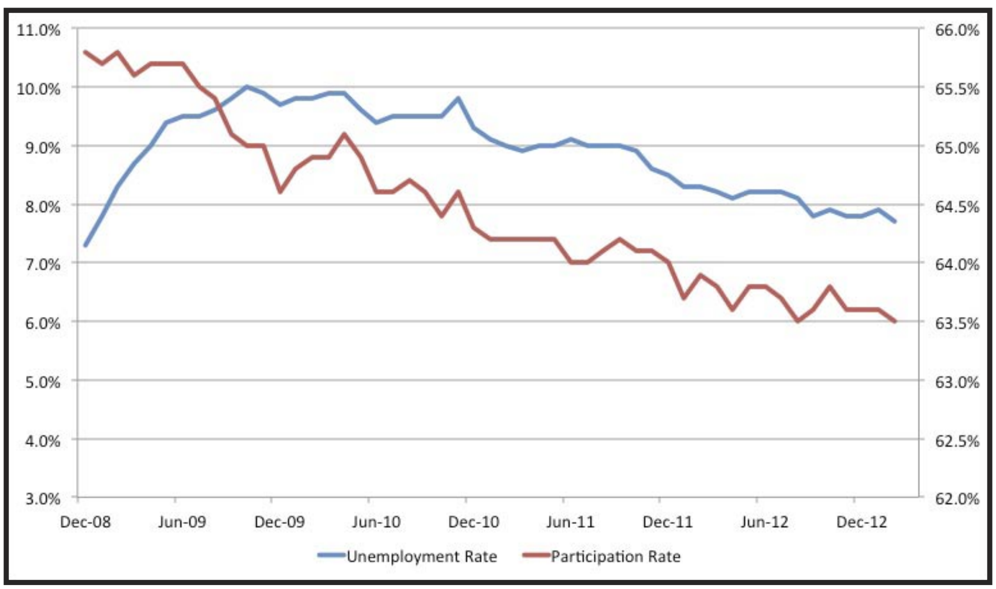
JAMESSON ASSOCIATES

03.2013 NEWSLETTER

RECENT ECONOMIC EVENTS

The big news on the economic front is the better-than-expected February employment report — a welcome positive after the disappointing fourth quarter GDP release and the ongoing political sideshow in Washington. Housing has clearly bottomed, and US energy production continues to build. These positives were apparently enough to convince the American consumer to overcome the bump in Social Security taxes, as both auto sales and overall retail sales showed strength in February. On top of all this, inflation remains quiescent, allowing the Federal Reserve to continue quantitative easing.



The United States economy created 236,000 jobs in February and the unemployment rate fell to 7.7%, the lowest level in over four years. The entire increase in jobs was due to private payroll increases as government once again cut back on employment. Not only did overall job growth exceed expectations, but the workweek expanded as well. The only fly in the ointment on the jobs front was the slight decline in labor force participation. The percentage of working-age Americans in the labor force tied a multi-decade low of 63.5% in February, suggesting that the headlines don't tell the entire story. In fact, only about 150,000 more workers were employed in February than in December 2008, even though the number of working-age Americans has increased by close to ten million since then. We clearly have a lot more road to travel before the employment picture can be judged bright.

GDP was originally reported as having declined marginally in the fourth quarter, but the first revision showed a similarly marginal increase of .1%. Even government bean-counters can barely tell the difference between the two figures. The bottom line is that overall growth is decelerating, having posted a fourth quarter to fourth quarter gain of 2.5% in 2010, 2.0% in 2011, and about 1.5% in 2012. The disappointing loss of momentum is a sign that things are different from what we had come to expect in the late 20th century.

Housing is now contributing to economic growth as prices, sales, and starts are well ahead of their pace a year ago. US oil production is flirting with 20-year highs and the glut of domestic oil is helping to reduce imports. The competitive advantage that American business has in energy costs is encouraging the return of some businesses that had fled the country in search of lower labor costs.

Validating the idea that one should never bet against the American consumer, spending has hardly missed a beat since the New Year began. February annualized auto sales tallied 15.4 million, the highest level since before the recession, and total retail sales surged by 1.1%. Keep in mind that this performance *(continued on page 2)*

Recent Economic Events (cont.)

was in the face of an increase in Social Security taxes coincident with the first paycheck of the year. The impact on the typical family was a reduction of about $1,000 annually, or roughly $20 per week. This is a not insignificant sum considering that the average household's inflation-adjusted income has stagnated over the past few decades.

