Ashdon Investment Management

Q1 2014 ECONOMIC COMMENTARY

April 2014

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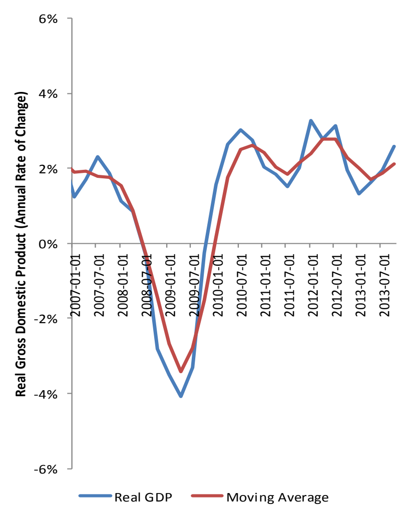
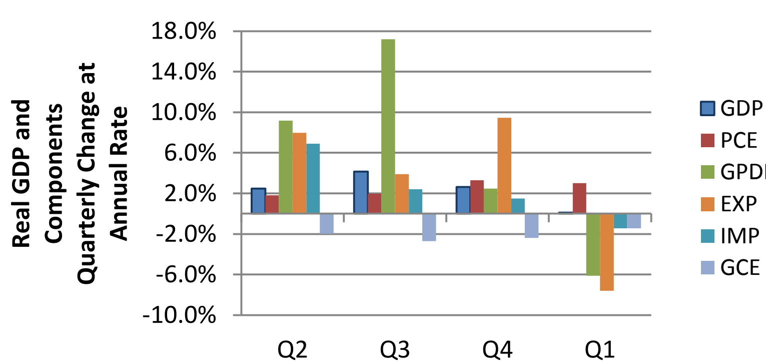
Investment Management

First Quarter 2014 Economic Commentary

The title of a recent article from The Economist opined: "You can have any recovery you like, so long as it's mediocre". The dry wit of those British authors fully captured the data for this quarter – and nearly every preceding quarter since 2009. While we have experienced moments of excitement as single data points have been much higher or much lower than "mediocre", the data taken together meekly proclaim the unexciting fact of a moderated economic expansion in the wake of a major, global financial crisis.

First quarter GDP, while initially interesting, was revealed to be understandable and unexciting upon closer inspection. The Advance release of GDP data for Q1 reflected a notable slowdown in the US economy. The BEA reported that the economy grew at an annual rate of just 0.1%. That rate is likely to be revised downward to reflect *deceleration* as the data are refined in the months ahead. If a negative reading does emerge, it will be the second negative reading since the bottom of the recession (GDP growth for Q1 2011 was -1.29%). Sector level data suggest that the economic slowdown was broad. Formally robustly growing sectors like the residential and non-residential construction spending and equipment investments were detractors during the quarter. Government consumption weakness continued as expected.





Finally, declines in exports detracted from growth. Personal consumption continued to grow, offsetting weakness in the other economic sectors. As the second quarter evolves, emerging data are hinting at a robust recovery from the unexpectedly weak Q1 print. The chart to the right shows the trend in GDP over time since the recovery. The “down in Q1, up in Q2” pattern is characteristic of the current recovery.

