

## Welcome to the fall issue



Welcome to the fall issue of our newsletter! We hope you all had a great summer.

Fall marks the transition of summer into winter and also the beginning of the holiday season. We wish you all a wonderful holiday season with your friends and family.

In this issue, we provide a few articles about the current economic environment along with some other interesting pieces. Happy Fall! Enjoy.

# Economic Commentary

by James Pafundi



*Despite a recent global stock market sell-off, equity valuations here in the US remain somewhat elevated from a historical perspective while yields on fixed income remain low.*

In the Eurozone, economic indicators are troublingly weak. Germany recently announced that annual factory orders fell 5.7%, the largest drop since the financial crisis began in 2009. Expectations were for a decline of 2.5%. Developments in Russia and Ukraine, a slowdown in China, and deflation in the Eurozone have all dented German confidence in the recent months. This is now showing up in the numbers.

The US economy, on the other hand, has shown solid readings. This has made many economists think that rate hikes will come sooner and at a quicker pace than previously expected, although this interpretation is not reflected in today's bond markets. Why?

Some of this lack of bond market reaction is probably due to the role of geopolitical risks being played out in today's headlines, as well as the lower relative rates in other major global bond markets. Also, when you dig into the nitty-gritty of the recently announced unemployment numbers, taking into account the increase of the labor pool, you find some lack luster growth in jobs for the 25-to-54 year-old category. This makes the headline of "230,000 net gain" much less impressive.

That being said, as we look towards the end of 2014, leading economic indicators for the US, Canada and the UK are all pointing to stable economic growth with Japan and China moderating and the Eurozone weakening.

*The economic forecasts set forth in the communication may not develop as predicted and there can be no guarantee that strategies promoted will be successful. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual.*

## What is going on in the markets?

By James Pafundi

Sources: Treasury, Federal Reserve, BEA

Europe 2.0... New and improved. A few years ago, starting just after the financial crisis hit the US Stock Market, the European Union went into a crisis that threatened the future of the EU. Greece, Portugal, Spain, Italy... remember that?

The crisis finally started to break its grip on the market news flow in September of 2011. Gold prices, functioning this time as a fear gauge while coming in at all time highs, started to recede. Then Mario Draghi mentioned those magic words -- "everything necessary" -- and the market believed him. Europe became the new place to invest your cash amongst the institutions. The average individual investor was still on the equity sidelines. Fast forward to 2014...

Well, like most analysts were reporting at the time, Europe hadn't done much of anything from a monetary basis because the ECB lacked the power. Seventeen countries make up the European Union. It makes sense

that without a strong central bank, making real monetary change is very difficult. The question of who's going to pay for it was brought up -- Germany?

That's exactly what the Germans were thinking, and that's exactly what Europe got... not much relief. It was hoped that things would be different, such as possibly following the US economic recovery. However, the US followed a very different model than Europe, primarily because it could, not because it was popular. The Federal Reserve liquefied the US economy and continued to liquefy with QE1-3. Most remember TARP, the Troubled Asset Relief Program. That was \$750 billion. But do you remember the \$16 trillion the



## What's going on in the markets?

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lent out to other international entities like banks, companies, and countries? (Bloomberg, 2011) Needless to say, it was a lot of liquification. Right now, Japan is going through a liquification process with their own version of QE3. In fact, I recently read in the Japanese Abenomics article on Wikipedia that their QE would be equivalent to \$200B a month if it was taking place in the US market. So, Japan is liquefying and Europe needs to do the same, but can they? How quickly? What will it take to convince the market? Answers to these questions are unknowable.

The US economy is doing okay but not great, and Europe goes into a 2.0 recession, only this time it's new and improved. So what are the impacts? Investors are selling European stocks and currency. With margin debt being at an all time high, it makes sense that along with Euro stock selling you also have to have US stock selling. The US dollar is strengthening. With proceeds from the sales, and as a hedge against coming volatility, investors are buying US Treasuries. The 10yr yield dropped below 2% on the morning of October 15th. Looking at the European crisis 1.0 should provide some insight as to how to handle 2.0.

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# Fixed Income Update

## Why Short Term Rates May Go Up Faster Than Long Term Rates

Sources: Treasury, Federal Reserve, BEA

*A unique dynamic has been occurring since the beginning of the year as short-term rates have slowly been rising, while long-term rates have slowly been decreasing. This dynamic is known as a flattening yield curve, interpreted as long-term inflation expectations having actually resided somewhat.*

The fact that long-term rates have fallen may actually mean that the Fed is accomplishing its job of minimizing inflation expectations. As long-term rates drop, inflation becomes less of a concern long term. Long-term rates are set by the market, while short-term rates are set by the Federal Reserve.

In addition to benefiting from subdued inflation expectations, international demand for long-term government bonds has also translated into higher prices and lower yields.

As a result, rates on the 2-year Treasury note have increased at a faster rate than long-term Treasury Bonds with a 30-year maturity. Longer dated bonds are driven more by inflation expectations than changes in Fed Fund rates, and it appears the Fed has kept inflation in check according to recent inflation data.

