1DB Asset Management

Securities offered through 1st Discount Brokerage, Inc.
Member FINRA, SIPC

Q4-2014

Letter to Investors

To gain a sense of perspective, let me bring you up to date before looking towards the end of the year. GDP growth, currencies, commodities, fixed income and equities have been on a topsy-turvy ride of late. What does this mean for investors over the near and intermediate term?

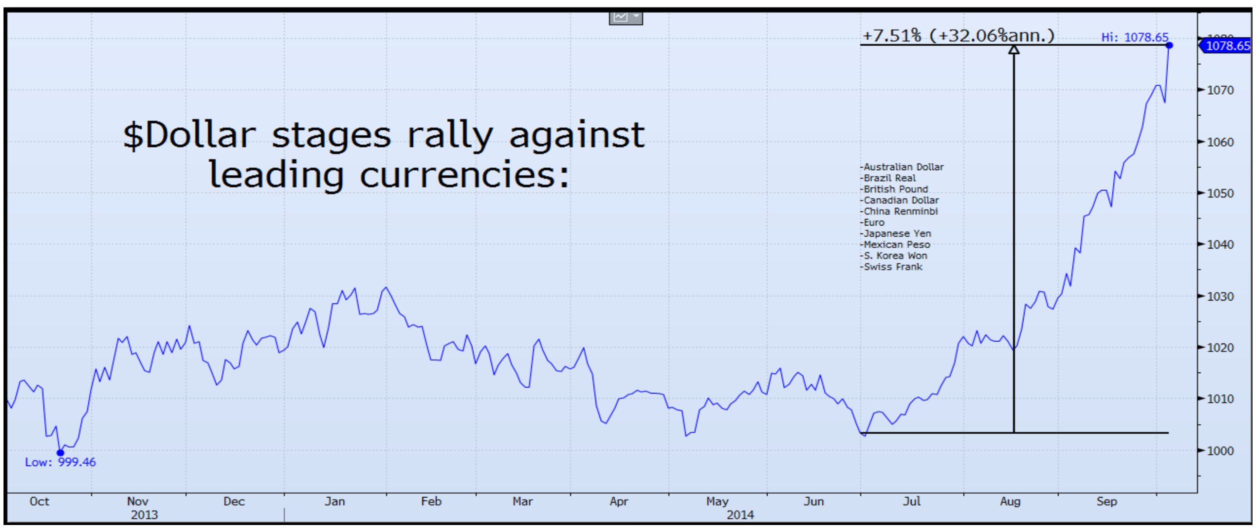
Economic Growth

Gross Domestic Product (GDP) measures the total value of goods and services produced in a country each year. Economists and Wall Street analysts track the GDP growth rate as a gauge for estimating earnings, employment, deficits, interest and exchange rates, et cetera. This past winter was so severe that business activity and consumer expenditures were stymied in the first quarter. The GDP growth rate slowed from 3.5% at the end of 2013 to -2.1% the next three months. As the winter thawed and spring sprang forth, GDP sprang with it, rising to a 4.6% growth rate over the next 90 days. It is interesting that an economy as large as the U.S. at $17.3 trillion can fluctuate to that degree in such a short time frame. What is the GDP growth rate forecast presently? The table below (provided by the Atlanta Fed) forecasts a GDP growth rate of 3.2% for Q3 and consensus view for Q4 is 3.1%.

