Ashdon Investment Management

Q4 2012 ECONOMIC COMMENTARY

January 2013

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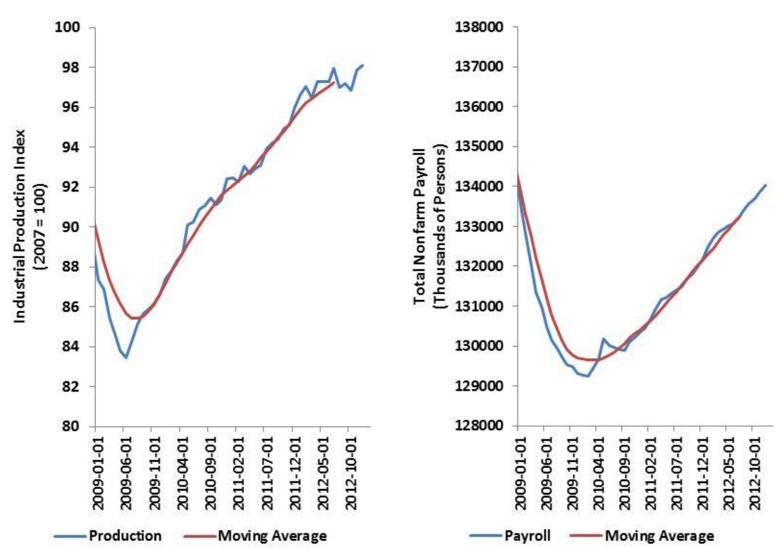
- **The modest recovery of the US economy continued in the fourth quarter**
- **Production related metrics show growing production, and growth in consumption and the ability to consume.**
- **We expect the US economy to continue to expand at its current rate. We believe employment trends will continue to improve and inflation will remain in check.**

Fourth Quarter 2012 Economic Commentary

The modest recovery of the US economy continued in the fourth quarter. Employments trends continued to improve and inflation remained under control as the US Federal Reserve FOMC kept monetary policy extraordinarily accommodative. Based on data released in December, the US economy has grown for 13 consecutive quarters. This period of economic expansion is not over long by any historical standard. However, it has taken place in the context of a major, global financial crisis and with the resulting headwinds. Expansion has been weak, leaving the economy at risk of tipping into recession at any time.

Some investors question whether or not the economy may be tipping into recession now or in the coming months. Subjectively, there does not seem to be a broad decline in US economic activity. Looking at the measures cited by the National Bureau of Economic Research (NBER) for judging economic turning points, the subjective statement can be made objective. The NBER looks at, among other things, four broad gauges of economic activity: Production, Employment, Sales and Income. Charts of Production and Employment are provided below:

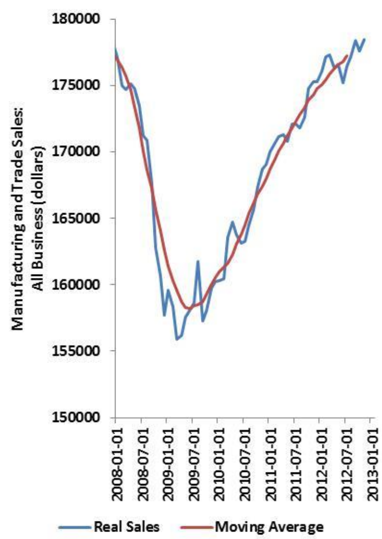
Economic Activity: Production and Employment

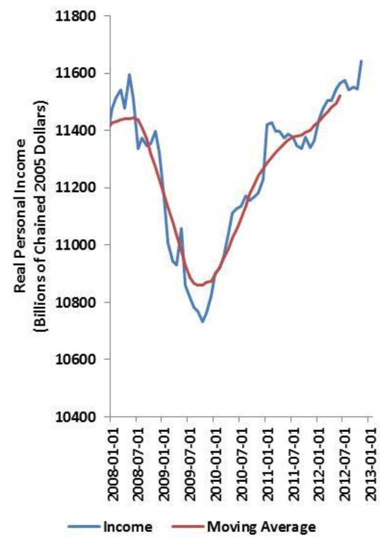


Ongoing positive trends for Production-related metrics which show growing production.

Consumption-related metrics for Sales and Income show a consistent path of growth.

Economic Activity: Sales and Income





Ongoing positive trends for Production-related metrics show growth in consumption and the ability to consume.

Raw data for each data series is shown with a moving average. The moving average smoothes the short term noisy data and reveals the underlying data trend. We will take each series in turn and look a bit deeper.

The Industrial Production Index is designed to measure "the real output of all manufacturing, mining, and electric and gas utility establishments located in the United States". Increasing activity for these economically sensitive producers will be reflected in the data as an increase in the index value. The index value has been on an upward trajectory for some time now. The most recent data may reflect a deceleration in the rate of growth of production, but it does not suggest a decline at this time. US payrolls are tracked by the Bureau of Labor Statistics using several statistics. The so called "Non-Farm Payroll" survey is one of the most widely followed. These data show that after a lagged recovery in 2009, employment trends are upward with no signs of slowing.

Of course, the pace of job growth has been slow compared to past recoveries. We have discussed in the past how employment trends are affected by a variety of factors such as global competition, skills mismatch, and worker mobility. We believe that these other factors are working to suppress job growth; in the meantime, job opportunities continue to increase. Real consumption activity continues as well. Sales of manufactured goods measure the ability of companies to deliver their finished goods into the market. The trend in this metric also shows a solid upward bias. This data is supported by different measures of consumption. The final data series is Real Personal Income which tracks the income trends of US citizens. After a brief period of decline in late 2010, this historically noisy data series shows expansion as well.

All these data taken together show that going into the end of 2012, the economy was on the same general upward trajectory that it had been for most of the last three years. As noted, this recovery has been subdued and, the economy is being supported by Federal Reserve policy. But there is no doubt that economic active has and continues to recover.

Going into the new year and looking ahead, the situation is still uncertain. Late in the year, Congress passed a “small deal” resolution to the so-called “Fiscal Cliff”, thereby holding off the worst of the fears and reassuring the markets. However, two weeks into the year investors were discussing dire consequences surrounding the “Debt Ceiling”. Briefly, we are confident that the US government has the ability and willingness to pay its debts. But we are also confident that politicians and media personalities will use the debate in furtherance of their own short term goals. As frustrating as this is, it is the nature of our process.

In the meantime, we are looking forward to the more important economic trends. Over the next twelve months, we believe the US economy will continue to expand at a rate similar to the past year. During this expansion, we expect to see employment trends accelerate slightly and inflation to remain subdued. We do not expect to see any major shifts in US monetary policy. The outlook sets up an interesting situation for 2014 and beyond. At the end of 2013, we expected to have seen 5 years of continuous growth, to be closer to full employment, and an inflation rate of about 2%. The compounded growth will give the FOMC the latitude to begin removing accommodation from the economy. How this is likely to occur is foggy at the moment. While markets will react quickly (and spasmodically), it will take some time to see how the economy reacts. We will keep a watchful eye on the bond markets which we believe will be the best first indicator of economic reaction.

Over the coming months, we expect the US economy to continue to expand at its current rate. We believe employment trends will continue to improve and inflation will remain in check. Additionally we think there is a chance that FOMC will begin to pull back on accommodation in the economy.

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