

FEBRUARY 4, 2013

## WEEKLY INVESTMENT COMMENTARY

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### Decent Economic Data Powers Stocks Forward

#### Investors Focus on the Positive to Lift Markets

Although the headline economic data last week was a report showing that the US economy contracted during the fourth quarter, investors brushed aside the bad news and continued to move into stocks, causing markets to rise for yet another week. For the week, the Dow Jones Industrial Average climbed 0.8% to 14,009 (closing above 14,000 for the first time since October 2007), the S&P 500 Index rose 0.7% to 1,513 and the Nasdaq Composite advanced 0.9% to 3,179. In fixed income markets, prices declined slightly yet again as the yield on the 10-year Treasury notched up a few basis points to close the week at 2.02%.

#### Economic Trends Skewing Slightly Positive

Headline economic data has been a bit mixed, but while none of the data points to an economy that is taking off, it does suggest that the economy continues to slowly improve.

The fourth-quarter gross domestic product report had some rather frightening headlines. The consensus among economists was that the data would show that the United States grew around 1% in the final quarter of 2012, but the data actually showed that the economy contracted by 0.1%, the first negative GDP reading in over three years. While a negative GDP number is never good news, the report was not as bad as the headline number suggested. Personal consumption actually rose and business investment was healthy. The contraction was essentially a result of two factors: a massive drop in government spending and a significant drop in inventories. The latter hardly came as a surprise since much of the third quarter's jump in growth was attributed to a buildup in inventories. In all, we would say the GDP report was disappointing, but we would still expect growth to be positive in the first quarter of 2013.

Also in economic news last week was the release of January's employment data. We would characterize the data as respectable, given that 157,000 new jobs were created last month, which is consistent with the average over the last two years. While jobs are continuing to be created, however, the labor market is still struggling to break out of its slow-growth mode. New jobs are not being created fast enough to help wages rise, and many Americans are still looking for work. Additionally, the Bureau of Labor Statistics' "U-6" rate that includes underemployed (such as those who are in part-time jobs looking for full-time work) stands at 14.4%, meaning that roughly one-in-six Americans are still out of work or are underemployed.



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Perhaps the best economic news last week came from the manufacturing front, which is beginning to show some real signs of improvement. Many companies are starting to see an increase in the pace of new orders, which is a good sign for future growth. This trend is not limited to the United States. We are also seeing indications that manufacturing levels are growing in Germany, Brazil and (perhaps most importantly) China.

### Look to US Mega Caps and Emerging Markets

Stocks have certainly benefitted from the modestly positive trends in economic growth and it does appear that investors are making some long-awaited moves back into equity markets. Flows into equity mutual funds and exchange-traded funds have been relatively high lately, a sign that investors are growing less risk averse.

In our view, we believe stock prices can continue to rise, but we would encourage selectivity when investing. We continue to favor emerging markets (including China) and mega-cap US stocks, which should benefit from the improvements in the global economy.

In contrast, we would exercise more caution when considering consumer sectors and smaller cap companies. Small caps have done quite well so far this year, but we believe they may be relatively vulnerable. From a valuation perspective, small caps look somewhat expensive to us. As long as investors are continuing to pour more money into equity funds, small caps should still hold up. We are, however, expecting the pace of flows to moderate in the coming months, which could make this area of the market vulnerable, particularly if we see any pullback in consumer spending.

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