Market & Economic Commentary

Summer 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.

THE NORTH PIER*spective*

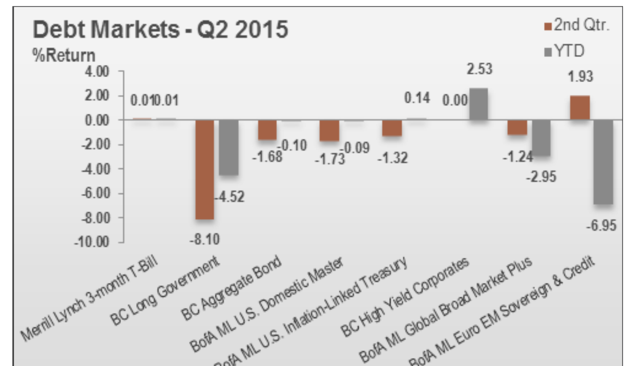
Market & Economic | Summer 2015

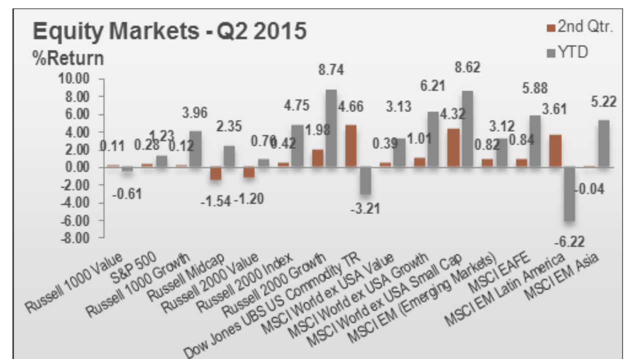
By: Jim Scheinberg - August 6, 2015

It All Sounded Greek to Me. Can Anyone Read Chinese?

Once again Greece and China dominated the headlines in the Second Quarter. Uncertainty about the broader implications for the EU – if a workable solution could not be found for Greece – cast a shadow of doubt over global markets. Unlike the prior incarnations of the European debt crisis in years past, the other PIGS nations (Portugal, Ireland, and Spain) are all seeing strong economic recoveries. Thus, the spread of a potential contagion was absent. The main point of the discussion was more about the confidence in the institution of the EU as a whole. A case of political-ego. Further dampening confidence was the state of the Chinese economy, which appears to be slowing down to a disappointing 6½% growth-rate for the next couple of years. Domestically, the U.S. continued to show economic resiliency. The result was a quarter with muted market moves, either up or down.

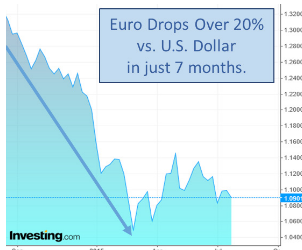
How the Markets Fared





The Federal Reserve seemed to be inching closer towards its first monetary tightening in 8 years. This was likely the reason Treasury yields climbed during the quarter, with the bellwether, 10-Year rising from 1.93% to 2.34%. Losses in high quality bonds resulted in the BarCap Aggregate wiping out all of its gains for the year. Waning confidence in the U.S. economy caused credit spreads to widen modestly. In the high yield arena, coupon returns were completely offset by price declines, resulting a net zero for the period. Emerging market debt improved in all major regions, mostly from currency rebounds against the U.S. Dollar. Commodities in general also rebounded after the trouncing they took over the last few quarters, but still show losses for the year.

Globally, equity markets took a pause. The U.S. large cap indexes were up a fraction of a percent, as were their developed market international peers. There was no leadership from neither the value nor growth side of the spectrum. Domestic small caps faired only a hair better. Here, there was a decisive advantage in the tech and biotech weighted growth areas. International small caps enjoyed the best gains of the quarter. Latin American stocks rebounded about half way after a rough Q1 while the rest of the EM was mostly flat.



Ex"poor"ts

Exports continued along near the same depressed levels of last quarter. As we discussed in depth in our Spring Commentary, "[t]he currency winds that are Europe's back are clearly blowing across the Atlantic, right into our face." This trend in international trade continued in the second quarter. According to the Census Bureau, total exports of goods dropped

$43 billion or 5.6% for the first six months of the year compared to the same period in 2014. Usually boring, consumer products companies in the U.S. with seemingly stable sales, like Procter and Gamble, are seeing revenues decline 10% or more year-over-year while European-based companies like AG Bayer are seeing increases of the same amount… in U.S. dollar terms. Their upside surprises in Euros are even more dramatic. It is likely to be another two to three quarters before the year-over-year comparisons are based on this new exchange rate. Until then, earnings reports are likely to be skewed dramatically in both directions.

At Your Service!

The latest Institute of Supply Management Reports on Business confirms our theory. While the international trade sensitive manufacturing sector seems to be struggling to maintain growth, the more domestically focused services side of the U.S. economy is roaring ahead. In the RoB Manufacturing report for July declined to 52.7, still indicating modest growth ahead, but far from the last summer's peak of 58 (before the Dollar surged against the Euro and other major currencies). This was caused in part by the export data declining to 48, indicating further contraction ahead. As a reminder, a number above 50 suggests expansion; below 50 indicates contraction. More troubling is that the backlog of orders pulled back to 42.5. Prices decreased from 49.5 to 44 in just one month. This suggests that U.S. Exporters are cutting prices (and digging into profit margins) in order to stay competitive with their overseas rivals.

