Market & Economic Commentary

Spring 2015

Jim Scheinberg CIMA® AIFA®
Managing Partner

w 800 403 7065 x272
e jim.scheinberg@npier.com
www.npier.com

The information and statistical data contained within are from sources which North Pier Fiduciary Management, LLC believes to be reliable but in no way warranted by us to accuracy or completeness. North Pier does not undertake to advise you as to any change in figures of North Pier's views. This is not a solicitation of any order to buy or sell. North Pier, our affiliates, and any Officer, Director or Stockholders, or any member of their families, may have a position in and may from time to time purchase or sell any of the herein mentioned securities.

Market & Economic | Spring 2015

By: Jim Scheinberg - May 29, 2015

Swimming Against the Currency

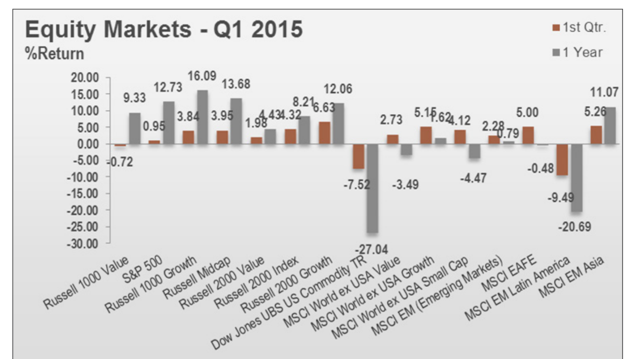
In our Winter issue, we highlighted the dynamic created by last year's massive rally in the U.S. dollar. Just one short quarter later, we are seeing the effects of that dynamic play out… in a very big way. To review our prior observation:

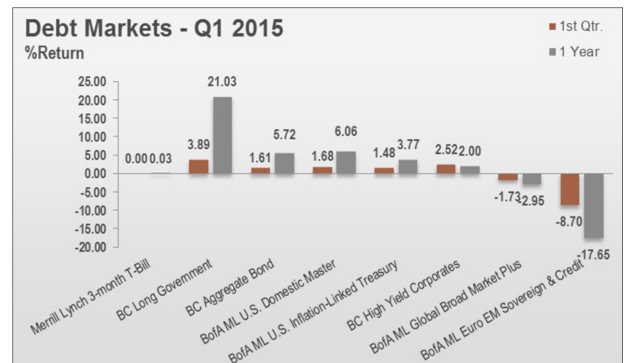
> *[T]he U.S. dollar rallied 10% versus the euro last year. Companies from Apple to PfiZer are reporting headwinds due to the appreciating U.S. currency making their products and services less affordable overseas… [C]urrencies always [have] a winner and a loser, this time its European firms that are gaining an advantage."*

Though the U.S. equity markets continued to advance during the First Quarter, it was European stocks that took the lead. This is to be expected as U.S. multinationals find it more and more difficult to compete against their European peers. Every data-point that we will review this quarter (as well as the year to come) must be examined with this revaluation in mind. The U.S. economy, in dollar terms, is facing a statistical headwind of remarkable proportions. If we can maintain our numerical growth during this adjustment period, it will be a testament to our strength. And it may well be the shot in the arm that Europe needed to join the party.

How the Markets Fared

Developed international markets (as measured by the EAFE) rallied nearly 11% in their own currencies during the first three months of the year, having their best quarter in over five years. U.S. investors in those markets didn't feel all of those gains due to an additional 11% fall of the euro vs. the dollar. Even measured in dollar terms, the MSCI EAFE was up an impressive 5% vs. just 1% for the large cap dominated S&P 500. Smaller U.S. companies, which are historically less sensitive to currency swings, outperformed large caps by over three percentage points. The same was true for growth-oriented names, whose prices are pinned more towards their products and less based on the cyclical nature of global competition (think Facebook vs. Proctor & Gamble). The performance of emerging market stocks (EM) followed this logic. Consumer product focused Asian emerging markets were also up around 5% during the quarter, while the commodity-sensitive Latin emerging countries were down over 9% (commodity prices declined another 4% in Q1 after last year's massive drop).

