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April 2013 Commentary

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The Economy

The U.S.

Now five years past the height (or trough, as it were) of the sub-prime crisis, the U.S. economy continues to fight on. Like a weary boxer enduring countless rounds of punches, the economy battles through bad headlines and government uncertainty. The latest data revealed that the U.S. economy grew at a 2.5% annual pace in the first quarter of 2013. While this growth is higher than other recent readings, it was nonetheless below expectations.

Paul Simon wrote about fighting on, in spite of exhaustion and disillusion, in his song "The Boxer." Written in 1968, the song works well in describing the conflicted growth of our nation's economy today.

In the clearing stands a boxer,
And a fighter by his trade
And he carries the reminders
Of ev'ry glove that laid him down
And cut him till he cried out
In his anger and his shame,
"I am leaving, I am leaving."
But the fighter still remains

On one hand it is encouraging to witness the steady return of the residential housing market and growth in the domestic energy sector. On the other hand, our growth trajectory suggests many more years of modest recovery until we return to a truly healthy economy. A plodding, punched-out boxer trying to avoid a knockout seems an apropos comparison.

Relatively weak economic data were common in April. The ISM Manufacturing Index was 50.7 for the month, down 0.6 percentage points from March. The indicator suggests that manufacturing activity growth is slowing to a crawl. The U.S. ISM Non-manufacturing Index declined to 53.1 in April, also indicating slower growth than in March. The latest Commerce Department report highlighted a weakening of consumer spending growth in March. Many economists attribute the tepid growth of spending in March to the payroll tax hikes that began in January.

A common theme over the past few years has been strong U.S. economic data at the beginning of the year, followed by declining conditions as we enter the summer months. While there has been a mid-year slump in equity prices in each of the past three years, attempting to time when to exit the market and when to re-enter the market is a challenging task. A 10% or greater pullback in stocks has occurred about once a year over the past 114 years. Successful investors prepare themselves in advance to maintain their discipline and allocations in turbulent markets.

There continue to be bright spots in our economy. The latest Case-Shiller Index suggests that national housing prices have risen 9.3% year over year, the biggest annual increase since May 2006. Rising home prices contribute to improved household balance sheets and more jobs in the housing sector. The unemployment rate fell to 7.5% in April, a better than expected reading. The economy added 165,000 jobs for the month, ahead of most Wall Street estimates. The employment picture in the U.S. continues to improve, though weakly. Gas prices fell 3.5% in April, a boost to U.S. consumers.

The World

Conditions calmed down in Europe during April, leading to an eleventh consecutive month of gains for the MSCI EAFE Index and lower bond yields in Italy and Spain. It is often said that markets "climb a wall of worry." In the case of Europe, the worry of the fiscal crisis has not been enough to derail significant investment gains. ECB President Mario Draghi has done a masterful job, at least so far, in keeping fear out of the sovereign bond markets in peripheral Eurozone countries with his promise of unlimited bond buying.

Japan was very noteworthy in April. Fighting deflationary pressures that have their roots in the early 1990s, the Bank of Japan has embarked upon a new round of policy measures aimed at boosting growth and inflation in their economy. Japan's policies include inflation targeting at 2%, depreciating the yen, quantitative easing and expansion of public investment. These moves had quite an impact in April, as Japanese stocks rallied by 11.5%. The stimulative monetary policy also served to depreciate the Japanese yen, as the currency lost about 4% against the U.S. Dollar in April.

Margaret Thatcher, former U.K. Prime Minister and one of the great leaders of the western world in the 20th century, died in April. Her uncompromising commitment to free markets and deregulation helped save the British economy in the 1980s. Her death serves as a reminder to European leaders that perhaps the best course of action is not towards government intervention, but for the private sector and free markets to lead the charge.

The Markets: Risk Assets Continue to Climb

Stocks rose for the fourth consecutive month in April, as the U.S. stock market approached all-time highs. For the month, the S&P 500 gained 1.93%. A brief correction and rise in volatility followed the Boston Marathon bombing on April 15th. Financial markets rebounded from the attack by the end of the month.

