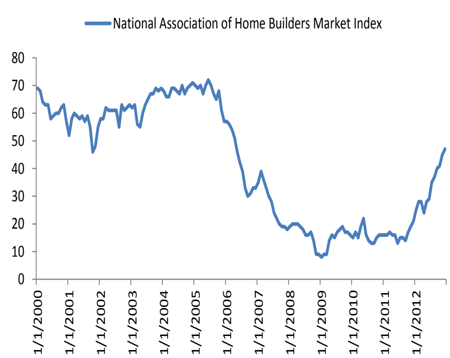
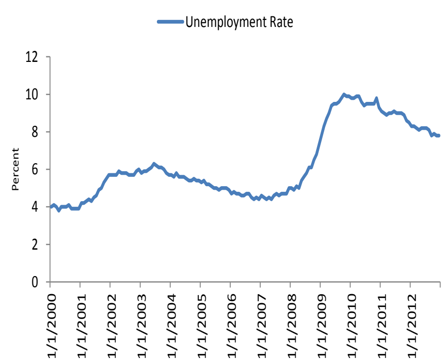
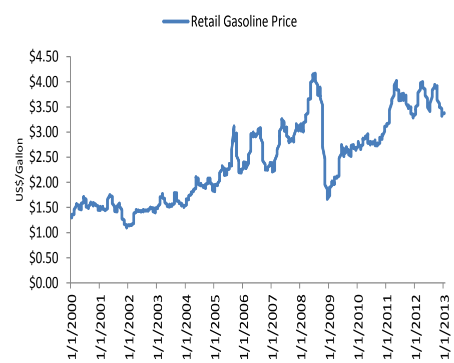
Monthly Commentary January 21, 2013

The U.S. economy continues on an unremarkable but steady growth path despite the efforts of politicians in Washington to be a hindrance to that growth. Unemployment is improving, housing has turned positive, and gasoline prices have declined providing a boost to the ability of the consumer to spend. These are just a few measures of an economy in recovery, although not yet strong enough to be self-sustaining. Hence, Fed Chairman Bernanke continues to provide stimulus through quantitative easing and near zero interest rates. We are going into year 5 of this recovery, so it is not young, but it is relentless. We are of the belief this economy would be much stronger if not for the uncertainties engendered by the infighting and political gridlock in Washington. If there were to be a positive resolution to these uncertainties, we can envision a release of pent up demand that would lead to renewed capital spending and hiring and more robust growth.







The avoidance of "the fiscal cliff" was an example of the "brinkmanship" that is now the norm. Investors have come to expect this behavior; wait until the last minute and then do the minimum to avoid disaster. The final compromise made permanent the Bush tax cuts (for up to $400m in income), and resolved legislation on the alternative minimum tax and estate tax exemptions. The payroll tax cut was allowed to expire while the average taxpayer will see only an $80 to $100 decrease in monthly income, many of those affected live paycheque to paycheque so this will have an impact on consumer spending. More importantly the "sequester", which will remove $1 trillion of government spending from the economy, was delayed for two months. The debt ceiling and entitlement reform were left for the new Congress to deal with.

Some suggest the compromise brings new hope for bipartisanship; we are not of that belief. The Republicans won no spending cuts and will try to achieve them through the debt ceiling debates, which must be resolved by March 1 or the Government will have to start to prioritize what payments it makes. The rhetoric has begun with both sides taking entrenched positions. Republicans are demanding spending cuts equal to the increase in the debt ceiling, while President Obama and his Democrats are adamant this is not a point of negotiation. There is risk of high market volatility over the next three months, as Congress and the President deal with the sequester, the Budget and the "Continuing Resolution" (which expires March 27th and provides funding for Government agencies).

Europe remains in recession, but at least is addressing its issues. Credit markets have eased, markets are better, but in no sense have its real problems gone away. Countries such as Spain and Greece are receiving aid from the Central Bank and IMF, but with the imposed austerity measures to get that funding, are falling deeper into budget deficits. (It's being called the "Doom Loop").

Here are three more concerns:

1. Italian elections could see an anti-reform government to resist E.U. austerity demands.
2. There is rising support in Britain to exit the E.U.
3. Japan's new government is aggressively easing monetary policy. The yen is down, the stock market up, raising concerns of currency wars.

The S&P 500 Index is looking very strong, as more and more stocks are reaching recovery highs. Such a broad based advance is reassuring. The market continues to climb the "wall of the worry" with the help of an improving economy and central bank easing. Newly elected first-term Democrat, Senator Joe Manchin, put it best; "Something has gone terribly wrong when the biggest threat to our American economy is the American Congress".