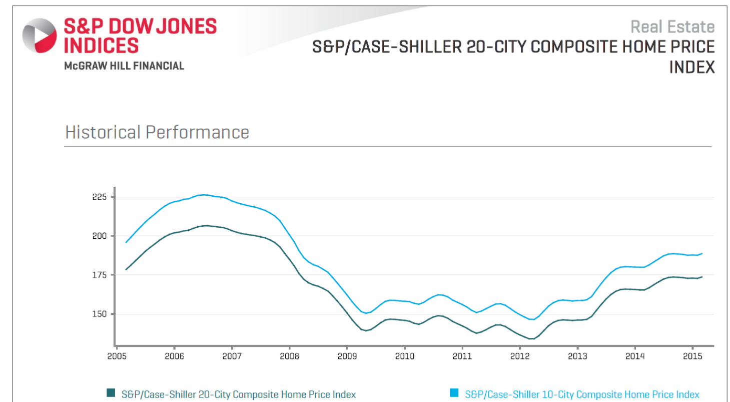




U.S. fixed income markets saw a fair amount of volatility during the quarter. The yield on the benchmark 10-year Treasury declined during the quarter from 2.17% to 1.93%, trading as high as 2.25% and as low as 1.67%. This helped the BarCap Intermediate Aggregate Index post another 1.6% return. Inflation-protected bonds saw similar gains. The high yield market reversed Q4's losses with 2.5% gains, as confidence in the economy helped credit spreads narrow. Renewed appetite

for risk in the debt markets also helped emerging market debt prices recover as well. Despite the continued advance in the U.S. dollar, EM debt managed to tack on nearly 3% during the quarter. The same could not be said for developed market debt, wherein upside performance, when measured in their own country currencies, could not overcome the relative strength in the dollar, resulting in continued declines.

Real Estate Re-rallying?

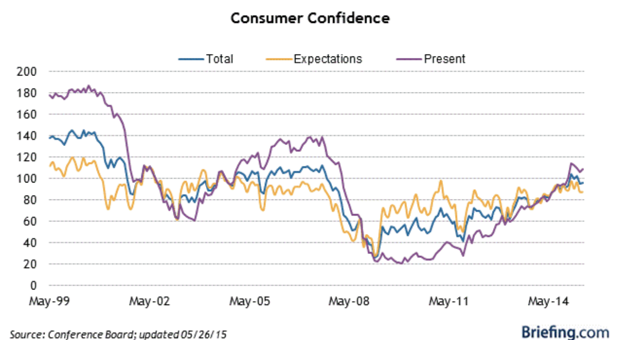


It looks like the deceleration in home price appreciation that we've seen over the last several months appears to be ending. As the spring selling season gets underway, home prices are starting to show initial signs of improvement. After a big double digit spike in 2012 and 2013 off the lows, gains had slowed to 4.3% year-over-year. The April report now shows them moving up 5.5% (NAR existing homes). An area that has been a point of complaint, inventory, is starting to show signs of improvement as well. Houses available on the market increased 10% in April to 2.21 million for a 5.3–month supply, which was up from 4.6 months the prior month. Real Estate professionals had said that it was the lack of quality homes on the market that had been responsible for the slowdown in sales (not a logical conclusion but nonetheless, plausible in the current environment). Low supply should be good for pricing; however if it's too low, the market may frustrate some buyers. Help might be on the way with new units as well: housing starts jumped 20% in April on top of a 2% upward revision to the March number. Builders are a-building. All this suggests that the atypical spike off of the lows and then the digestion phase that followed may be over and we may be entering a normal and healthy real estate market.

Yaybor Markets

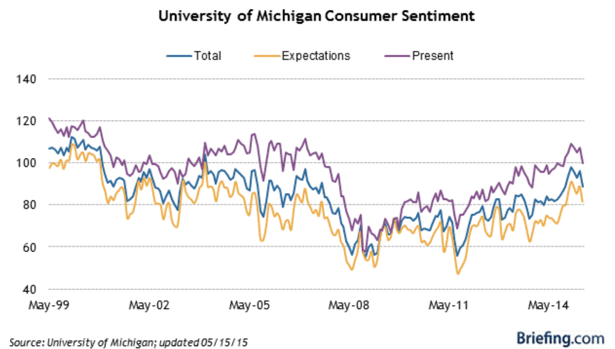
The jobs market in the U.S. continues to improve, now approaching 'healthy' levels. Lately we've been hiring here at North Pier, and I can tell you, talented people are harder to find and cost a fair amount more than they did just a couple of years ago. Nationally, unemployment has dropped to 5.4%, which is now back in what most would consider a normal range, and certainly is at a post economic crisis low. Further, real wages continue to climb. Wages and salaries increased 1.1% in Q1 alone. Wage growth, or lack thereof, was a real complaint during the early years of the recovery. Now that there is a better balance between supply and demand, further improvements are likely.

