***<u>Outlook for March, 2014: "A Consolidation…"</u>***

With global equity markets taking a much needed breather (and a pause for reflection as it were), market participants appear to be fearing the arrival of a "bear market". All the extensive macro-economic work that we do, coupled with the intense focus on ***valuation metrics,*** suggests that fundamentals remain supportive of higher equity prices.

We do believe that the ***"easy money"*** in this cycle has probably already been made (given that the bull market just celebrated its fifth birthday earlier this week). The reasons for the rise in equity prices have been many: The Federal Reserves' ongoing largesse with quantitative easing, renewed confidence among corporate chieftains resulting in more stock buybacks and mergers and acquisition activity, as well as improving consumer confidence to name just a few.

The ***real challenge, however, lies ahead of us,*** as the Fed starts to pull back on its accommodation (and perhaps even tightens monetary policy next year) and the economy invariably hits a rough patch or heaven forbid even enters into an inevitable ***cyclical recession.*** We do believe that our intense focus on valuation metrics and the evolving story relating to corporate profits and economic fundamentals will help us navigate these rough and troubled waters.

Economic data released recently remain ***reasonably positive***: The US economy added a seasonally adjusted 175,000 jobs during the month of February despite terrible winter weather affecting large swaths of the country. The economy has added ***on average 168k jobs*** per month in the past twelve months – an anemic growth rate to be sure, but growth nonetheless.

Among ***sectors of the economy,*** Professional and Business Services added 79k, Education and Health Services 33k, and Leisure and Hospitality gained 25k jobs for the month. The beleaguered Information sector was the only one that posted a loss of -16k for February. Average Hourly Earnings rose 9 cents (a gain of 0.4% compared to the previous month) while the Average Workweek fell by a tenth to 34.20 hours per week.

The politically sensitive ***unemployment rate actually rose 0.1% to 6.7%*** as the number of people counted as unemployed in the Bureau of Labor Statistics' household survey rose a seasonally adjusted 223k. The ***U-6 measure*** of unemployment (a more complete indicator of unemployment in the economy) dropped one-tenth to a still high ***12.6%*** for the month.

The Bureau of Economic Analysis of the Department of Commerce pegged ***US GDP growth*** at a seasonally adjusted annual rate of ***2.4% for 4Q2013*** – a regression from 3Q's growth rate of 4.1%. While real final domestic demand disappointed, rising only 1.25% during the quarter, consumer spending rose a reasonable 2.6% for the period. Non-residential Fixed Investment posted a robust gain of 7.3% for the quarter, while housing was a damp squib declining -8.8% for the period. Exports rose 9.4% during the quarter and imports (though much larger than exports in size) rose a more modest 1.5% for the period.

In other data, the Institute of Supply Management's Manufacturing ***PMI*** rose 1.9 points to 53.2 in February implying that the manufacturing economy was still expanding. The Institute of Supply Management's Non-Manufacturing Index however, fell 2.4 points to 51.6. Reported inflation readings remain quiescent with the index of ***Consumer Prices*** (or CPI) rising a benign 1.6% for the year ending in January, 2014. The ex-food and energy measure of CPI also posted a similar benign increase of 1.6% during the same period.

The Federal Reserve appears to be on pace to end its ***Quantitative Easing*** (QE) program toward the end of the current year, ***"tapering"*** its purchases of Treasuries and Agency Mortgages by roughly $10.0 Billion per Federal Open Market Committee meeting. While the FOMC and most senior Fed officials believe that QE has been an unqualified success, ***our own view is a little bit more nuanced***: If the aim of QE was merely to increase asset prices, then it appears to have achieved its aim.

However, much will depend on the manner in which the FOMC structures the ***Fed's exit and the concomitant shrinking of its Balance Sheet*** that is required for such a move. After all, the Federal Reserve has essentially ***quintupled*** the size of its Balance Sheet from around $800 Billion (pre QE 1.0 in September 2008) to roughly ***$4,200 Billion currently.*** Something in the far recesses of our brain tells us that the reduction in the size of the Fed's Balance Sheet is ***not likely to be painless*** – and we, along with many others will be rather interested observers of this process.

Janet Yellen the new head of the Federal Reserve (apparently she prefers to be called the Chair of the Fed – which we refuse to do, as a Chair is an inanimate object and not a person!) made an impassioned plea to continue to keep the ***"plight of individual Americans"*** in mind when making policy decisions at a speech at her ceremonial swearing-in on March 5th. My, how far we have come: We would be hard pressed to imagine the mercurial Paul Volcker or even the cerebral Alan Greenspan give such a speech at any occasion, let alone their ceremonial swearing-in.

Farther afield, much newsprint has been expended on Vladimir Putin's incursion (some call it annexation) into ***Ukraine and Crimea***. Despite all the gnashing of teeth and hand wringing among European and Western leaders, it is quite clear that none of the countries (including the good old US of A) have any ability to block the ***Russian Bear's foray*** into Crimea. Indeed, with much of the Russian Navy's Black Sea Fleet still stationed at Sevastopol, Crimea represents much in the way of strategic interest to Russia.

Russia is also flexing its muscles using its supply of Natural Gas to Western Europe as a strategic weapon by threatening to cut off Ukraine. Regardless of the outcome of these events, it is abundantly clear to us that securing physical supply of energy (both crude oil and natural gas) has become of vital strategic importance. This leaves both ***Japan and China quite vulnerable***, while the ***US looks to be in the cat bird seat*** (as long as we keep those pesky Canadians happy!).

Reports coming out of China seem to imply that the Chinese economy might be experiencing a ***significant growth slowdown.*** A recent speech by Chinese Prime Minister ***Li Keqiang*** seems to be laying the groundwork for some disappointment around the 7.5% GDP growth target. He used the word ***"flexibility"*** to indicate that a failure to hit the target might not necessarily be seen as a reason for major policy recalibration.

In terms of portfolio shifts during the month, we have ***booked profits in the US REIT fund***, and have redeployed the proceeds into a European Developed Markets fund. We do believe that the ***valuation differential*** between the US and Europe is compelling (in favor of the latter) and wanted to take advantage of this anomaly. Our long and hard search for a European Developed Markets manager has culminated in placing our faith with the manager we have purchased in client portfolios.

As US and Global equity markets pause and consolidate, we feel that valuation metrics imply modest gains going forward. Our asset allocation work continues to favor Equities relative to Fixed Income (with the latter being favored over Cash Equivalents). 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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