Q1 2012 ECONOMIC COMMENTARY

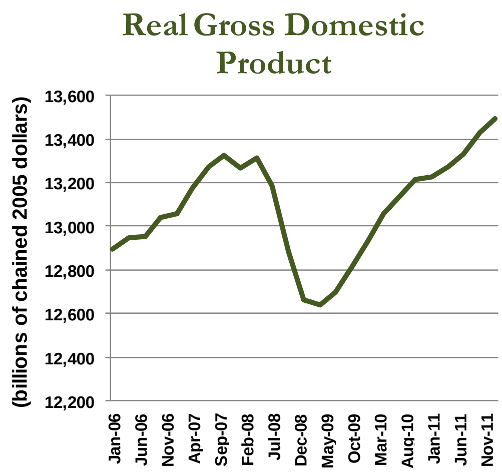
June 2012

ASHDON
Investment Management

First Quarter 2012 Economic Commentary

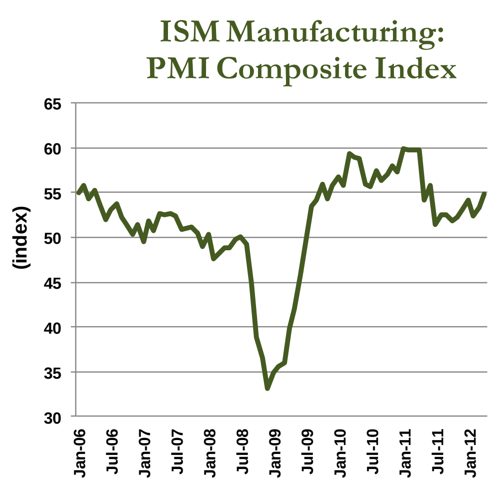
- **Upcoming U.S. policy change is suppressing consumer sentiment. Expect political turnover.**
- **European growth is stagnant, but more likely to climb than to fall.**
- **Asia and emerging markets have turned. Patience is required for investors.**

The first quarter of 2012 continued to enjoy the consistent economic growth of the past three years as seen in the Real Gross Domestic Product chart below. Headwinds to U.S. growth are abating. The housing market is no longer a detractor, business conditions and employment statistics are improving. All these factors indicate that the U.S. economy has gained enough momentum to be less sensitive to upcoming political policy changes.



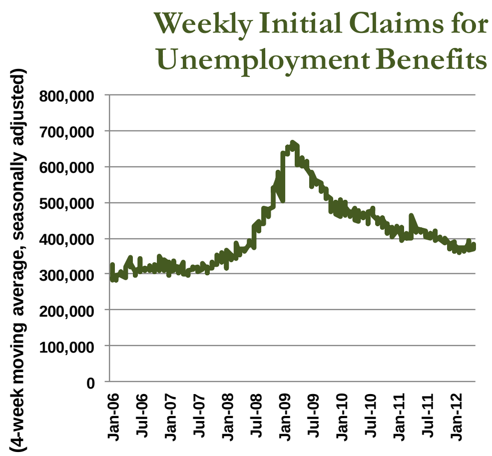
Source: U.S. Department of Commerce, Bureau of Economic Analysis

- **The economy has shown consistent growth over the past three years**



Source: Institute for Supply Management

- **Business conditions have improved over the past three years**



Source: U.S. Department of Labor: Employment and Training Administration

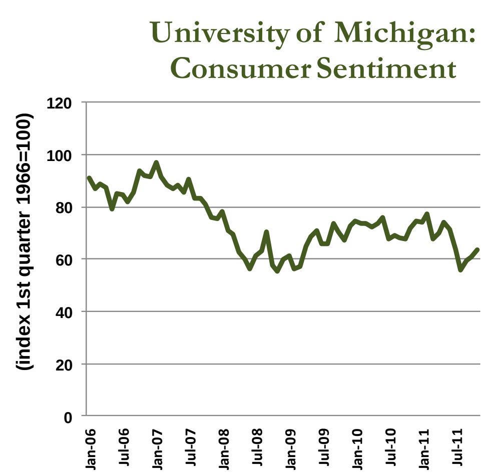
- **Job claims and Unemployment claims have significantly improved**

Source: U.S. Department of Labor: Bureau of Labor Statistics

While U.S. economies and markets show improving conditions, we believe we'll continue to see growth for the next several quarters. As always, there are economic risks.

Upcoming U.S. policy change is suppressing consumer sentiment. Expect political turnover.

