FBB capital partners

April 2, 2014

Dear clients and friends,

"I wake up every day, right here, right in Punxsutawney, and it's always February 2nd, and there's nothing I can do about it."
-Phil Connors, as played by Bill Murray, in the movie Groundhog Day

On February 2nd of this past quarter, Punxsutawney Phil, that most famous super-sized squirrel, emerged from his cozy Western Pennsylvania hole in the ground, saw his shadow, took a quick look at the television news cameras assembled around him, and succinctly declared, "It's cold outside, and will be for a while longer. See you next year."

Fittingly, just a day prior, Janet Yellen began her new job as Chair of the Federal Reserve. Yellen left behind the modernist *beaux-arts* architecture of the FRB quarters in San Francisco for the somewhat larger modernist *beaux-arts* Eccles building in DC, where upon arrival she walked steadfastly in her predecessor Ben Bernanke's long shadow. And in her first public testimony, she took a quick look at the Congressional representatives assembled around her, and tersely declared, "The economy is moving ahead very slowly, and will be for a while longer. See you next year." [1]

"Meet the new boss. Same as the old boss."
-Pete Townshend, of rock band The Who

The good news is that Yellen offers us few surprises as Fed Chair, with Fed watchers broadly expecting the Yellen era to look very much like the Bernanke era. Yellen had been Vice Chair from 2010 up until her promotion this year, and had been largely on the same page as Bernanke with respect to Fed Policy. We expect she will maintain a consistent, steady hand at the Fed's helm, much as Bernanke did, and in contrast to the reckless bubble-blowing-and-bursting we experienced under "Easy Al" Greenspan.

The less-fortunate news, like our marmot-extended winter this year (which may have finally concluded with last weekend's blast of snow,) is that Yellen's comments regarding the state of the economy appear correct. Though corporate profit margins are at all-time highs, the growth rate of earnings continues to moderate. Labor market gains have largely been attributable to statistical engineering and a drop in labor force participation, not ballooning payrolls. Inflation, which would help ease the US government's debt burden, remains unusually low (with *deflation* a growing concern elsewhere in the world.) We've mentioned our **"slow and low"** economic outlook many times over the past years, and nothing we saw in the most recent quarter changed that view.

"Plus ça change, plus c'est la même chose." [2]
-French journalist Jean-Baptiste Alphonse Karr

US stocks muddled their way through most of 2014's first quarter, finishing right around where they started. Last year's whipped dogs, the utility stocks and real estate trusts, were the leaders of the pack with high single-digit gains. European equities, also laggards last year, are outpacing the big US indexes so far this year. And contrary to widely-held beliefs about skyrocketing US interest rates, Treasury bond prices are higher, and interest rates slightly lower, than at the start of the year. Investors who moved money out of bonds following their unusually "bad year" in 2013 (the aggregate bond index was down a torturous 2% last year) soon found fixed income securities outperforming most equity sectors through the first quarter's end.

This leads us to the quarter's key takeaway, which is actually a point we made at the end of last year, but is one which we think merits repeating (over and over, as per the Groundhog Day movie's plot): **asset allocation works.** A diversified portfolio of imperfectly correlated investments helps us smooth out volatility over time, while still allowing for reasonable returns at acceptable levels of risk. That's why we spend so much time with our clients discussing their return objectives *and* their risk preferences, before we invest the first dollar on their behalf.

The asset allocation process doesn't mean investing blindly. We are certainly cognizant of interest rates in light of the Fed's ongoing "taper." So too are we aware that stock prices are at the upper end of the historical fair value range (though prices are far from extreme.) But given our modestly positive outlook for the overall global economy, and our previously noted expectation that bank lending and business spending will pick up by the end of the year, these conditions are likely to persist – for at least a while longer.

With warm wishes for Spring,

Mitch Schlesinger
FBB Capital Partners

1 Ms. Yellen's actual comments regarding the Fed's Quantitative Easing program and the extremely low level of interest rates were, "This extraordinary commitment is still needed and will be for some time," and "The scars from the Great Recession remain, and reaching our goals will take time." But we think the point is more or less the same.

2 "The more things change, the more they stay the same."