Date	Major Releases	GDP	PCE	Equip-ment	Intell. prop. prod.	Nonres. struct.	Resid. inves.	Govt.	Exports	Imports	Change in net exp.	Change in CIPI
4-Aug	Initial nowcast	2.6	2.5	8.0	4.6	2.4	4.5	1.9	4.4	3.6	0	-10
29-Aug	Real GDP, Personal income	2.3	1.1	11.4	5.0	2.0	9.2	1.2	5.7	4.3	2	3
10-Sep	Wholesale trade	3.0	1.3	12.9	5.1	7.6	8.8	1.6	6.0	2.2	17	-1
11-Sep	U.S. Treasury statement	3.1	1.3	12.9	5.1	7.6	8.8	1.8	6.0	2.2	17	-1
12-Sep	Retail trade	3.4	1.8	12.9	5.1	7.6	9.2	1.8	6.0	2.4	16	-1
15-Sep	Industrial production	3.2	1.7	12.3	5.1	8.3	8.5	1.8	5.6	1.9	16	-7
17-Sep	Consumer price index	3.2	1.8	12.3	5.1	8.3	8.3	1.8	5.6	1.9	16	-6
18-Sep	Housing starts	3.2	1.8	12.3	5.1	8.2	9.2	1.8	5.6	1.9	16	-6
22-Sep	Existing-home sales	3.2	1.8	12.3	5.1	8.2	9.4	1.8	5.6	1.9	16	-6
24-Sep	New-home sales/Construction prices	3.3	1.8	12.3	5.1	8.1	11.9	1.8	5.6	1.9	16	-6
25-Sep	Advance durable goods	3.3	1.8	13.7	5.1	8.1	11.9	1.8	5.5	1.9	16	-9
29-Sep	Real GDP, Personal income	3.6	2.3	14.6	5.6	8.6	12.8	1.8	6.3	2.7	15	-13
1-Oct	ISM manuf., Construction (C30)	3.3	2.3	14.6	5.6	2.4	11.0	1.6	6.3	2.7	15	-13
2-Oct	Manufacturing (M3), Auto sales	3.1	2.0	13.1	5.6	2.3	10.9	1.6	6.2	2.6	15	-13
3-Oct	Employment report, Foreign trade	$\boxed{3.2}$	2.0	12.8	5.7	2.2	10.5	1.6	6.4	2.0	20	-12

King Dollar

Last month, I blogged about King Dollar, the world's primary reserve currency. A reserve currency is one held in significant quantities by governments, sovereign wealth funds and institutions; it is sought as a sustainable, reliable form of economic exchange and value. The U.S. dollar has reestablished itself as the go to reserve currency in the world. King Dollar's supremacy has come under attack at times. For instance, prior to the financial crises our own former Federal Reserve Chairman, Alan Greenspan, held the opinion that the Euro could replace the dollar as reserve currency. I presume his rationale had something to do with the excess U.S. federal government spending, widening deficits and escalating debt loads. Seven years later the dollar's story once again changed. The chart below illustrates the magnitude and trajectory of the dollar's rise compared to 10 leading currencies in the world. In a matter of three months the U.S. dollar's global purchasing power increased by 7.5%.



Paris Anyone?

