



April 1, 2015

Dear Clients and Friends:

On the heels of a booming third-quarter 2014 GDP figure of 5.0%, the fourth quarter resulted in more modest growth of 2.2%, bringing full-year 2014 growth to 2.4%. While the final print seems benign enough, it is worth noting the volatility of the quarterly figures that comprised the aggregate. You may recall 2014 started with cold weather and slower economic data (sound familiar?) resulting in a first-quarter 2014 *contraction* of -2.2%. True to form, growth bounced in the second and third quarters. We would not be surprised to see similar "seasonal" volatility in first-quarter 2015 data, particularly if "weather" did, in fact, keep consumers at home, as consumer spending has been the obvious bright spot in recent quarters.

The improving employment figures are less choppy than GDP and, in fact, have been accelerating. As mentioned in last quarter's letter, monthly non-farm payroll increases averaged 240,000 per month for most of 2014, and if we look at that average during the last 6 months, the pace of improvement has accelerated to 293,000 per month. Continued improvement in the employment picture should eventually lead to increases in wages, which will eventually find their way to the Federal Reserve's "data-dependent" scorecard, which will ultimately lead to rate increases.

Speaking of the Federal Reserve, as expected, the FOMC dropped "patient" from its March 18 statement. However, in a brilliant bit of fed-speak jujitsu, Chairman Yellen stated that, just because the board removed the word "patient," does not mean that it will be "impatient." More importantly, we finally witnessed a pull-back in the governors' expectations for the Federal Funds rate over the long run (see Exhibit 1), providing markets with a clearer vision of the potential path and pace for future rate increases.

Exhibit 1

Fed Officials' Estimates For Appropriate Fed Funds Rate				
% At Year-End	2015	2016	2017	Longer Run
Median				
December 2014	1.13	2.50	3.63	3.75
March 2015	0.63	1.88	3.13	3.75
Mean				
December 2014	1.13	2.54	3.50	3.78
March 2015	0.77	2.02	3.18	3.66

Source: High Frequency Economics: Daily Notes March 19, 2015

Markets surged on this news, with the Dow closing some 350 points higher than the triple-digit loss seen earlier that day. Of greater interest was the simultaneous rally in bonds, as the yield on the 10-year U.S. treasury dropped 10 basis points. Typically with asset rotation (selling bonds to buy stocks), we would expect the opposite to occur, but the buying of both asset classes reinforces our belief that global dollars are still in search of both quality and yield.

There is a simple truth that money goes where it is most kindly treated. A quick glance at the yield on two-year Eurozone debt paints a clear picture of where money is not being treated kindly. Witness negative yields in nine Eurozone countries, ranging in value from -0.16% to -0.99% (see Exhibit 2); U.S. notes of similar

duration offer an attractive alternative at a whopping +0.50%. Thus, we are seeing the flow of capital into U.S. assets, driving the dollar higher against the Euro and other currencies.

Exhibit 2

Country	Two-Year Yield	Country	Two-Year Yield
Switzerland	-0.99	Netherlands	-0.20
Denmark	-0.54	Austria	-0.18
Sweden	-0.32	France	-0.17
Germany	-0.25	Belgium	-0.17
Finland	-0.22	USA	0.50

Source: Bloomberg

This trend of dollar strength may very well continue, due to the changing landscape of global monetary policy. Whereas the U.S. was once home to “cheap” money and low borrowing rates aided by asset purchases, the dynamic has now shifted. While the Federal Reserve ended quantitative easing last October, in January the European Central Bank announced further stimulative measures by expanding its own asset-purchase program.

For first-quarter 2015, companies generally reported earnings that exceeded estimates, while simultaneously tamping down expectations with forward guidance that was more subdued than expected. Investors seemed surprised to learn that, depending on the industry, companies are anticipating oil weakness and/or U.S. dollar strength to have a meaningful impact on near-term earnings power. With a lot of noise between New Year’s Eve and today, Large U.S. stocks basically ended the quarter where they began, while bond prices appreciated in the face of the aforementioned global quantitative easing and negative real rates of return in other developed countries.

As we move toward the second quarter, none of the components of our valuation formulae have changed: earnings are still growing, albeit slower, and rates are still low, in fact lower. Thus, we still feel stocks offer better relative value when compared to bonds. However, equity prices, while not extremely overvalued, are also not cheap by historical standards. We continue to believe that prudent pruning within the equity sleeve of portfolios has merit, particularly where client allocations have offered the flexibility for growth beyond strategic targets. As we have throughout the past several years, we are taking a measured pace when it comes to adding fixed income, as the market has often rewarded us for being patient by offering more attractive entry points.

With warm wishes for Spring,

FBB Capital Partners’ Investment Committee