Then we have our elected representatives in Washington. Although the headlines suggest they are lurching from crisis to crisis instead of working to solve problems in a responsible fashion, the net result has been a real reduction in the projected federal deficit. In addition to the abovementioned Social Security tax increase, we have both the increase in taxes for the more affluent and the reduction in defense and domestic spending as a result of the sequester. The total net impact in 2013 could easily reach $250 billion, bringing the deficit to a more manageable 5% or so of GDP although creating some headwinds for the economy.

Commentary

Those of you who read Superman comics in your youth will remember that when things got slow in the main story thread, the writers would pull out the Bizarro World. This was a cube-shaped planet called Htrae (Earth spelled backward) in which everything was the opposite of things on Earth. The Bizzaros worshipped ugliness, not beauty; being perfect was a crime; and Bizarro bonds were guaranteed to be worthless.

Hey, wait a minute! Have we unknowingly slipped into Bizarro World? Let's look at the facts.

The Federal Reserve has pursued Quantitative Easing to lower interest rates. However, since they began the last round in the second half of 2012, interest rates as measured by the ten-year Treasury are up. In fact, a perusal of the effectiveness of earlier programs shows that from the start to the end of QE1 and QE2, rates also rose. When they stopped their programs, rates fell. Is Ben Bernanke a Bizarro?

Federal deficits and debt have been shown to be impediments to a healthy economy over time. The longest peacetime expansion in US history took place during the 1990s when first the deficit was stabilized and then turned into a government surplus. Since the turn of the century, first President Bush, with the connivance of Democrats in

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Commentary (Cont..)

Congress, and then President Obama with the help of a Republican Congress, have either added to the deficit and debt or refused to act to reduce it. Both sides have devolved into partisan bickering. Have we elected Bizarros to represent us in Washington?

Fear of inflation is at a fever pitch as measured by negative yields on TIPS and the constant drumbeat of investment mavens predicting disaster from the run-up in debt. However, gold, the presumably quintessential inflation hedge, has been in a steady downtrend since the end of the debt ceiling crisis in late summer 2012, and bank deposits are at an all-time high and growing. Have Bizarro investors infiltrated our markets?

The honest answers to the three questions posed: yes, yes, and yes. Bizarros rule!!!

So what should we do?

Bizarro Ben should immediately promise to end QE3. Once the market processes the threat and realizes that the risk of a recession due to reduced monetary stimulus is real, rates will fall as they have after the end of both QE1 and QE2.

Bizarro Washington should stop trying to win political points with their base and agree on a comprehensive budget compromise which addresses the long-term costs of an aging population while limiting unproductive taxes and regulation.

Bizarro markets have to shake their obsession with inflation and safety and invest in productive assets which can help power our economy forward.

These prescriptions make sense in Bizarro World, but have little chance of being pursued. Our current situation may be even stranger than comic book fiction.

Market View

The stock market as measured by the Dow Jones is hitting new highs, interest rates are up from their lows last summer, and commodity prices are trending downward. The first two are direct results of the Fed's QE3 program while the latter is due to a general slowing in global GDP.

Since I see no realistic chance of the Fed easing off the accelerator over the next few quarters, staying long equities appears to be the best of our not very good investment options. Corporate profits are generally healthy and companies have been more inclined to return money to shareholders through dividends and stock buybacks, as investment opportunities appear to be hard to find. This lack of good organic investment options suggests that there is plenty of money chasing the few good possibilities. If this is the case, future returns for the entire market are likely to track the lower end of historical averages.

With short-term rates remaining very low, one would be inclined to buy longer-term bonds to capture yield. This strategy makes sense for those with an investment horizon of years, but the Fed is trying its best to generate some inflation, and you have to be wary of their power. That said, I don't believe they will be successful, and once the seasonal upward pressure on rates reverses in April/May, I see rates heading back down again. The best place on the yield curve is in the five to seven-year range on taxable investments and seven to ten years on municipals. Stay away from corporates, especially high-yield and from MBS and callable securities, as the spreads do not presently compensate for the risk.