International equities also gained in April, registering a blistering 5.21% gain. The Japanese stock market had much to do with the outsized gains. The Nikkei Index gained 11.5% in April, marking the best April in twenty years for Japanese stocks. Japan's new "Abenomics," the aggressive monetary policy of Prime Minister Shinzo Abe, has driven asset prices higher. Emerging market stocks experienced more modest gains in April; the MSCI Emerging Markets Index climbed by 0.75%.

Bonds also gained in April. The Barclays U.S. Aggregate Index rose by 1.01% in the month. Yields fell as economic growth remained subdued and inflation data weakened. U.S. mortgage rates touched near-record lows at the end of April, an encouraging sign for a continued housing recovery here at home. Credit of all types rallied in the U.S.: investment grade corporate bonds gained 1.83%, and the high yield index rose by 1.81%.

Tame inflation numbers and slowing global growth have hit commodities hard. For the month, the UBS Dow Jones Commodity Index was down 2.79%. Brent crude oil fell 7% in April, as inventories rose and demand declined. The decline in Brent crude will likely cut gas prices in the near term, a welcome development. Gold prices dropped 7.8% in April, the biggest monthly decline since December 2011. As inflation expectations have come down, so too have gold prices.

Table of Returns

April 30, 2013

	Performance(%)				
	1 Month	Year To Date	1 Year	3 Years	5 Years
Equities Index					
S&P 500 Index	1.93	12.74	16.89	12.80	5.21
Russell Midcap Index	1.28	14.41	19.20	13.70	7.24
S&P MidCap 400	0.63	14.16	18.84	13.76	8.37
Russell 2000 Index	-0.37	11.98	17.69	11.25	7.27
S&P SmallCap 600	-0.27	11.51	17.31	12.92	8.28
MSCI EAFE (net) Index	5.21	10.61	19.39	7.44	-0.93
MSCI Emerging Markets (Net)	0.75	-0.88	3.97	3.12	-0.32
Fixed Income Index					
Barclays Aggregate Index	1.01	0.89	3.68	5.51	5.72
Barclays Global Aggregate	1.39	-0.74	1.46	5.00	4.34
Barclays 1-10 Yr. Muni	0.70	1.19	3.28	4.59	5.04
CSFB Leveraged Loan	0.75	3.15	8.22	6.13	6.02
Barclays US Corp: High Yield	1.81	4.75	13.98	11.05	11.11
Other Index					
HFRI Fund of Funds Composite Index	N/A	N/A	N/A	N/A	N/A
Dow Jones-UBS Commodity Index	-2.79	-3.89	-5.33	-0.18	-8.28
Wilshire US REIT Index	N/A	N/A	N/A	N/A	N/A
S&P Developed Property	7.26	14.80	28.54	16.51	4.30
LPX 50 TR	4.75	18.42	35.32	13.20	-2.15
Citigroup 3 Month T-Bill Index	0.01	0.03	0.11	0.09	0.28

Closing Thoughts

The Denver Nuggets were eliminated recently by the Golden State Warriors in game six of the NBA playoff's first round, a heartbreaking loss for Nuggets fans. The Nuggets have exited in the first round of the playoffs for the ninth time in the past ten seasons. The loss to the Warriors came down to fundamentals. The Nuggets were 13 for 21 from the free throw line, an aggregate 61.9%. In the final three minutes and 34 seconds of game six, the Nuggets missed three free throws.

The loss in the playoffs suggests a lack of discipline and focus on the fundamentals from George Karl's club. Despite talent and potential from players like Ty Lawson and Andrew Iguodala, the Nuggets failed to deliver on the most the most important of concepts: do the basics well, consistently.

At Innovest, we have updated our capital markets projections for the next five years. In our upcoming client reviews, we will be discussing the changes in the global investment environment and how these have

impacted our latest return projections. We will discuss the modification of asset allocations to maximize return and minimize risk. Throughout the process, our methodical research and focus on valuations have continued to serve us well. We do the basics well so that our clients make the right choices regarding their asset allocation—their most important investment decision.

While the U.S. stock market continues to hit new highs, we emphasize the value of rebalancing investment portfolios. Rebalancing creates an automatic process for selling high and buying low—a process that creates discipline and a focus on the fundamentals. We cannot know what the future holds for the stock market, but we do know that a disciplined approach to investing will continue to serve our clients well.