MURRAY
INVESTMENT MANAGEMENT

2nd Quarter 2013 Update

Economic Review

The U.S. economy continued to show moderate improvement during the 2nd quarter. 1st quarter GDP growth was 1.8% with estimates for the 2nd quarter around 2%. This is considered to be modest growth in the context of what many believe to be long term growth potential.

The unemployment rate was steady at 7.6% in June, but job growth has picked up over the last several months. In addition, the housing sector and consumer spending have shown marginal improvement.

The Federal Reserve took center stage during the quarter by announcing in June that it may taper (phase out) its bond purchases if the economy continues to improve. This news rattled investors as many worried that markets may not be able to advance without the support of the Fed.

Equity Market Performance

	QTD	YTD
S&P 500	2.91%	13.82%
MSCI EAFE (International index net return)	-0.98%	4.10%

Domestic equity market performance has been very good for the first half of the year. Performance was solid during the 2nd quarter, but volatility picked up significantly in June as investors debated when and how the Fed will begin to reduce its accommodative stance.

International markets were under pressure during the quarter and generally underperformed relative to domestic markets. Emerging markets were particularly weak as a potential slowdown in China and a rising interest rate environment weighed on these stocks. Gold was also down significantly during the quarter.

Bond Market Performance

	QTD	YTD
Barclays US Aggregate Bond (Broad Bond Market)	-2.32%	-2.44%
Barclays Municipal	-2.97%	-2.69%
Barclays US Treasury Long	-5.58%	-7.83%
Barclays US Corporate	-3.31%	-3.41%
Barclays US Corporate High Yield	-1.44%	1.42%

News that the Fed may begin to reduce bond purchases led to a selloff in fixed income markets during the quarter. Bond prices fell as the 10 year Treasury rate increased from 1.87% to 2.52%. Long term Treasuries were among the weaker performers.

Economic Outlook

The U.S. economy should continue to grow with an improving housing market, better employment and the wealth effect driving growth in the near term. Higher taxes and reduced government spending are weighing on the economy, but on the margin, economic numbers should improve at modest rates over the remainder of the year.

How the economy responds to reduced monetary stimulus and potentially higher interest rates will be a key question over the next year. It appears that the improving economy is being driven by more than just monetary easing, and this should become more evident as the stimulus is removed.

Market Outlook

Given that a better economy may lead the Fed to reduce its accommodative measures, investors will continue to debate if good economic news is good for equity markets. In addition, since the amount of Fed accommodation is unprecedented, how the Fed unwinds this support will likely cause a great deal of uncertainty / volatility in bond and equity markets.

What cannot be dismissed and what many seem to be missing, however, is the reason for the Fed's considering a less accommodative stance: the economy is getting better. This is a good thing and should not be a reason for equity markets to sell off. Going forward, it will be interesting to see if investors focus on 1) the reduced stimulus or 2) the reason (a better economy) that the Fed is pulling back.

The transition from low interest rates to a higher rate environment is generally not supportive of attractive bond returns. In addition, when comparing the 10 year Treasury yield (2.52%) to the earnings yield of the S&P 500 (over 6%) equities appear to be more attractively valued. This is a relative comparison, but additionally, on absolute basis, the broad U.S. stock market does not look overly stretched.

In addition, as investors digest their 2nd quarter bond returns and review the risk/reward trade off, there is an argument to be made that we may see more money flow out of the bond market and into equities. This would be supportive of equity markets and potentially drive them higher.

Murray Investment Management

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please give us a call. Also, please pass along our name to anyone that may be in need of investment advice.

Source: bls.gov, Morningstar, bea.gov, cnbc.com, wsj.com, iShares and treasury.gov
The performance data shown represents past performance, which is not a guarantee of future results.
Return data is as of 6/30/2013. Except as noted, index returns are Total Returns.

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