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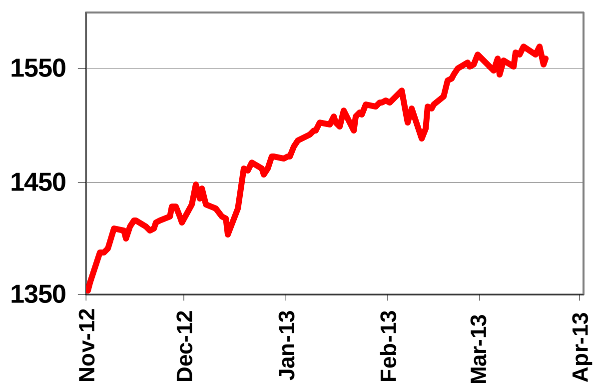
Investment Matters

For the quarter ended March 31, 2013

10 Reasons To Be Cautious About Stocks

In the last 4 ½ months the S&P 500 Index has advanced 16%, more than the typical return from stocks in a full year. It's been a wonderful ride for equity investors but there are a number of reasons to be cautious:



The S&P 500 Is Up 16% Since Last November

1. Strong market rallies, the ones which hold their gains, are usually associated with an increased volume of stock trading. The current advance has not been accompanied by an increase in volume.

2. A classic sign of a market which is approaching a top is that even as the popular market indexes continue hitting new highs, fewer and fewer stocks within the broader indexes are making new highs. When the S&P 500 hit a new high on March 28th, only 381 of the 1867 stocks traded on the NYSE reached their new highs, down from 419 at the February 1st high and 454 at the January 2nd high.

3. The NYSE Composite Index is currently further above its underlying trend than it was prior to the 24% pullback beginning in April 2011 or the 17% correction beginning in April 2010.

4. Although the S&P 500 Index has been up on most trading days, it has generally declined in the last hour of the trading This divergence, particularly over an extended period of time, is not a healthy sign.

5. Stocks are getting expensive. By almost any measure stocks are the most expensive they have been in almost five years, even as economic growth remains anemic.

6. The stock market is not necessarily predicting a better economy. The best performing stock groups have been Staples and Health Care, both considered defensive groups.

7. Economically sensitive stock groups like Technology, Materials and Energy have underperformed the market during the rally.

8. Of the 110 companies in the S&P 500 which have issued earnings guidance for the recently completed first quarter of 2013, only 24 gave positive guidance, the lowest ratio since 2006.

9. Company insiders have been selling shares of their own companies at a much faster than usual pace, even as small (read: less sophisticated) investors have decided it's finally safe to re-enter the market.

10. The level of borrowing to purchase stocks is back to a pre-recession level. Increased margin borrowing suggests growing speculation in stocks.

Why Is There No Inflation?

If an excess of money always leads to high inflation, why, with the Federal Reserve pumping unprecedented amounts of money into bank reserves, are there no signs of a developing inflation problem.

A big part of the answer is that money in the form of bank reserves is only potential money. In order to have any actual economic effects it must get out of the banks and into the economy; the only way for that to happen is for banks to loan it out to businesses and individuals. So far, that is not happening, at least not enough to throw the economy into high gear or to ignite a rise in prices.

At least two factors are holding back bank lending, even at the current bargain basement lending rates. New restrictive federal regulations are one and lack of confidence is the other. Potential borrowers are not sure they will be prosperous enough to pay the loans back and bankers fear the same thing. After all it was only a few years ago that bad loans brought them to their knees.

Many of those bad loans are still outstanding – on the books of the banks but not currently being paid down. In 2009, delinquent loans peaked at 5.7% of all

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Inflation: continued

outstanding bank loans. Today, although that figure has improved to 3.7%, it is still high compared to the 2.4% historical average.

At the current rate of decline, non-performing loans will reach the historical average in about three years. At that point bank lending activity should also be approaching normal levels. If the banks loan just the right amount of money, the economy will prosper and inflation will stay in check. If they loan out more than the economy can absorb, the excess will ignite inflation. The difference will be determined by whether or not the Federal Reserve can put the giant money genie back in the bottle at exactly the right time.

In just the month of March, 496,000 people dropped out of the U.S. labor force.

Not Widely Known

As a percentage of consumption spending, Americans spend only 6.7% for food at home, the lowest percentage of 84 countries surveyed.

Ford, General Motors and Chrysler are paying a total of $360 million in profit sharing bonuses to hourly workers, even those recently hired. At Ford, each worker is receiving $8,300, at General Motors, $6,750 and at Chrysler $2,250.

In Midland , Texas, teenagers fresh out of high school are being paid $75,000 per year as truck drivers. The shale oil boom has made Midland a boom town.

In the last five years oil production in the U.S. has climbed from 5 million barrels per week to 7.2 million barrels per week. Virtually all of the increase has come from Texas and North Dakota.

Since 1950 the number of children in K – 12 public school has doubled while the number of non-teaching school administrators and staff has risen 700%. Non-teaching staff now outnumber teachers in 25 states.

According to the Brewers Association, there are now more breweries operating in the US (2,336) than at any time in the last 125 years, going back to 1887. Americans consume about 82 quarts per person per year, 12th highest in the world.

Last year, as a result of the quota which limits the amount of foreign sugar allowed into the U.S., consumers paid an extra $3 billion for higher priced domestic sugar.

The Wilshire 5000 Index which measures the performance of the entire U.S. market of publically tradable stocks is down to 3,678 companies, less than half the number in the index only fifteen years ago.

Just one dozen banks now hold 70% of all the assets in U.S. banks. The other 6,000 banks hold the rest.

In 1960, 49.4% of the federal budget went for defense. In 2010 it was 19.1%.

In a recent poll, Gallup found that only 11% of Mexicans said they would emigrate to America if given the chance. That's down from 21% in 2007. Mexican unemployment is only 5%.

In 2012 the top 10 business taxpayers paid $115 billion in income taxes, more than the bottom 75% of all U.S. individual taxpayers.

Of the top eight selling cars in the U.S. so far this year three were pickup trucks, including the top selling F Series Ford.

The net worth of all U.S. households is $66.1 trillion, up 16% from the recession low and almost back to the pre-recession high of $67.3 trillion.

America spends nearly $400 billion per year on research and development, or 2.9% of the total economy, the highest ratio ever recorded.

In normal economic times about 300,000 people per week, or two out of every 1,000 workers, apply for unemployment benefits. Most have new jobs within a few months.

The Bottom Line: 3/31/2013

Market Indicator	**Current Value**	**One Year Change**
Large company stocks *(S&P 500 Index)*	1569	14.0%
Small company stocks *(S&P Small Cap Index)*	531	17.1%
Short term interest rates *(3 Month T-Bill Yield)*	0.1%	No change
Long term interest rates *(10 Year T-Bond Yield)*	1.9%	From 2.2%
Inflation *(Consumer Price Index)*	232.8	2.0%
Energy *(West Texas Intermediate Crude Oil)*	$97.20bbl.	-6.0%
The economy *(Inflation adjusted GDP)*	$15.9 trillion	1.7%

QUOTABLE

"A high debt burden is a problem precisely because it reduces a country's capacity to deal with future shocks."

Kenneth Rogoff, Economist

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