Third Quarter 2013 Market Review

In spite of the uncertainties that have been driving the headlines, economic trends have been quite stable during the quarter. Year-over-year economic growth has been around 2.8%. The private sector drivers of this growth include consumer spending, business investment, exports and housing. The weakest part of the economy during the quarter was the public sector, as a result of spending cuts at the FED, state and local levels. While this growth is good, it is far from robust. Remember, dynamic growth comes from the addition of more workers and enhanced productivity from the workforce. Despite massive Fed stimulus over the past two years, the level of productivity growth remains weak.

During the quarter, we saw the market take some dramatic moves. Remarks by the FED Chairman had the most impact on the fixed income market. A hint that to delay future tapering caused a substantial rally in rates, with the 10 year Treasury rallying 30 basis points. This reaction caught the FED off guard and Bernanke immediately backed off and whispered “just kidding”.

What this tells us is the system is not functioning properly. To put it in medical terms, QE is like a morphine drip on the economy, the term structure of interest rates and speculative behavior. Further, it has distorted the rationality of Corporate America. Bernanke’s “Great Experiment” looks to be eagerly adopted by his successor Janet Yellen. We don’t know when it will end, but we know it will. Given the markets and economy’s addiction and both psychological and physical dependence on the FED’s opiate, the inevitable withdrawal won’t likely be pleasant

We continue to ladder the portfolio and reduce duration when possible.