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ASSET MANAGEMENT

"By the Way"

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Vice President

We are in a bull market until proven otherwise. The market has thrown a lot at investors; the "noise" level is deafening, but the fact of the matter is that the trend remains higher. Nevertheless, that does not preclude us from assessing the negatives, and preparing for a change that may be in the offing. Specific indicators that are cause for concern should include: weak breadth tells us fewer stocks are participating in the current market; economically sensitive stocks and small cap stocks are underperforming signaling less appetite for risk; and investor sentiment has been overly bullish, which is a contrarian measure.

In the short term, the market appears oversold with 20 day lows, the put/call ratio, and the low percentage of stocks above their 50 day average all implying some capitulation. Therefore, a rally should be forthcoming, and how that rally transpires will be crucial to whether or not this was a correction or we are in fact in the process of putting in a market top. We will want to see sufficient broad-based strength to negate the above-mentioned concerns. As a cynical friend of mine pointed out yesterday, *"Every bear market begins with a bull market correction".*

The economic landscape remains much the same. The majority of reports in the U.S. demonstrate an improving economy, while most of the rest of the world is in the doldrums, particularly the Eurozone. One need only note the most recently reported unemployment rate in the two areas to see the dichotomy: U.S. 5.9% - Eurozone 11.5%. While on the subject of the labor force in the U.S., it was thought-provoking to note that while 248,000 jobs were created in September, 230,000 of the additions were in the 55-69 age group. As a member of that crowd, I have to say it is probably less productive than the 24-54 age group which actually lost 10,000 jobs.

The situation in Europe shows no sign of improvement. France and Italy both recently lowered the outlook for their respective economies, and admitted they will not be able to meet lower debt targets set by the European Union. Germany, which until recently was Europe's engine of growth, has seen industrial production fall by 4% over the summer and this week the government lowered GDP estimates for 2014 to 1.2% - down from 1.8%, and next year to 1.3% from 2%. A coordinated policy response, both monetary and fiscal is needed, but unfortunately does not appear to be imminent. The problem is that in some countries, particularly Germany, fiscal restraint is still seen as an important core policy, and as a result near term improvement for the EZ seems unlikely. The question then becomes, what will be the effect on the U.S. economy, which while growing is not yet that powerful. There is no doubt it will be a headwind but it should not be sufficient to derail the recovery. Since two-thirds of U.S. GDP is consumer driven, the effect of trade on the economy is much less than in other countries, and at the margin not that big a negative.

There is no need to reiterate the many geopolitical risks in the world; they are on the front page every day. We can become numb to the onslaught, but the risks from conflict, and now disease, are real. On that cheery note, we will await the next rally and prepare ourselves to analyze its implications for a longer term positive market outlook.

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