Bank of England.

The Board of Governors of the Bank of England picked a Canadian (Mark Carney) to run the old lady of Threadneedle Street. While Mr. Carney has been able to burnish his credentials during his stint at the Bank of Canada (where the Canadian banks were able to navigate the financial crises quite well), it will be interesting to see how Mr. Carney handles future interest rate policy as well as bank regulation – given that Her Majesty's Treasury still owns substantial chunks of at least two major banks in the U.K.

Farther afield, the ***crisis in Egypt*** appears to be deepening: At the time of writing, the army appears to have conducted a coup de tat in Cairo, ousting ***President Morsi*** of the Muslim Brotherhood. It appears that President Morsi had essentially lost some legitimacy by trying to usurp further powers (greater than what was granted to him under the Constitution), but had also become more and more alienated from the common man in the streets of Cairo. Time will tell whether this is a positive, but yet again, this episode points up the inherent risk in emerging markets – ***political stability*** is not what it often seems to be.

In ***summary***, we suspect that ***"talk of tapering"*** might have more to do with Chairman Bernanke's exit from the Federal Reserve rather than any specific improvement in the outlook for growth or inflation in the US economy. With both the European Central Bank and the Bank of England now taking a page from Bernanke's playbook (using the phrase ***"an extended period of time"***), 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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