Market & Economic Commentary

Spring 2014

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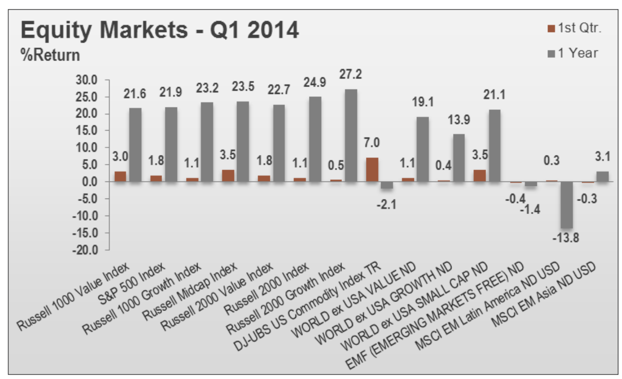
By: Jim Scheinberg - May 27, 2014

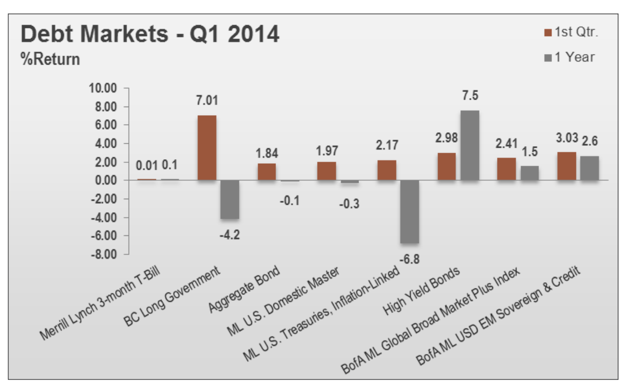
COME-ON-dities!

After an explosive 2013, where most major U.S. stock indices surged well more than 30%, and a fourth quarter that rivaled the best in history, things quieted down rather quickly with the start of the new year. Q1 2014, with its low volatility and modest 1%-3% for returns for both stocks and bonds alike, seemed to put many market watchers to sleep. Even our closely followed economic indicators seemed to solidify in a consistent yet uneventful manner. The most talked about economic news seemed to be the weather, quite literally. With near 30 year record low temps, fears of weather impact seemed to shake things up the most. But in the end, those jitters thawed with the temperatures. Again, to most, a rather uneventful quarter. But something very exciting actually happened in Q1; something that North Pier has been looking and waiting for, for over two years. Commodity prices woke up. And they woke up big.

The DJ US Commodity Index reversed its multi-year decline of nearly 30% in Q1 in dramatic fashion, rising nearly 7%. It continued this momentum through April climbing nearly another 2½%. There is still a long way to go to reclaim the May 2011 highs, but the shift in momentum is extremely encouraging. Why do we think this move is so important? For those of our readers who have had personal conversations with us, you likely remember the head scratching that we've been doing over the decline in global commodity prices. During this time, we were quite vocal and consistent with our opinions of a general global economic recovery. To begin 2013, we foreshadowed the beginning of a broad economic optimism. Last quarter, we reviewed the generally positive and building conditions of the business to business environment in over 15 countries and regions. However, none of this optimism fit a scenario where global demand for raw materials was weak, and corresponding commodity prices in decline. Well that trend seems to have reversed… at least for now.



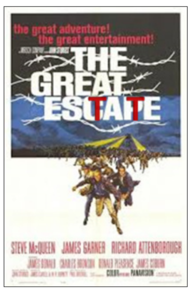
How the Markets Fared



To say that commodities were the only strong performing markets globally in Q1 may be a bit overstated. Long U.S. government and high quality bonds, which got clobbered in 2013, rebounded in Q1. The BarCap Long Government Bond index matched the commodities index's gain of 7%. This was due to a pullback in interest rates after their big run up in 2013. The 10-year Treasury finished the quarter near 2¾% after surging from 1¾% to 3% last year. Long Bond yields declined even more dramatically, pulling back 40 bps from nearly 4% at the beginning of the year. This flattening of the yield curve exaggerated the move in prices on the long end. Other than that, bond returns were generally in line with those of equities. Even the more volatile TIPS and high yield markets were muted with 2-3% gains. Global equities all seemed to align right around that number with most major markets somewhere between flat to up 4%. Domestically, Value indexes slightly outperformed their growth counterparts and larger companies edged out smaller ones. That was not true internationally, where value and growth generally paced each other, and where small companies edged out larger ones. All in, the differences were slight.