However, the July Non-Manufacturing (AKA services) report surged ahead 4.3 points to 60.3, its highest level post-crisis. This was due to a jump in productions and new orders. Arts, Entertainment & Recreation; Educational Services; and Retail Trade; Real Estate, Rental & Leasing topped the areas of growth. Clearly these are domestically driven industries, which would not be nearly as susceptible to the elevated Dollar as the Manufacturing sectors showing contractions: Wood Products, Primary Metals, Plastics & Rubber Products, Chemical Products; and Machinery.

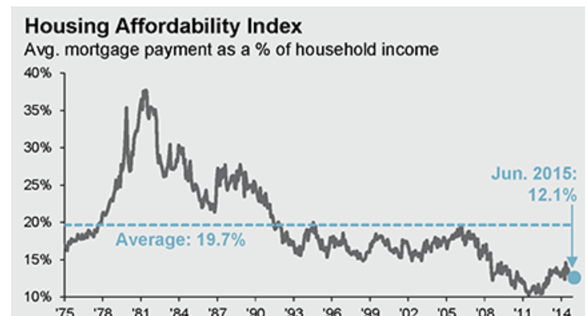
It's worth noting that of all the jobs created in the United States this year, virtually all of them have come from the services side of the economy.

	FEB	MAR	APR	MAY	JUN
Goods-Producing	20k	-20k	16k	4k	1k
Service-Providing	241k	137k	185k	246k	222k

Establishment Survey of U.S. Jobs Created

Homeward Bound

U.S. home owners continue to benefit from steady, and apparently sustainable growth. Median home prices rose 6.5% over the same time last year, finally eclipsing the peaks of 2006. The Case Shiller data (20 City Index for May) confirmed that strength, showing gains of 1.1% over April and 5% year over year. Existing home sales improved by another 3.2% in June, now to a healthy 5 1/5 million units per month. Many speculate that the higher and higher prices and increased mortgage rates after the Fed raises discount rates will reduce affordability and dampen demand. However, with average mortgage rates still hovering in the low 4% range, there is

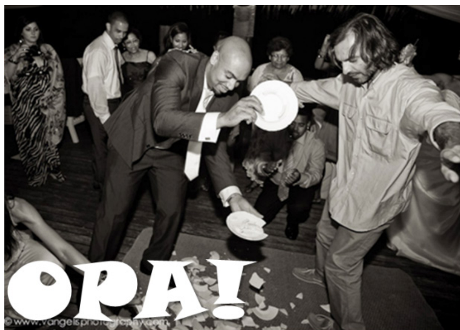


Source: JPMorgan Asset Management, Guide to the Markets

plenty of room for interest rates to rise before affordability becomes more than a slight physiological factor for buyers. (See chart right) More likely is that with the first rate increases, there will be rush of buyers that don't want to miss out on historically low borrowing costs.

'Mericans

All in all, things are looking pretty good for most Americans these days. The labor markets continue to improve. We continue to average more than 200,000 new jobs a month; a trend that has been steady for several quarters now. This has helped whittle the unemployment rate down to 5.3%. Now that supply in the labor market has come back into balance with demand, personal income is growing nicely. Personal income increased 0.4% in each of the months of April, May, and June. Jobs a-plenty, increased earnings, and growing home values should have the consumers feeling pretty comfy about things, and they do. The University of Michigan Consumer Confidence Survey is still showing that people's present situation index is well over 100 – a very optimistic level. However, there is something a bit troubling in the survey data; future expectations continue to decline. It seems that Americans are quite happy with their lot today; but are growing dubious that the good times will continue. Whether this is foreshadowing of things to come or simply a case of Post-Traumatic-Crisis-Syndrome remains to be seen. But for now, in the face of troubles in Greece and a slowing Asia, Americans are still standing tall.



PIER*ing* Ahead

We view the Greek story as a major distraction. There is no 'next country' to fall anymore. Unless Greece is allowed to exit the Euro, letting their currency devalue to reduce debt and stimulate their economy, the EU will need to continue to bail them out time and time again. Either way, this is a non-issue in our eyes. The Greek economy is smaller than that of the city of Boston's and roughly one-tenth the size of Germany's. One way or the other, this issue should fade from the headlines again, as it has in years past.

What is important, but what seems to get shockingly little attention is the story of the U.S. Dollar. The drama of the fall of the Euro seems to have ended in March. Since then, currencies appear to have stabilized around the "new norm." However, we will continue to see trade and corporate earnings implications in both the European and our domestic economies for the next few quarters. Benefitting from the cheaper Euro, most of the EU is now on track for modest growth. However, Asia looks to be facing a regional headwind, everywhere except for Japan. Domestically, key drivers of growth still look encouraging – some, albeit at more tepid levels. Though U.S. GDP improved to 2.3% in the second quarter, we still believe that expectations for the second half are overly optimistic due to continually weak exports, again created by the strong Dollar. How deep the impact of the trade imbalance turns out to be is unknown. If the domestic components cannot continue to make up the slack for weak trade numbers, a meaningful pullback in the U.S. markets is likely. However, there is a chance that things like strong labor, housing, and consumer spending will more than offset the drag from poor exports. Regardless, we would view any correction as aberrational, and as a buying opportunity. Once year-over-year comparisons fully reflect the new higher valuation of the Dollar, comparisons should improve. At that point, we see a strong acceleration in all U.S. data, both from manufacturing as well as service sector. With a strong U.S. consumer and a strengthening European economy, export-sensitive Asian economies should firm as well. From our PIER*spective*, all of this should come together by Spring/Summer 2016. At least we Opa!