



AND THAT'S THE WEEK THAT WAS... For the Quarter Ended March 31, 2013

Market Matters...

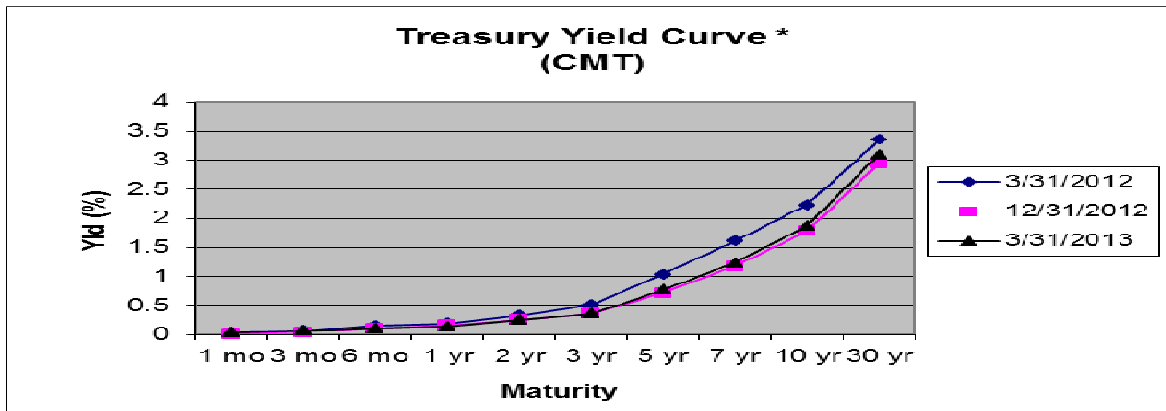
| Market/Index | Year Close (2012) | Qtr Close (03/31/13) | YTD Change |
|------------------------|-------------------|----------------------|---------------|
| Dow Jones Industrial | 13,104.14 | 14,578.54 | 11.25% |
| NASDAQ | 3,019.51 | 3,267.52 | 8.21% |
| S&P 500 | 1,426.19 | 1,569.19 | 10.03% |
| Russell 2000 | 849.35 | 951.54 | 12.03% |
| Global Dow | 1,995.96 | 2,110.73 | 5.75% |
| Fed Funds | 0.25% | 0.25% | 0 bps |
| 10 yr Treasury (Yield) | 1.76% | 1.85% | 9 bps |

Apparently investors don't care much about the happenings in DC these days. During the first quarter, the nation's "best and brightest" continued with their game of kick-the-can as "fiscal cliff" became "sequester" with very little to show in the way of budget compromise. With no deal in place, the \$85 billion in automatic spending cuts moved forward with each side blaming the other for putting our personal safety at risk through reductions in the defense budget. Wage earners were hit with higher payroll taxes and naysayers warned of decreased consumer and biz spending and the potential of layoffs. While earnings season was considered a moderate success, many companies including key benchmarks **Alcoa** and **UPS** reduced forecasts given the budget standoff and cloudy economic outlook. And yet, against the backdrop of uncertainty, equities surged in the quarter with the Dow Jones and S&P 500 setting all-time highs and the small-cap Russell 2000 leading the way in terms of performance. So what gives?

Corporate board rooms again played "let's make a deal," highlighted by Warren Buffett's **Berkshire Hathaway's** interest in **Heinz**, **AMR** (American Airlines) joining forces with **US Airways**, and **Office Depot** and **Office Max** coming together to corner the paper clip market. Michael **Dell** seemingly had enough of the endless public scrutiny, but his proposal to privatize his computer company was halted by a few large shareholders looking for a better deal. Other companies like **MasterCard**, **HP**, and **BP** rewarded shareholders through share buybacks and dividend increases. Automakers continued to report stellar sales numbers and retailers (even discounters like **Wal-Mart**) have enjoyed decent traffic despite the payroll tax hikes as the initial fears of the consumer entering hibernation appear to be premature. Likewise housing moved beyond its doldrums (see below) and gave the economy a nice shot in the arm. While Congress cannot agree on much, the politicians did pass a bill to keep the gov in biz through September 2013.