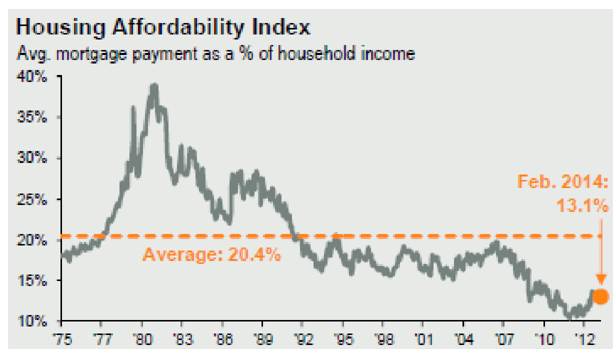
Fourteen So Far

So how are things looking through the first third of 2014? The key elements of economic improvement continue to look promising. As we've stated many times before, the drivers of recovery are the same major areas of weakness that brought us into the financial crisis: real estate, jobs and consumer behavior. Clearly, these were all linked on the way into the last recession, and thus far they have been highly correlated coming out of it.



The Great Estate

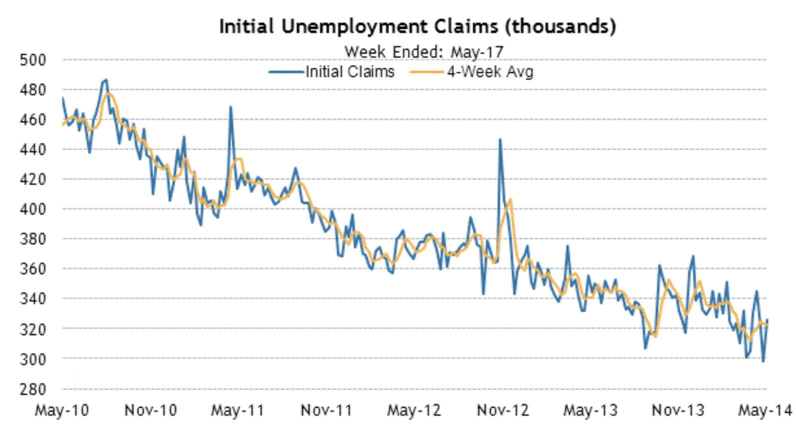
Residential real estate continues to show strong improvement. The March Case Shiller 20-City Index improved better than 12% year-over-year, and now stands nearly 25% off of the lows reached just 24 months ago. This marks an almost 50% recovery of the value lost during the bursting of the 2007 bubble. The pace of growth quarter-over-quarter has slowed, with just a fractional gain in Q1 over Q4 2013, causing some to speculate that the market may have exceeded a reasonable value. At North Pier, however, we believe that this is a digestive phase, as home buyers temporarily lament over missed bargain prices and historically low interest rates. An extremely brutal winter through much of the U.S. also likely contributed to the slowdown. Once potential buyers reassess the clear benefits to purchasing over renting, a new wave of purchases is bound to emerge. Though we're not quite at the record low levels of cost to purchasing a home, affordability is still about 20% more attractive than the best levels seen for the 30 years prior to the crisis. This reality will almost certainly set in, spurring more buying and further price gains.



Source: J.P.Morgan Guide to the Markets; via jpmorganfunds.com

Nice Jobs!

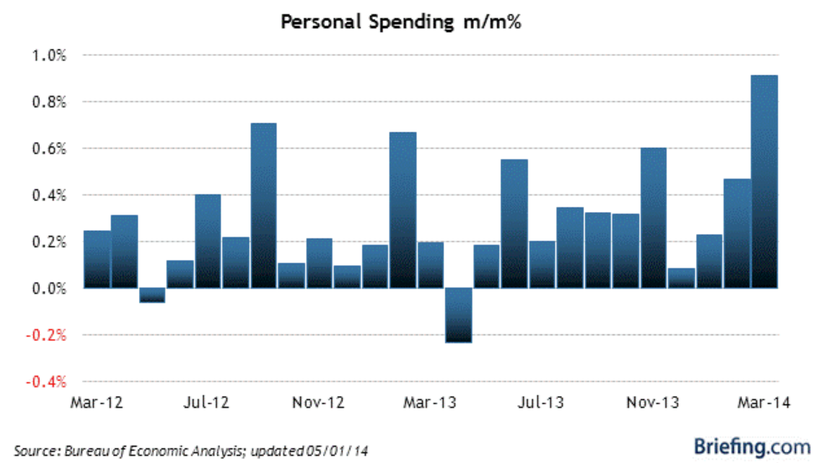
The labor markets continue to heal, and are now adding jobs at the best pace of the recovery. Unemployment claims are at six year lows. Non-farm payrolls saw a better than expected increase of 288,000 jobs in April, and have averaged about 250,000 a month now for the last three months. This is far better than the longer term trend of about 175,000. This new increase in jobs along with further declines in the labor force (partially due to retiring Baby Boomers) shrunk the unemployment rate all the



