EMERALD ASSET ADVISORS, LLC

Investment Strategists for **Successful Families**

First Quarter 2014

Thank you for reading GreenThought$. It is our privilege to provide you with our insight on current financial market events and our outlook on topics relevant to you.

Cold Weather = Headwinds

During the first quarter of the year an extraordinarily severe winter allowed local weather reporters across the country to have their day in the sun (so to speak). We focused on their every word as they reported ever more cold and ever more snow. One exception was California where there was no cold, no snow, and tragically, no rain! At the same time, our business commentators and economic sages blamed less than impressive economic fundamentals on inclement weather. It seems reasonable to conclude that bad weather could impact housing and retail, but are freezing temperatures and piles of snow also responsible for a lack of corporate confidence to build, expand, and hire? Over the next few months we will see if bad weather is truly to blame or if the economic slowdown is the result of more structural economic challenges.

Eventually spring will bring warmer weather, housing will likely improve and retailers may again feel the love of consumers. However, sustainable economic growth is dependent on the virtuous cycle of improving corporate confidence > increased business investment > meaningful job growth > rising consumer confidence and purchasing > top-line corporate revenue growth > and back to improved corporate confidence. We are closely watching for evidence of improved corporate confidence and increased spending on equipment, R&D, and product development – the drivers of job creation and sustainable economic growth.

The Importance of Employment

Business investment in Q1 looks to be softer than expected coming off of 2013, which will likely cause Q1 GDP to come in shy of the annualized 2.4% growth rate in Q4 2013. The March jobs report showed an increase of 192,000 net new jobs, all of which were generated in the private sector, which has now recovered all the jobs lost in the 2008 financial crisis. This jobs recovery has been the slowest on record since the Labor Department started tracking the data in 1939, which reflects the magnitude of the Great Recession and explains why after five years we are just reaching the expansion phase of the recovery. Notwithstanding a net increase of over 500,000 new jobs in the first quarter of the year, the unemployment rate remains at 6.7%. Moreover, the U-6 unemployment rate, which includes the unemployed, the underemployed and discouraged workers no longer looking for a job, is 12.8%. On a positive note this number is down from 13.5% over the past 60 days. Adding to the unemployment challenge is the sobering fact that we now have 3.8 million unemployed workers who have been out of a job for more than six months (long-term unemployed). A recent Princeton study revealed that only 11% of the long-term unemployed in any given month found full-time work a year later. Suffice it to say, until or unless business investment increases substantially and job creation reaches 250,000 per month, economic growth will remain tepid, at best.

Some Encouraging Signs

Despite the challenges we face on the unemployment front, we continue to see some encouraging signs for the overall economy. Corporate profits have repaired company balance sheets and made them more competitive, technology-driven oil and gas production is leading to energy self-sufficiency and an improving geopolitical landscape. As well, cheap domestic natural gas prices are driving a meaningful “on-shoring” of energy-dependent manufacturing companies, which should help with job creation. An improving economy has reduced fiscal deficits in Washington and many municipalities across the country, allowing less stress on and better behavior from politicians. An improved housing market and lower levels of household debt have brightened the spirits and confidence of consumers. Inflation continues to be relatively benign, due in large part to non-existent wage growth. Improving economic conditions have led Janet Yellen and Fed policy makers to continue with their $10 billion monthly “taper” of open market bond buying. At the same time, economic conditions aren’t strong enough for the Fed to abandon its zero-bound interest rate policy any time soon.

The Markets

The fixed income markets performed well in the first quarter considering the Fed reduced its monthly purchase of bonds in the open market by $30 billion. Concern about economic growth and an unsettling situation in Russia and Ukraine caused investors to favor US Treasury securities. The result was a continued flattening of the yield curve with short and intermediate yields staying steady and long yields coming down. The yield on the 10-year US Treasury ended the quarter at 2.72%, down from 3.03% and the end of 2013. Generally improving economic conditions again favored high yield bonds and municipal securities.

The stock market is a discounting mechanism that anticipates economic conditions in the future. As such, the economic improvement realized over the past five years was anticipated by the market and is reflected in current near-record high levels. Despite a headwind of economic uncertainty, the Russian/Ukraine conflict, unimpressive employment gains, and the continued Fed tapering, the S&P 500 finished the quarter up nearly 2%, its fifth consecutive quarter of gains. However, the market has experienced an increase in volatility, which we believe will accompany further gains in the equity market. The S&P 500 has not had a 10% correction since August of 2010, so we believe that the market is overdue for a correction. Equity valuations are not cheap, but they are also not extreme. However, bad news sells newspapers and drives broadcast ratings, so we can count on some piece of “bad” news that will, no doubt, rattle investor nerves and cause a correction. We would consider such a move healthy for the continued life of the bull market and would likely add to our equity positions. Most of the easy money has been made in this market and, as such, we think it is timely to overweight active managers versus passive indices.

On the International front, 2014 has proven difficult for investors as the slowdown in global growth has continued. The MSCI All Country ex-US and the MSCI Emerging Market indices were down marginally and the EAFE index was up 0.7% for the quarter. However, all three experienced significant volatility. Much of the global slowdown in economic growth is emanating from China where GDP growth has slowed from over 10.4% in 2010 to a projected 7.5% in 2014. In addition, China is migrating from a manufacturing export economy to a service economy for its rapidly expanding middle class. The impact of this has been felt worldwide, but the world will adjust. Europe is coming out of a recession and though certain deflationary risks remain, economic growth is gradual but building.

Over the next several months the training wheels of Fed stimulus will be taken off and we will see if the US economy can ride a two-wheeler. While we remain cautiously optimistic about the economy's ability to ride the bike, our caution always outweighs our optimism as our bias is toward asset preservation and our ultimate objective of helping our clients achieve their goals.

As always, if you have any questions please do not hesitate to contact us.

The Emerald Team

About Emerald

Emerald Asset Advisors, LLC is a Registered Investment Advisor (RIA) founded in 1998. For more information, please visit our website.
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