



April 4, 2013

Dear Clients and Friends,

***The first day of spring is one thing, and the first spring day is another.  
The difference between them is sometimes great.***  
~ American author Henry Van Dyke

The stock market is often viewed as an indicator or predictor of the economy's health. Many believe that large selloffs are harbingers of future recession, while surges higher suggest sunny days ahead.

This notion of stock market as leading economic indicator is not always dependable, however. For example, the US economy fared quite well for a few years after the 1987 stock market crash, and rather poorly after the highs of 2007. Indeed, stocks didn't find solid ground again until the Spring of 2009, though the brunt of the mortgage crisis had already passed. One might argue that the National Park Service does a better job forecasting peak blooms for Tidal Basin cherry blossoms than the stock market does forecasting the economy.<sup>1</sup>

On the other hand,<sup>2</sup> sometimes higher stock prices do portend better economic conditions. The steady post-recession climb from 1991 through 1995 was fodder for market bears, yet that period preceded one of the greatest economic and stock market booms in history, concurrent with the commercialization of the internet and the dawn of the Information Age. And all that happened despite two global financial crises and the near meltdown of the US financial system during the same period!<sup>3</sup>

So here we are in the midst of one of the coolest Springs in memory, with US stock markets near multi-year or even all-time highs. Are the markets predicting better economic weather? We're not convinced.

It's important to note that other key markets around the globe appear far less optimistic of an economic thaw. European stocks have barely budged so far this year, likely due to the unexpected banking crisis in Cyprus and ongoing fiscal struggles with Greece et al. China is slowing as it shifts to a demand-driven economy, and some emerging markets like Brazil are seeing capital outflows. And don't forget we've still got the budget sequester moving in like an economic cold front. At this point, only Japan's Nikkei is outpacing the US markets by a wide margin, helped by a new stimulus program that may, finally, get them out of their *two decades long* slump.

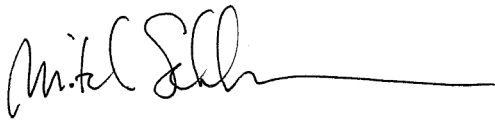
The bond market doesn't seem convinced Spring is here either, with the rate on the 10-year US Treasury about where it was at the start of the year. Fed Chairman Ben Bernanke has suggested the Fed won't deviate from their Quantitative Easing experiment (hoarding Treasuries and mortgage bonds, forcing bond buyers to seek income elsewhere) until perhaps 2015, so we do not expect material rate changes for at least the next year.

Our base-case economic outlook thus remains as it has been for several years now: **a slower than normal recovery, for longer than normal**. We acknowledge that the “wealth effect” of rising stocks adds a reason for optimism, and the housing recovery continues apace as we have documented previously. However, the headwinds remain brisk, and are not likely to diminish anytime soon.

In this environment we seek companies that generate above-average cash flows, and we are shifting a number of our security selections to underscore this point. Rising cash flow means the company can fund expansion without seeking external capital, or it can buy back stock, or it can pay dividends. Ideally we’d like to see all three! We also think higher cash flows will give our holdings better stability should conditions become more uncertain.

As always, we thank you for your continued trust in our investment team. We greatly appreciate having you as clients, and we would be honored to work with your friends, relatives or associates who may benefit from our services.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Mitch Schlesinger", followed by a long horizontal line extending to the right.

Mitch Schlesinger  
FBB Capital Partners

- 1- Statistician Nate Silver’s book “*The Signal and the Noise: Why So Many Predictions Fail - but Some Don’t*” offers some interesting insight on both weather forecasting and stock analysis.
- 2- “Bring me a one-handed economist!” – Harry S. Truman
- 3- As Mark Twain said, “History does not repeat itself, but it does rhyme.” Many of the events that happened during the 2008-09 financial crisis can be explained by those of the 1997-98 financial crises. We suggest Roger Lowenstein’s classic “*When Genius Failed*” as perhaps the best account of that topic.