Source: Department of Labor; updated 05/22/14 way down to 6.3%. If this trend keeps up, it is conceivable that we will reach 5% or less unemployment sometime in 2015, approaching full employment.

Consumer SpenDing-Ding-Ding-Ding!

As nearly 70% of the U.S. economy is still based on consumer spending, this is likely the most relevant gauge in the bunch to get a sense of where we stand at this particular moment. With home prices quickly on the mend and jobs becoming more plentiful, one would expect to see consumers in a better mood. And that they are. Consumer confidence has pushed to post crisis highs over the last few months, now residing near a reading of 83 for both the present situation index as well as future expectations. However, as we have commented on in the past, these readings can prove to be fickle, moving emotionally with a big news story… or even the weather. To confirm this strength we don't just want to know what consumers are feeling, but what they are actually doing. Here too the news is good. Once the record cold weather of January and February abated, personal spending began trending higher, with the March report showing an increase of a powerful 0.9% month over month. This is likely due not only to the increased optimism from consumers, but also to the fact they have more to spend; personal incomes rose 0.5% in March as well.



Back to Business

Given all the supporting news we have been seeing from the consumer sensitive side of the economy, one would hope that business conditions would continue to be constructive. That they are. Domestically, the Institute of Supply Management's Report on Business (ROB) has recovered nicely after a little regression in the winter chilled months. The May manufacturing ROB rallied back near a reading of 55, suggesting sustained above average growth. The Services ROB also showed similar strength, coming in slightly better than 55. In the C-suite, we find optimism as well. The Conference Board Measure of CEO Confidence improved to a two year high in the first quarter of 2014 with a reading of 63, up from 60 in Q4. As with the ROB, readings of more than 50 suggest more positive than negative responses. Lynn Franco, Director of Economic Indicators at The Conference Board, reported that, "both current conditions and expectations [were] improving. CEOs were more positive about short-term growth prospects in the U.S. and Europe, but less positive about prospects for Japan and emerging markets."

So how do those markets look from a business-to-business perspective? Generally, the international Purchasing Manager Indexes continue to look good. We are seeing a slight slow-down in the resource dependent markets of Brazil, Russia and Australia. Further, China continues to weaken, approaching pre-recessionary levels. Japan's growth, as well as broader Asia as a whole, is starting to moderate a bit after boom-like readings a few months ago. Nonetheless, those markets are still showing meaningful strength. Europe generally is on the rise as well, with the stars of the European debt crisis all showing sustained improvement, with perhaps the exception of Greece. We at North Pier believe that the Euro-zone holds the best chance for an upside surprise as we move into the second half of 2014.

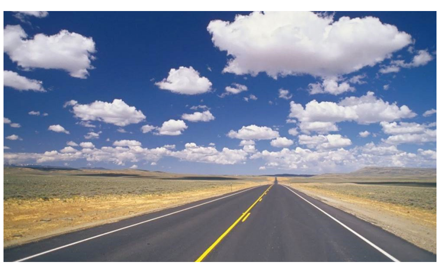
Global Purchasing Manager's Index for Manufacturing