Commodities are ultimately driven by the interaction of the global economy's demand and the technology for producing the supply. It pays to look carefully at each commodity's specific situation today, rather than believing

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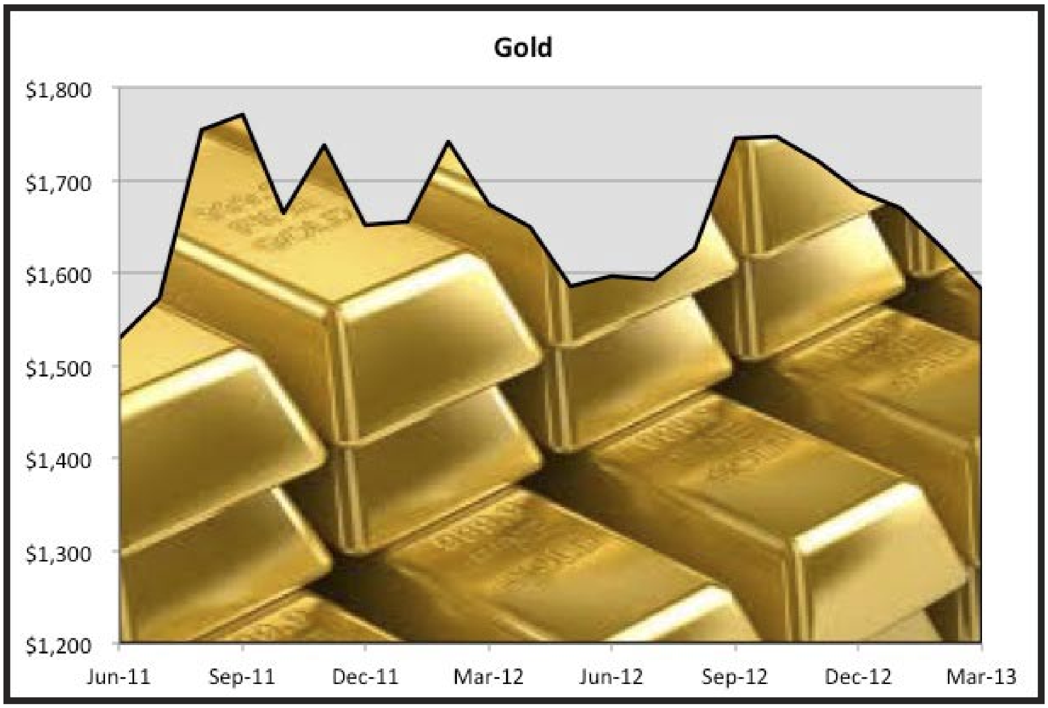
MARKET VIEW (CONT.)

that a rising tide will lift all boats or that general trends will place downward pressure on all commodities. Take energy: technology is creating new supplies few thought possible short years ago, but what's hard to determine is whether those finding the energy can profit in the face of a glut. This suggests that looking for users of cheaper energy is a better bet. Remember, Levi Strauss got rich off the Forty-niners, and Australian miners have ridden the infrastructure investment wave in China.

On the other hand, agricultural commodities have a secular bid as emerging nations seek first-world diets. Since this story is well-known, and since climate change created drought conditions for grains in the last few years, there may be a nice cyclical reversal due to much better snowfall this year. I would pick my spots on a pullback with foodstuffs.

Finally, a comment on precious metals. The rather poor action on gold over the last year and a half suggests to me that all the buyers are already in. Unless something additional happens to juice the market, the likely course is for further erosion. As an insurance policy against the rest of the portfolio, a small position may be justified. As a core investment, it is overpriced.



EDITOR'S NOTE

The United States has labeled a branch of the Chinese military a threat to the nation's security based on hacking attacks. Targets as diverse as the American financial system and the Pentagon were cited in a report on the activities involved. When, in late December, I found myself unable to access the internet or my email account, my IT administrator investigated the problem and concluded that Jamesson Associates was subject to a massive "denial of service" attack which originated in — you guessed it — China. He blocked the attacks and restored my network to health. Previously, I had been unaware of my critical importance to the US financial system. However, communication with cyber-security experts in the Department of Defense has convinced me that Asset/Liability Consultants are indeed the linchpin of American economic security. The Chinese were hoping that without current market knowledge, one misplaced interest rate bet could bring down the system. Thwarted this time, but constant vigilance is required.

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