



*“There are grounds for cautious optimism
that we may now be near the end of
the search for the ultimate laws of nature”*

Stephen Hawking

“THE ECONOMY” – Strength in Fundamentals

In our January economic outlook letter we described the economy of 2012 as moving toward global resolution from the various political and economic uncertainties such as the forthcoming high-profile presidential elections in France, Egypt and the U.S., to the enduring, yet narrowing, unrest in the Middle East to the impact of the fiscal austerity and stimulus policies impacting national economies throughout Europe and the United States. Regardless of the results of all of these resolutions, 2012 will bring forth more **certainty** to the strategic investor who relies on **clarity** to best manage wealth. At work are the **economic fundamentals** that tell the story of what *is* happening in the economy and more importantly, how we can march ahead with the ongoing theme of this era – **cautious optimism**.

■ **The U.S. Economy – slow growth, steady trends**

- According to the Federal Reserve’s quarterly report, first quarter **GDP growth** measured 2.2% with projections to finish the year at or slightly above 3.0%
- 2013 GDP is projected to be at or slightly lower than 3.0% implying that the economic growth over the next 24 months will remain slow
- U.S. **GDP per capita** remains very strong – the highest in world compared to other fully diversified nations at \$48,100
 - This number measures the overall standard of living which essentially means that the nation’s **economy** produces for its citizens
- The **unemployment rate** continues a very slow decline from 9.0% at the beginning of 2011 to 8.2% at the end of March 2012
 - Projections for the unemployment rate for the end of 2012 are targeted at 7.58%
 - This rate is still very high compared to the 4.5% rates from 2007, yet is significantly lower than the peak of 10.0% during the fall of 2009

- Banta recognizes that GDP growth must hit at least 4.5% for **economic expansion** to reduce the unemployment rate; therefore indicating that the current slow decrease in the unemployment rate is partly due to people removing themselves from the job market altogether combined with only incremental monthly job growth
- The **inflation rate** fell to 2.7% in April 2012 from 3.0% measured in January 2012
 - Exactly one year ago in April 2011, the inflation rate was 2.7% seeing a high of 3.9% in October 2011 mainly due to a spike in energy prices
 - Projecting low inflation for the foreseeable future, the Federal Reserve will maintain the 0 – 0.25% federal funds rate well into 2014
 - Though low inflation is good for the consumer, wages will similarly remain low
- **The Broad Outlook – bit by bit**
 - **Consumer spending** increased in the last part of 2011 largely driven by auto purchases and general retail
 - One anomaly is pointed to the warmer winter allowing traditionally colder states to save money on heating thus putting more money in their wallets to spend
 - The increased price of gasoline has not shown a measured shock to consumer spending, however gasoline above \$4 a gallon is projected through 2012 potentially impacting consumer spending during the all-important fall retail season
 - Complementing steady and growing consumer spending is a strong rebound in **consumer credit** – in essence, **household debt is falling**, credit worthiness is improving and more large ticket items are being financed
 - The lending market is showing that for the first time since 2008, there is an increase in outstanding commercial real estate loans thus reducing delinquencies and loan write-downs
 - The **construction** industry – namely residential and non-residential – is starting to turn a corner where vacancy rates in every major category of non-residential have been falling and rents have stabilized
 - Construction has always been a major sector of the national economy and with this industry showing signs of recovery – such as specialty construction in infrastructure, hotels and long-term healthcare facilities – the trends indicate recovery, but very slow
- **Business Investments and Markets – the bright spot for growth**
 - **Exports** remain steady due to the falling U.S. dollar in part fueling industrial production where capacity utilization in manufacturing recently hit 77%, very close to the 80% pre-recession level
 - This implies that businesses will be seeking to expand capacity through investments in capital and workers
 - Although the export measures are positive, the recent dip in first quarter orders for durable goods, primarily military aircraft and other high capital-intensive goods, will have many economists watching exports with *careful enthusiasm*
 - **Financial Markets** remain one clear source of optimism – the Dow in particular, moved above 13,000 earlier in the year – helping inject some strength into the economy both through the wealth effect and by increasing collateral value while also helping the lending markets turn around
 - Unlike the previous rallies in 2010 where much of the recovery was due to a recovery in inventories

and not in labor markets, this time around the rally is based on the **robust economic fundamentals** described above

- And while P/E ratios look high, the spread over interest rates is still very large – this implies that either stocks are underpriced or bonds are over priced
- Also, with Europe calming somewhat, the United States will likely be less desirable as a safe haven for international investors potentially sending rates up slightly higher – thus a good year appears to be in store for the **equity markets**

At the beginning of 2012, we said that the year ahead must be approached with **vigilance and patience** where our vigilance drives our **optimism** and our patience supports our **caution**. At Banta Asset Management we believe that **fundamentals** are the cornerstones in understanding the new economy. The fundamentals provided in this letter are the compass by which we pilot through what will no doubt be an exciting year of global politics, global economics and even a dash of Olympics.

With continued confidence,

Banta Asset Management