<u>Outlook for September, 2014: "A Hail Mary Pass…"</u>

With the National Football League ("NFL") season starting in earnest this weekend, decisions announced by Mario Draghi the President of the European Central Bank appear to be like a ***"Hail Mary Pass"*** to get the European economy out of its funk. The unfortunate connotation of such a move is that it is ***typically a desperate one*** by a quarterback who is heaving a pass deep downfield in the hope that it is caught by one of his receivers rather than anyone from the opposing side.

Economic growth in the US, on balance, has been ***reasonable***: The economy added a paltry 142,000 jobs in August (below consensus expectations around 220k), with the private sector (134k) responsible for a bulk of the gains. The job count for July and June was also revised downwards by an aggregate 28k, further dampening the good feelings that previous jobs reports had generated.

Among the sectors, Professional and Business Services (+47k) and Education and Health (+37k) posted the largest gains while information (-3k) and manufacturing (0k) were the laggards. The unemployment rate ticked down a tenth to 6.1% while the ***U-6 measure*** of under-employment also posted a decline of two-tenths to a still high 12.0% in August. The average work week held steady at 34.5 hours while the average hourly earnings figure rose 6 cents to $24.53 for the month.

Net, net the labor market appears to be ***healing, albeit slowly,*** in keeping with Fed Chairwoman Janet Yellen's speech at Jackson Hole, WY. Despite this being a much heralded speech, it appeared to be one in which Yellen manifested herself almost like a Hindu Goddess with multiple hands (rather than a two-handed economist who says "on the one hand and on the other hand").

While she made it abundantly clear that she was not monitoring just the unemployment rate (for after all, it is just a single indicator and perhaps flawed at that), she did give credence to a ***"labor market dashboard"*** that has been developed specifically for this purpose by her army of Ph.D. economists on the Federal Reserve's staff. Among them were such gems like the participation rate, part-time employment for economic reasons, labor market flows and the pace of hires and quits.

It is important to note that she did successfully ***sow doubt in the minds*** of those Fed and market watchers who were fairly certain that the time for increasing interest rates was nigh. In our opinion, both Janet Yellen and the rest of her Federal Open Market Committee are likely to delay any tightening even if inflation does raise its ugly specter in order to ensure that the economy is on a self-sustaining path.

The Bureau of Economic Analysis pegged ***2Q GDP growth at 4.2%*** (seasonally adjusted annual rate) - an upward revision of two-tenths from the preliminary estimate announced in July. This revision improved business investment spending and exports while data on consumer spending will likely lead to another "final" revision later this month. In other data, surveys of manufacturing and the service sector suggest that the momentum from 2Q appears to have carried over nicely into the 3Q as well.

Farther afield, the European economy appears to have lost significant momentum recently – a devil's cocktail of geopolitical issues in Ukraine, a stronger Euro currency and plumbing issues in the European monetary system. Indeed, European GDP has underperformed - barely growing at 0.7% (quarter-on-quarter seasonally adjusted annual rate) during 2Q14.

In a surprise move, the European Central Bank ("ECB") ***lowered interest rates*** by a further 10bp taking its deposit rate to -0.20% (from the current -0.10%) and promised to purchase asset backed securities and covered bonds issued by European banks. It is expected that these actions will have a significant impact on the ECB balance sheet as well – ballooning it just as the Federal Reserve did with its own balance sheet when it promulgated Quantitative Easing.

The ECB's move smacks of a "Hail Mary Pass" by a desperate quarterback – just as the NFL season gets underway – that time honored rite of passage into the American Fall. The NFL is called "Not For Long" known by many long-term analysts given the proclivities for coaches and players to lose their jobs in a heartbeat – either as a result of the whims of owners or as a result of injury.

We wonder in a similar vein whether the ECB's Hail Mary Pass is likely to be ***"intercepted"*** and the old saying attributed to the great Longhorn Darrell Royal "three things can happen when you throw the ball and two of them are bad" could come true. No doubt, the ECB's move will likely ***propel asset markets higher*** – as equity markets already appear to be telegraphing. It will also push some investors to take on excess leverage, in situations where they can ill afford to take on such additional risk.

In the currency markets, the ECB's move had the effect of weakening the Euro against the US Dollar and the Yen. While a weaker Euro is desired by European exporters of capital goods (making their exports more competitive relative to those of Asian exporters), it needs to be pointed out that a currency rate is a ***relative (and not an absolute) price***. A weaker Euro by definition implies a stronger US Dollar or a stronger Japanese Yen – neither of which is a desired outcome for that country's policy makers.

Unlike the fictional Lake Woebegone ("where all the men are above average"), all currencies cannot weaken against each other! Put simply, a weaker Euro will, by definition, mean a stronger US Dollar – somewhat reversing the Federal Reserve's move to improve economic growth prospects in the United States. A weaker Euro also mitigates moves by the Bank of Japan and Prime Minister Abe in Japan to improve growth there as well.

Ongoing skirmishes in Ukraine between Russian troops, Ukrainian separatists and Ukrainian troops have also conspired to worry market participants about Europe. Russian President Vladimir Putin appears to be painstakingly ***re-engineering the old Soviet Union*** and it is quite clear that he is Machiavellian in the pursuit of his objectives. It does not also help that both the United States and the European Union have reacted in a very muddled fashion to Russia's moves in Ukraine and elsewhere in Eastern Europe.

Events in the Middle East (especially in Iraq and Syria) where a well-organized terrorist group called ***"Islamic State"*** appear to have garnered vast territory and actually have a governance structure and sources of revenue (including oil sales and extortion premiums) are unsettling as well. The brutal beheading of two American journalists underscores the barbaric nature of this group – which seems to be attracting blood-thirsty elements from around the world.

In summary, despite all the geo-political issues around the world, equity markets seem to have an ***upward bias.*** We will continue to remain fully invested with your portfolios given the fundamentals of rising corporate earnings and reasonable valuation multiples. We consider the disciplined nature of successful and long term investment management to be more like ***"running the ball"*** and ***securing the pigskin at all times*** – no Hail Mary passes here!

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