BRIEF REFLECTIONS

May 1, 2013

Outlook on the Economy:

The U.S. economic recovery appears to be intact during the first quarter. Despite the impact of the payroll tax hike and higher gasoline prices on real incomes, first quarter real consumption growth is on course to increase at an annual rate of 2.0%. The key economic indicators have strengthened, orders and production are rising rapidly, and employment growth confirms our moderate expansion forecast. The housing rebound continues to gather pace, boosting net wealth and construction activity. Fiscal policy however, remains a downside risk, with the possibility that budget negotiations break down and again threaten a government shut-down later in the year, and the euro-zone crisis still staggers on.

Nevertheless, with the Federal Reserve likely to keep monetary policy unusually loose, we expect first quarter GDP growth to come in at 2.3% annualized or better with a further pick-up to the 2.5% rate later this year. Any weakness in the U.S. expansion in the near term will further encourage the Fed to remain supportive of its asset purchase program.

Overall, while many U.S. economic statistics are improving, investors are still quite cautious with respect to the effect that austerity measures, both global and domestic, will have on economic growth. This is evident in the performance of the market so far this year. As the market raced ahead 10.6% in the first quarter alone, the reining sectors were defensive in nature. Healthcare led the rally, followed by Consumer Staples and Utilities. The wealth effect and its ability to mitigate the impact of budgetary cuts is crucial to sector performance in the months ahead. In response to fiscal tightening, we have witnessed a number of downward revisions by economists with respect to GDP expectations and earnings, leading us to believe that much of the potentially negative impact is already priced into the markets.

Investor anxiety has resurfaced in recent weeks, aggravated by the sell-off in commodities/gold, a drop in Treasury yields, and weakish economic data coming from both China and Europe. This has raised concerns about the sustainability of global growth. These macroeconomic headwinds continue to have an impact on the day-to-day volatility in the marketplace, and as always are sporadic and unpredictable. Individual stocks don't always move in the anticipated direction and therefore trade at absolute or relative premiums/discounts throughout any given cycle. Our value-oriented investment style, our "anchor to windward" in stormy weather, allows us to build positions in companies that we believe are currently undervalued and present long term investment potential. As we often remind clients, investors should be careful not to let daily price fluctuations become a distraction from their long term investment objectives. Characteristically, the lower multiples (price-to-book, price-to-earnings, and price-to-sales) produced by lower expectations lay the foundation for renewed leadership, and should result in outsized corporate profits and subsequent superior investment performance in an inefficient world.

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