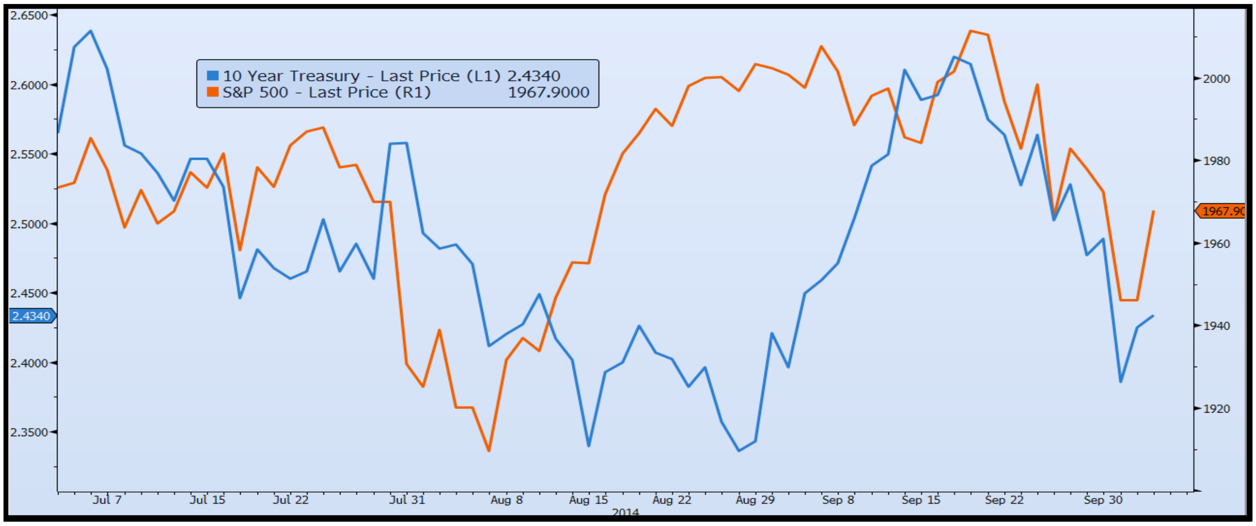
The chart below illustrates the Euro/Dollar exchange rate. It is evident that the Euro has been under attack. The Euro is now down more than 10% and the chart doesn't indicate that an end is in sight. A falling currency can be both a curse and a blessing. It makes exports for goods and services more attractive for the country with the devaluing currency, but at the same time holders of the weaker currency lose coveted global purchasing power. I'll take the immediate increase in global net worth over future sales growth any day. What's pushing the Euro lower? It all starts with the sputtering Euro Zone economy. The EU posted a paltry 0.2% GDP rate of growth Q2 versus 4.6% here in the United States. Mario Draghi, President of the European Central Bank, insisted the ECB would take bold stimulus action to reinvigorate the EU, but his actions thus far speak otherwise. German, French, Spanish and Italian 10 year bonds have an average yield of 1.64%, compared to the U.S. 10 year treasury at 2.43%. Foreign capital is increasingly moving to dollar based assets, positively impacting domestic bond prices. Tension from Vladimir Putin's Ukraine campaign has dampened the morale of Eastern Europe and with it tapered foreign investment into the region. The confiscation of deposits that occurred in Cypriot banks a year ago has not been forgotten. There is a silver lining for Americans interested in traveling overseas. If you are planning your next trip to Europe, the cost is becoming more affordable by the day.

Gold, Silver & Oil

Commodities worldwide have been under pressure from waning demand. China's growth rate remains above 7%, but it is expected to decelerate and Europe's woes make matters even worse. King Dollar's appreciation is immediately felt in commodities markets, driving prices lower as the dollar rises. Increasing domestic crude oil and natural gas output is lowering prices worldwide. The chart below shows the performance of gold, silver and oil of late.