Investors welcomed the temporary end of the daily fiscal cliff talk and stocks were off to the races in January with the Dow enjoying its best monthly performance since October 2011. By March, the Blue Chips and their S&P counterpart had moved into record-setting territory though the tech-heavy Nasdaq was hurt by a disappointing quarter at **Apple**. Investors moved from the safe-haven of treasuries into risk assets like small-caps and junk (high yield) bonds. Health care, consumer staples, and industrials comprised the top performing sectors and the Dow ended the three-month period up over 11%, its best first quarter since 1998. In the "can history repeat?" category, **Birinyi Associates** points out that in the 12 times the S&P 500 index topped 10% in the first quarter, it ended in positive territory for the year 11 times, though most of the gains occurred in the first three months. Shifting abroad, European and Asian stocks (ex-Japan) underperformed the US as continued budgetary challenges in the Eurozone stalled any early optimism on its outlook and a diminish trade picture impacted China and certain emerging markets. Japan's Nikkei, on the other hand, soared close to 20% to a 4.5 year high on expected central bank stimulus. For now, the market trend remains favorable (if only politicians can stay out of the way).

Economically Speaking...



When Congress was unable to reach compromise and halt the automatic spending cuts (did they really try?), analysts worried about dire repercussions on the economy. Add higher payroll taxes to the mix and the threat of diminished consumer activity seemed very real. Instead, the overall results have been quite favorable in the first quarter. **Housing** continued its resurgence as home sales posted year-over-year gains for 20 straight quarters and single-family construction surged to its highest level since June 2008. Likewise **manufacturing** remained comfortably in expansion mode as the auto sector contributed solid output. Despite the never-ending **labor** concerns, the unemployment rate fell to its lowest level since March 2008 and nonfarm jobs additions exceeded expectations. **Consumers** even appear to be overlooking the bite that payroll taxes may be taking from their wallets as retail sales climbed for four consecutive months. While energy prices remain volatile, few analysts seem overly concerned about **inflation**. Still, 4th quarter GDP depicted the slowest pace of growth since early 2011 and some worry that “sequester” (automatic spending cuts) will serve as a headwind for the remainder of the year.

For now, the Fed has played a major role in the stability of the economy and the policymakers have debated how to wind down the stimulus and allow the growth to continue on its own. While the Central Bank is buying \$85 billion in bonds (treasuries, mortgages) each month, some expect it to begin a tapering strategy to wean the economy off of this key program before inflation emerges or investors engage in excessive “risk-taking” (been there, done that). For now, the officials will focus primarily on the monthly labor numbers in making policy decisions.

While plenty of domestic concerns remain, the situations abroad look far more unstable. Cyprus joined the game of “follow the leader” by becoming the latest Eurozone member to create havoc on the region. When the dust settled, the country received a much-needed 10 billion euro bailout, but only after its second largest financial institution was shut down and new controls were placed on depositors. Italy held controversial elections that cast a new dark cloud on a country trying to come to grips with harsh austerity measures, a contracting economy, and recent credit rating downgrades. Germany continues to be “on the verge of recovery” and call the shots in the region, much to the chagrin of many of its suffering brethren. China’s gov took measures to counter the impact of surging home prices and the potential for significant inflation. While its economy is still expected to grow at about 7.5% this year, many remain concerned about its reliance on trade with its European partners who have failed to put their challenges behind them.

On the Horizon... Each of the past three summers brought dramatic market pullbacks that wiped out early year gains. Will history repeat as sequester and payroll taxes take their tolls? Or can the ongoing strength from labor and housing propel the economy (and markets) and allow Bernanke and friends to successfully navigate the ship forward? Where is Cyprus, by the way?