Economic & Market Review

~ February 2014 Investment Newsletter ~

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Monthly Summary

A widely expected acceleration of economic activity in 2014 has thus far proven illusive. Fourth quarter annualized GDP growth was revised lower (3.2% to 2.4%), and consumer confidence, already off the highs of 2013, fell in February from a downwardly revised level in January. Higher mortgage rates and limited inventory have cooled housing markets, and retail sales, led by disappointing auto sales, contracted sequentially in both December and January. Manufacturing activity has been lackluster as well. A sizable drop in January's purchasing manager's manufacturing index was confirmed by declines this year in durable goods orders, industrial production, and capacity utilization. Labor markets have also not supported the theme of faster expansion. Disappointing payroll gains in December, initially dismissed by many as a transient data point, repeated in January. In short, as illustrated below by the drop in Citigroup's Economic Surprise index, economic reality has fallen short of hopes and the trend is not encouraging.

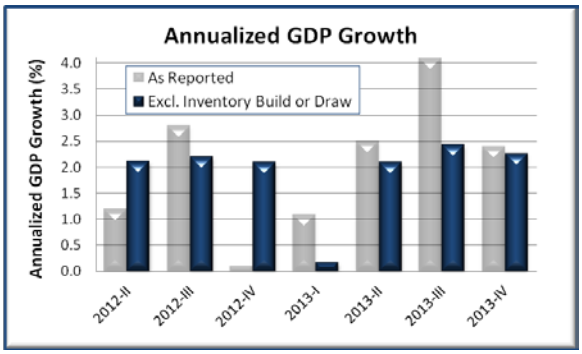
Despite overwhelmingly disappointing economic results, investment markets rallied strongly in February. Two themes have emerged to explain the paradox. The first suggests short-term weather related challenges have masked an otherwise healthy economy. The second camp, less sanguine than the first, places faith in a sympathetic Fed slowing its pace of tapering. Although many factors argue against both theories, investors may not have clarity until post winter data emerges in April and May.

Economic Data

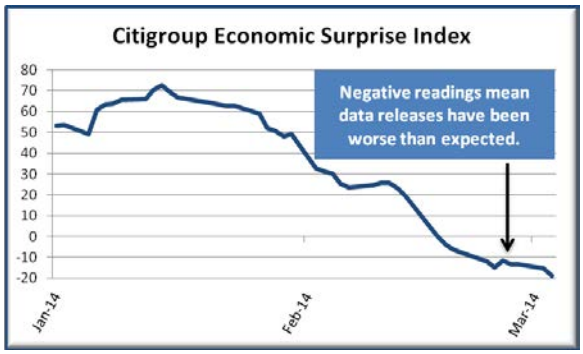
General	Prior	Current
GDP growth	4.1% (Q3)	2.4% (Q4)
Trade balance	-$34.6 B (Nov)	-$38.7 B (Dec)

Employment	Prior	Current
Initial jobless claims	334,000 (2/15)	348,000 (2/22)
Continuing claims	3.0 MM (2/8)	3.0 MM (2/15)
Change in nonfarm payrolls	75,000 (Dec)	113,000 (Jan)
Unemployment rate	6.7% (Dec)	6.6% (Jan)
Average weekly hours	34.4 (Dec)	34.4 (Jan)

Consumer	Prior	Current
Consumer confidence index (Conf. Board)	79.4 (Jan)	78.1 (Feb)
Retail sales growth (YoY)	3.7% (Dec)	3.0% (Jan)
Change in consumer credit	$12.4 B (Nov)	$18.8 B (Dec)



Data Source: U.S. Department of Commerce

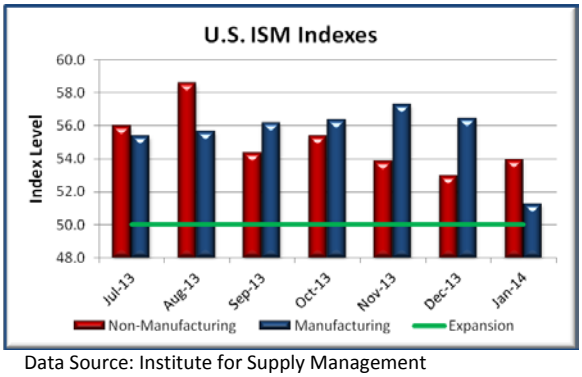


Data Source: Bloomberg

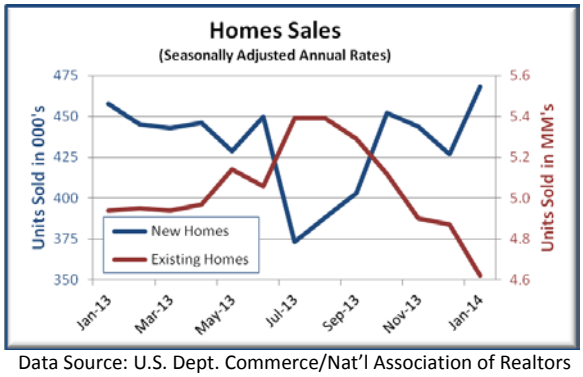
Manufacturing & Service	Prior	Current
ISM manufacturing index	56.5 (Dec)	51.3 (Jan)
ISM non-manufacturing index	53.0 (Dec)	54.0 (Jan)
Durable goods orders growth	-5.3% (Dec)	-1.0% (Jan)
Industrial production growth	0.3% (Dec)	-0.3% (Jan)
Capacity utilization	78.9% (Dec)	78.5% (Jan)

Real Estate	Prior	Current
New home sales	427,000 (Dec)	468,000 (Jan)
Existing home sales	4.9 MM (Dec)	4.6 MM (Jan)
Case-Shiller home price index (YoY)	13.7% (Nov)	13.4% (Dec)

Inflation	Prior	Current
Consumer price index/Core (YoY growth)	1.5%/1.7% (Dec)	1.6%/1.6% (Jan)
Producer price index/Core (YoY growth)	1.1%/1.2% (Dec)	1.2%/1.3% (Jan)



Data Source: Institute for Supply Management



Data Source: U.S. Dept. Commerce/Nat'l Association of Realtors

Market Returns

The S&P 500 gained 4.6% for the month and is now up 1.0% for the year. Developed international equity markets, as defined by the MSCI EAFE index, were up 5.6% in February while the MSCI Emerging Markets index rose 3.3%. Dollar weakness, in aggregate, lifted monthly returns for U.S. dollar based investors. Year-to-date, international developed and emerging markets have returned 1.3% and -3.4%, respectively.

In the fixed income market, the Barclays U.S. Aggregate index gained 0.5% for the month, and the yield on the 10-year U.S. Treasury note ended essentially flat at 2.66%. For the year, the Barclays U.S. Aggregate is up 2.0%. High yield credit spreads plummeted 40 basis points during the month to end at a new post-crisis low of 3.81%. The Barclays High Yield index gained 2.0% in February and is up 2.7% so far this year. International bonds gained 2.0% for the month and are now up 2.8% for the year-to-date. In other markets, the DJ U.S. Real Estate index gained 4.7% for the month while commodities tacked on an additional 6.2% on top of gains from January. Year-to-date, real estate and commodities are up 8.5% and 6.6%, respectively.