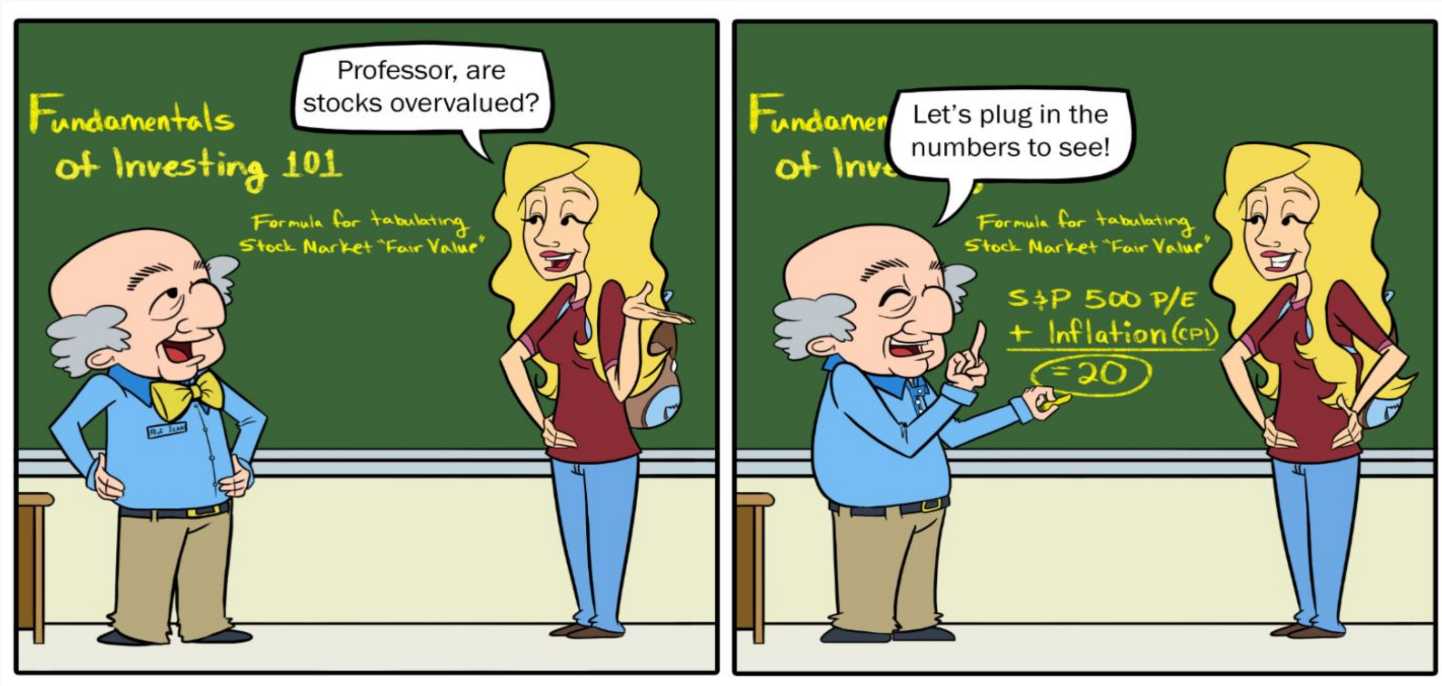
Stocks & Bonds

The last quarter was anything but normal. Since 1945, the third quarter has been the worst performing quarter each year. According to S&P Capital IQ, July, August and September have posted average returns of +0.89%, -0.03% and -0.56% respectively; this past quarter the figures were -1.51%, +3.77% and -1.55% with the S&P 500 +0.62% for the quarter. Bonds also acted strange; history has shown that when rates increase bond prices decrease. The Federal Reserve has done everything but spell out when it will raise the federal funds rate. This intent has spooked equity, currency and commodity markets around to globe. It's ironic that with interest rates poised to rise, we actually saw bond prices increase modestly last quarter sending yields down from 2.61% in July to 2.43% now.



Rule of 20

Sam Stovall, Standard & Poor's Chief Investment Strategist, reminds investors that the "Rule of 20" has withstood the test of time. The "Rule of 20" is tabulated by adding the market's trailing 12 month GAAP Price-to-Earnings Ratio 18.22x to the most recent Consumer Price Index figure 1.7%. If the sum is equal to 20 the market is considered to be at fair value; 18.22 + 1.7 = 19.92. The rule suggests the market is slightly underpriced.



Bull or Bear

Last week's BLS unemployment number far exceeded street consensus estimates. USA added 248,000 new jobs last month, lowering the unemployment rate to 5.9%. The positive report lifted spirits and pocketbooks alike. Over the next couple of months, markets will be influenced by upcoming earnings announcements and mid-term election assumptions. Bears are sharpening their claws at this point and clamoring on about how the market is overvalued. They advocate that we need pro-growth fiscal policy to sustain current price-to-earnings multiples. Bulls on the other hand see valuations in line with historical norms. Since World War II, the fourth quarter has enriched investors with average returns of +0.95%, +1.24% and +1.79% for the months October through December. That being said, color me a bull.

Respectfully,

William "Chip" Corley, MBA, RFC