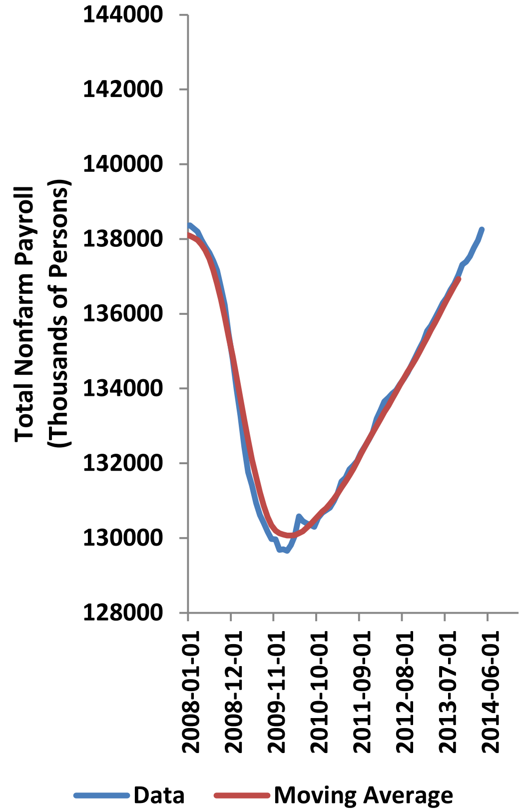
Employment data were the cause of optimism. The unemployment rate dropped to 6.3% in March – easily within range of “full employment”. The BLS reported that the US economy added an average of 221,000 jobs each month during the first quarter. As of the end of April, the total nonfarm payroll exceeds the pre-financial crisis payroll. Celebration was premature. Underneath the data, were less attractive data: discouraged workers’ data was high, participation rate dropped, wages growth was stagnant. One strategist was quoted by the Wall Street Journal as follows:

“Investors are likely to find this report mixed and unclear.”

Probably true, but not particularly helpful.

There are really no surprises here. These data series are inherently volatile. A careful analyst will not react to the month-to-month fluctuations in the data because he/she understands that the information content is not in the data point; the information is in the *data set*.

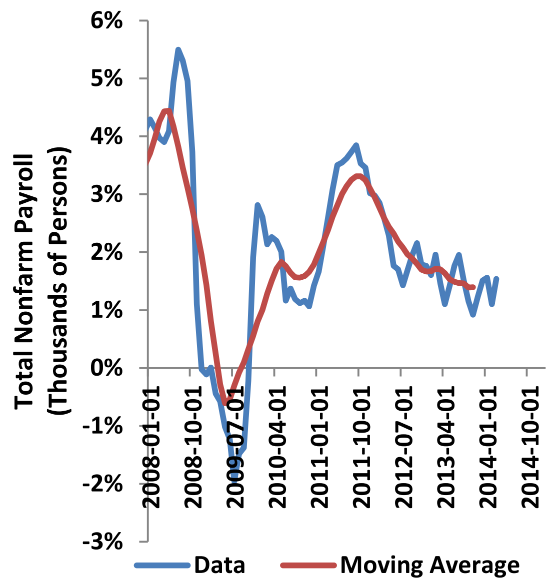
And the data set is not at all mixed or unclear. The US economy is in the midst of a “mediocre” post-crisis recovery and it is likely to be here – barring an unpredictable extreme event or a major policy blunder – for many quarters to come.



Last quarter, we noted that the FOMC was unlikely to change its policy any time soon. In spite of Janet Yellen's comments – possibly to the contrary - the FOMC has little reason to begin a policy change under their current thinking. Even though the job market is very clearly healing itself, inflation is well below FOMC targets. With inflation this low, the FOMC has no pressure to tighten. Further, the FOMC's fear of deflation – and their curative easy money prescription – one would think that tightening is very far away. The bond market appears to agree with the forecast of persistently low inflation, if not deflation.

As we said last quarter - we are not on "Taper Watch" – at least not in the same way as the media. We will stick to our bias for fundamental investing to both protect against permanent capital loss and as a basis for searching for opportunity. In the next few quarters, our gaze will be cast offshore. Commentary has been US-focused for some time now and we believe that we should begin sharing our thoughts on the major non-US economies and will do so through 2014.

Markets experienced more volatility than usual during the first quarter as disappointing economic data in the U.S., mixed with Geo-political tensions in Ukraine and continued China growth fears in Asia weighed into investors' global outlook. Further, intensifying volatility during the quarter spurred global investors to rebalance asset classes, sectors and individual positions from winning themes of the previous year into more fundamental positioning going forward. It is these types of markets that offer opportunistic entry points for value-minded investors. Ashdon is optimistic about capital markets going forward into 2014.



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