	2012				2013												2014		
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Global	48.7	48.9	49.6	50.0	51.5	50.9	51.2	50.4	50.6	50.6	50.8	51.6	51.8	52.1	53.1	53.0	52.9	53.2	52.4
U.S.	51.1	51.0	52.8	54.0	55.8	54.3	54.6	52.1	52.3	51.9	53.7	53.1	52.8	51.8	54.7	55.0	53.7	57.1	55.5
Canada	52.4	51.4	50.4	50.4	50.5	51.7	49.3	50.1	53.2	52.4	52.0	52.1	54.2	55.6	55.3	53.5	51.7	52.9	53.3
U.K.	48.2	48.0	48.4	50.7	50.9	48.2	49.3	50.6	52.1	53.0	54.7	57.3	56.7	56.5	58.1	57.3	56.7	56.2	55.3
Euro Zone	46.1	45.4	46.2	46.1	47.9	47.9	46.8	46.7	48.3	48.8	50.3	51.4	51.1	51.3	51.6	52.7	54.0	53.2	53.0
Germany	47.4	46.0	46.8	46.0	49.8	50.3	49.0	48.1	49.4	48.6	50.7	51.8	51.1	51.7	52.7	54.3	56.5	54.8	53.7
France	42.7	43.7	44.5	44.6	42.9	43.9	44.0	44.4	46.4	48.4	49.7	49.7	49.8	49.1	48.4	47.0	48.8	49.7	52.1
Italy	45.7	45.5	45.1	46.7	47.8	45.8	44.5	45.5	47.3	49.1	50.4	51.3	50.8	50.7	51.4	53.3	53.1	52.3	52.4
Spain	44.5	43.5	45.3	44.6	46.1	46.8	44.2	44.7	48.1	50.0	49.8	51.1	50.7	50.9	48.6	50.8	52.2	52.5	52.8
Greece	42.2	41.0	41.8	41.4	41.7	43.0	42.1	45.0	45.3	45.4	47.0	48.7	47.5	47.3	49.2	49.6	51.2	51.3	49.7
Ireland	51.8	52.1	52.4	51.4	50.3	51.5	48.6	48.0	49.7	50.3	51.0	52.0	52.7	54.9	52.4	53.5	52.8	52.9	55.5
Australia	43.0	42.8	44.3	44.3	40.2	45.6	44.4	36.7	43.8	49.6	42.0	46.4	51.7	53.2	47.7	47.6	46.7	48.6	47.9
Japan	48.0	46.9	46.5	45.0	47.7	48.5	50.4	51.1	51.5	52.3	50.7	52.2	52.5	54.2	55.1	55.2	56.6	55.5	53.9
China	47.9	49.5	50.5	51.5	52.3	50.4	51.6	50.4	49.2	48.2	47.7	50.1	50.2	50.9	50.8	50.5	49.5	48.5	48.0
Indonesia	50.5	51.9	51.5	50.7	49.7	50.5	51.3	51.7	51.6	51.0	50.7	48.5	50.2	50.9	50.3	50.9	51.0	50.5	50.1
Korea	45.7	47.4	48.2	50.1	49.9	50.9	52.0	52.6	51.1	49.4	47.2	47.5	49.7	50.2	50.4	50.8	50.9	49.8	50.4
Taiwan	45.6	47.8	47.4	50.6	51.5	50.2	51.2	50.7	47.1	49.5	48.6	50.0	52.0	53.0	53.4	55.2	55.5	54.7	52.7
India	52.8	52.9	53.7	54.7	53.2	54.2	52.0	51.0	50.1	50.3	50.1	48.5	49.6	49.6	51.3	50.7	51.4	52.5	51.3
Brazil	49.8	50.2	52.2	51.1	53.2	52.5	51.8	50.8	50.4	50.4	48.5	49.4	49.9	50.2	49.7	50.5	50.8	50.4	50.6
Mexico	54.4	55.5	55.6	57.1	55.0	53.4	52.2	51.7	51.8	51.3	49.7	50.8	50.0	50.2	51.9	52.6	54.0	52.0	51.7
Russia	52.4	52.9	52.2	50.0	52.0	52.0	50.8	50.6	50.4	51.7	49.2	49.4	49.4	51.8	49.4	48.8	48.0	48.5	48.3

Source: Markit, J.P.Morgan Guide to the Markets; via jpmorganfunds.com

PIER*ing* Ahead

For those of us who have driven across the country, you know those stretches where all you see is straight highway for what seems like an eternity? You drive 40 miles up a small ridge only to find the road doesn't turn and stretches directly ahead out to the horizon again. That's where we find ourselves a quarter into 2014. All our themes and projections continue on, supported with three more months of confirming data. The global recovery seems to in fact be firming. We suggested last quarter that The World Bank would prove correct in their prediction of generally improving and stable growth in 2014. Now with the last piece of the puzzle, commodity prices, supporting instead of contrasting this theory, we truly believe… again… that we are "off to the races."



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