Fiscal and monetary policy officials in the U.S. have done all in their power to bring about the recovery we have seen over the past three years. Policy makers have pledged to keep new policies in place for many years ahead to sustain the recovery and to make investors, the business world and consumers more confident in the sustainability of the recovery. Yet any acceleration of U.S. growth moving forward requires policy actions that can come only from the legislative branch, suggesting political turnover is ahead. Key decisions seemingly pushing the country toward a "fiscal cliff" --the expiration of the Bush tax cuts, the resetting of capital gains taxes and the expiration of unemployment benefit extensions--are all due at the end of 2012 and are all likely to impact sentiment, as well as continued growth. While we fully expect reasonable resolutions to the issues forming the proverbial fiscal cliff, the behavior of our elected officials during this election season is prolonging and intensifying the country's anxious state. Sentiment indicators remain suppressed (see Chart Five). Yet while this presents risk to economic growth, the economy has gained enough momentum over the past three years to withstand any potential policy errors, and continue its recovery.



Source: Thomson Reuters/University of Michigan

- **Consumer sentiment remains suppressed**

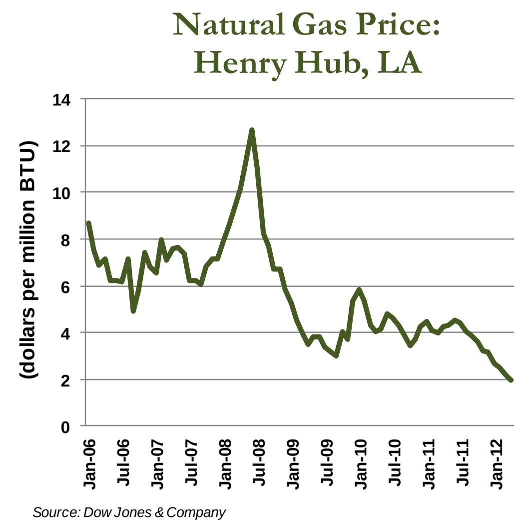
European growth is stagnant, but more likely to climb than to fall.

The stressed state of the economies of the European Union (EU) member states and satellite countries is largely stagnant, yet widely reported by the media. While the EU and European Central Bank (ECB) were poorly equipped to handle the initial crisis and made classic mistakes in their early responses (austerity measures in the UK, for example), they have dramatically expanded and significantly improved their actions in the market and in their policy making. However, it will take time to see the effects of these actions.

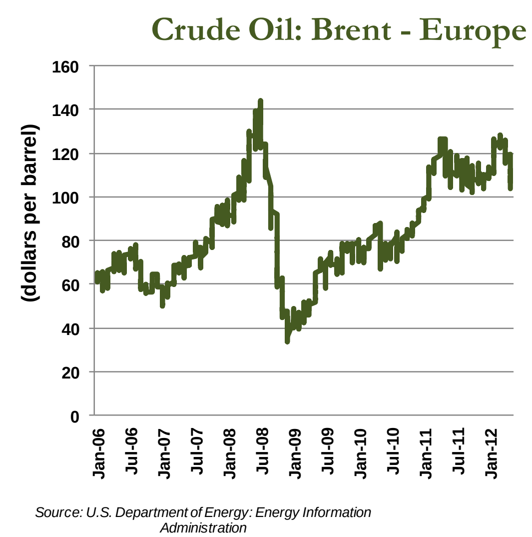
While we may be sanguine about the medium and long-term prospects for Europe, we aren't necessarily recommending a rush to European markets. The larger point is that the ongoing effects of the European economic disaster are dramatically overstated and unlikely to dislodge the U.S. economic recovery.

Asia and emerging markets have turned. Patience is required for investors.

The situation in Asia and in emerging market regions is different than in Europe, particularly for emerging market economies. Rapid growth in these regions over the last two decades has resulted in several long-term trends including rising standards of living, rising consumptions of goods and energy, increasing productivity, rapidly growing GDP and floods of foreign investment. Some of these dynamics have had global impact, with rising commodity pricing being an important example. However, these trends seem to be reversing. Looking at global commodities – and it's not a simple story – we see broadly ranging price slumps. Natural gas is the poster child for the price slump, and oil's recent downturn seems to be following suit. Gold, silver, and copper are all down. While speculative investment has played an important part in these commodity price dynamics, supply and demand rules and there has been a clear shift toward supply being up and demand being down.



- **Natural gas lead the slump in global commodities**



- **Oil prices experienced a recent downturn**

Because this behavior correlates so well with Asian and emerging market central bank tightening, softening GDP growth, and an equity market index downturn, we believe that emerging market economies have entered an important soft patch after two decades of consistent growth. Yet, such a soft patch is part of a normal economic response to the business cycle and not a prelude to a global meltdown.

Looking longer term (i.e. two years), we believe Asian and emerging market economies have strong fundamentals and will recover well, albeit not as robustly as in the past. Such is the nature of developing economies. Given our more benign view of the downturn, and our more sanguine view of the future, we don't anticipate that emerging market issues will boil over into the U.S. and/or derail its recovery.

Outlook

In this environment, we expect the U.S. economy to experience ongoing trend-like to below-trend growth for the next several quarters. At the same time, we expect European, Asian and emerging market economies to labor forward under their burdens, but not to affect U.S. markets as the media would perhaps like us to believe.