Everyone Loves a Winner (Especially the Winner)



Consumer sentiment, as measured by both the University of Michigan and Conference Board, reached post-crisis highs during the First Quarter. In fact, the consumer is now nearly as confident as they were prior to the end of the Dot-Com boom in 2000. And why wouldn't they be? In addition to a strengthening jobs market and healthy growth in residential real estate, gas prices are relatively low and the stock market is firm. With wages up, consumers are starting to take on more debt, with consumer

credit rising at about a 7% year-over-year pace. Even with the expansion in the use of credit, household debt service remains near a 35 year low. Further, the personal savings rate remains well above 5%, a very healthy clip. The average American's fiscal house seems to be well in order, which is something to feel confident about. The question is, is all this optimism sustainable? And if so, for how long? The Consumer Confidence Index declined into the 95 range in April and May from a 101.4 in March led by over an 8 point drop in the expectations component of the index. The University of Michigan data, showed a similar drop in May. Will this be the begging of a trend or just a one month blip?



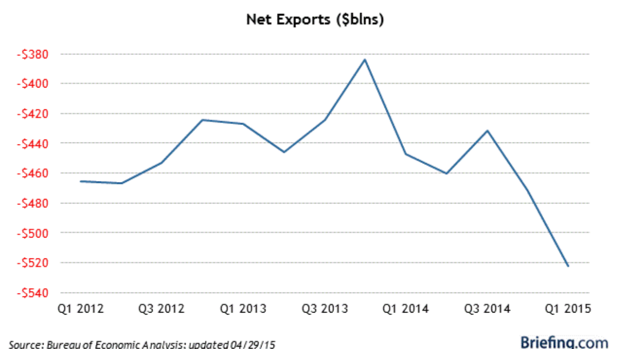
A Tale of Two ISMs

On the business front, the service sector in the U.S. is humming along well. The April Institute of Supply Management Report on Business showed its non-manufacturing (services) index rising to 57.8% (readings above 50 indicates expansion). This data suggests that the services sector is likely to enjoy further advancement in the coming months. This logically tracks our euro/dollar-theme, as services naturally tend to be more domestically-focused. The manufacturing side of the coin, however, tells a completely different story: the manufacturing index from ISM, which is much more sensitive to international trade and currencies, has pulled back to just 51.5% in the last two months. Though still showing growth, these numbers are certainly not robust. Further evidence of the two very different conditions facing our economy is the fact that the vast majority of job growth has been in the services sector for the last several months.

	APR	MAR	FEB	JAN	DEC
Manufacturing	1k	0k	3k	17k	19k
Service-Providing	182k	115k	241k	151k	255k

The dollar's a real drag, man.

Exports decreased a staggering 7.2% in the first quarter… again in U.S. dollar terms. The strong dollar led to a 1.8% increase in imports during the period as well. This was despite a labor lock-out in the country's largest port, in Los Angles, which had goods backed up over a month. This caused the trade deficit to swell nearly 10% to $522 billion in Q1. That's a $50 billion jump in just one quarter! Briefing.com reports that this increase in the trade-gap reduced first quarter GDP growth by 1.25 percentage points. Yet, the U.S., in dollar terms, still managed to post fractional gains of 0.2% in GDP. I can't emphasize this enough: *the move in the dollar is by far the most potent wild card in the global economic deck*. The currency winds that are Europe's back are clearly blowing across the Atlantic, right into our face.



PIER*ing* Ahead

Since the Euro bottomed at 105 vs. Dollar in March, it has rebounded nearly 7%. Assuming global exchange rates stabilize, economies should normalize around these new levels. The U.S. economy has proven to be remarkably resilient, despite the competitive disadvantage dealt to our large multinationals. I have no doubt that it will take a few quarters for the new "norm" in currencies to fully work their way through the earnings cycle. Further, domestic economic reports are likely to show signs of slowdown… when observed in Dollar-terms. If one keeps the impact of the rally in the Dollar in their perspective, they will realize that things are likely stronger than the numbers would indicate. Investors should be mindful that if looked at through a more global lens, our data is actually likely to continue to be strong. Investors should beware that it will likely take three to four quarters for comps to fully factor the net results of the revaluation. The investment media will not likely dissuade concerns with a sage viewpoint, so volatility should be expected as the year unfolds. Across the pond, the decline in the Euro should continue add stimulus to their economic engine that has been sorely lacking. Initial data for EU GDP suggests 0.4% growth for the quarter resulting in 1.6% for the trailing 12 months. This is a marked improvement over the last few years of malaise. Though ECB quantitative easing will likely get the credit, it is the cheap Euro that will continue to lift economic conditions for the region. At least that's our PIER*spective.*

Jim Scheinberg CIMA® AIFA®
Managing Partner