Managed Asset Portfolios

MAP Views

Third Quarter 2014

During the second quarter, the S&P 500 rose 4.7%, chalking up 16 record closes, in route to its sixth consecutive quarterly gain. Year-to-date, the S&P 500 is up 6.1%. Stock market strength was also strong around the world, with the MSCI AC World Index added 5.23%, bringing its year-to-date advance to 6.5%.

The bond market performed well, also, as the yield on the 10-year Treasury (which moves inversely to prices) fell to 2.51% from 2.76% at the beginning of the quarter.

Perhaps most surprising to us during the quarter was the lack of volatility. The S&P ended the quarter having gone 51 sessions in a row without closing up or down more than 1%, the longest such streak since 1995. The CBOE Volatility Index (commonly referred to as the VIX) hit its lowest level since 2007.

Investors shook off news of negative GDP for the first quarter, attributing much of the problems to the brutally harsh winter experienced by much of the country. Many industries, ranging from retail to restaurants, railroads to manufacturing, cited weather as a reason for earnings that were below expectations. Going forward, Wall Street economists forecast the economy to grow at a modest clip for the balance of the year, which should be supportive of improved corporate earnings. Given the magnitude of the stock market advance over the past year and a half, we would not be surprised to see a pullback, but believe it would be modest (single digit percentage terms). We believe central banks around the world will continue to be accommodative, which should be viewed positively by equity investors.

Below are a few questions posed to the portfolio managers of MAP (Michael Dzialo, Peter Swan, and Karen Culver).

Q. The U.S. Labor market appears to be gaining traction, with unemployment declining to 6.1%. MAP has been concerned about the labor market for quite some time. Have your views on the labor market and economy changed?

> ***We believe the U.S. labor market continues to be challenged. We believe the issues impacting the employment picture are structural in nature, as well as cyclical.***
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> ***As an example, June's jobs report showed a gain of 288,000 jobs, which on the surface appears impressive, as it showed the sixth straight month of jobs growth. What was not discussed as much is the fact that 523,000 full time jobs were actually lost in the June***

report and over 800,000 part-time jobs were created. New jobs are always welcomed news, but part time jobs usually come with lower pay, fewer benefits and less security. We believe, the shift toward lower paying, part-time service jobs creates a significant headwind for the U.S. economy as there is less discretionary income for U.S. consumers to spend. Additionally, we think numbers such as U6 (which measures unemployment as well as under employment) and the labor force participation rate (which measures the percentage of Americans that are actually employed) are better barometers of the health of the jobs market than simply the unemployment rate. U6 remains elevated at 12.1% and the labor force participation rate stands at 62.8%, near its lowest level in 30 years. The last time this statistic was this low, inflation, interest rates and unemployment were all at double digit levels and the misery index was at a record high.

Q. The U.S. stock market continues to defy its skeptics, making up all of the losses incurred during the 2008 - 2009 financial crisis, in route to new all-time record highs. Do current valuations concern you?

Overall, we view current valuations as fair. Stocks are not historically cheap, nor do they appear overly pricey. The S&P 500 is trading at a price-to-earnings multiple of 15.8 times next year's earnings. Given our forecast for economic growth in the 2% range, we believe equities should be able to outperform other asset classes over the next year. We do, however, anticipate a pickup in volatility.

We would note, however, there are pockets of the market that do concern us. In particular, we believe valuations in the small-cap space are getting rich. The Russell 2000 index is trading at a price/earnings ratio of more than 19, well above its 20-year average of 16.9, as well as its five-year average of 15.8. There are individual stocks in the social media space such as Facebook and Twitter that appear to be grossly overvalued. As value investors, we shun areas of high valuations and concentrate our efforts on value stocks, which we believe offer better risk versus reward characteristics than stocks with higher valuations. With that said, we have recently found attractive opportunities in Sweden, Netherlands, France, Thailand, and the U.S.

For more insights on our thoughts on the economy and financial markets, please visit our website at www.managedassetportfolios.com to view our latest quarterly webinar.

Enjoy the remainder of the summer!

Kindest regards,

Michael S. Dzialo

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