Economic growth in the U.S. is further ahead than other developed economies right now, therefore, rate hikes are generally expected as the economy gets stronger. In other developed economies such in Western Europe and certain Asian countries, the discussion will likely be about further easing and the need to fight deflation.

The dollar's strength over the past few months is now translating into the U.S. Treasury market, where yields have become increasingly attractive relative to other developed nations' debt. Traditionally, a rise in a country's currency is a result of higher government debt yields. Yet, as the demand for government debt increases, the corresponding yields on the bonds may actually decrease. This dynamic has been evident with U.S. Treasuries as long-term bond yields have gone down as the dollar has elevated.

Of concern for many homeowners and would-be home buyers across the country is how the Fed's increase in rates affects mortgage rates. Long-term rates are what affect mortgage rates most, such as conforming 30-year rates. Historically, as the Fed has escalated the Fed Funds rate, which is a short-term rate, mortgage interest rates tend to lag, yet tied closer to long-term rates.



# What's Cooking *by Gina Pafundi*

*This issue's featured ingredient is quinoa, an Andean grain-like cereal. Interestingly enough, my mother grew up in Ecuador eating quinoa, however she never used it after she came to this country.*

## Facts on Quinoa

- Quinoa is a highly nutritious, grain-like food that comes from the Andes Mountains in South America. Native Andeans have been cultivating quinoa for thousands of years. Communities pass down traditional knowledge about growing, harvesting, processing, and using the plant.

– Oregon Museum of Science and Industry

- Quinoa is actually not a grain – it is a relative of spinach, beets, and chard. We eat the seed, cooked like rice, which is why it is gluten free.
- Quinoa is a complete protein, which means it contains all nine of the essential amino acids that cannot be made by the human body.

– Five Things You Probably Didn't Know about Quinoa, *The Huffington Post*



*Five Things You Probably Didn't Know about Quinoa*

– *The Huffington Post*

## Turkey Quinoa Soup

by Gina Pafundi

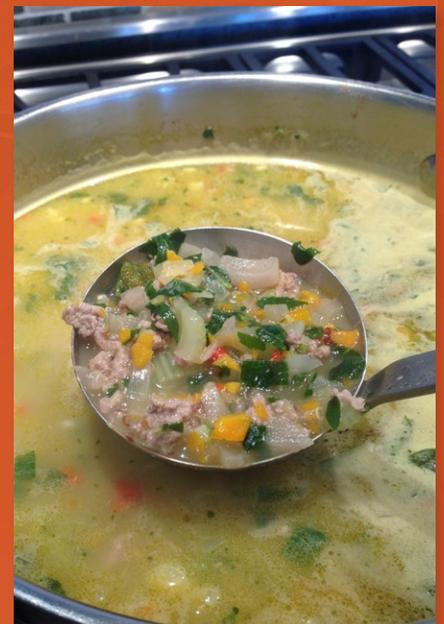
- 2 cups chopped celery
- 1 cup finely chopped carrots (can also be chopped in a food processor)
- 1-2 med-large chopped brown onions
- 1 small-med chopped red onion
- 6-8 cloves of roasted garlic
- 1 pound ground turkey meat
- 1 tbs salt
- 2 tsp pepper
- 1 tbs coriander
- 2 tbs olive oil
- 2 boxes of chicken broth
- 1-3 chopped jalepeños, serrano peppers or red peppers (optional)
- 1 c quinoa
- 2 c finely chopped kale
- 2 tbs fresh parsley

Begin by pre-heating the oven to 400 degrees. Wrap the garlic in aluminum foil and drizzle with olive oil. Roast garlic for approximately 30 minutes and set aside.

Cook quinoa according to the instructions on the box and set aside. Finely chop kale and set aside. (I use a frozen version of quinoa and kale that I regularly purchase at Costco. Your local grocer may also have this – a lot of stores nowadays sell frozen quinoa.) Sure makes it a lot quicker to cook a healthy dish!

In a large stock pot, heat olive oil and add onion, celery, and carrots. Sauté until soft. Add turkey meat and cook thoroughly. Add salt, pepper and coriander. Add two boxes of chicken broth and bring to a boil. At the same time, add the cooked or frozen quinoa.

Finally, in a blender, take some of the broth and add the roasted garlic. Puree the garlic and broth and add back into the soup. This final step can be optional but I think it really takes the soup from great to wow! Enjoy.



# Travel & Adventure

## Climbing Mt. St. Helens

By James Pafundi

In February this year I was contacted by a friend of mine who lives in Portland and asked if I wanted to climb Mt. St. Helens with him. Unfortunately, when the time came for the hike, the friend who invited me had a conflict of scheduling. In his stead, I invited my good friend and former college roommate, as well as his fourteen year-old son, to take the hike with me. Since we moved to the Pacific Northwest some three years ago, I have been to the Johnson Ridge Observatory no less than a dozen times with various family and friends who have come to visit us. It is always a destination we recommend to our guests, and one that both Gina and I find quite interesting. So many times I've looked at that gaping hole and wondered what it would be like to be on the top ridge looking down into the massive crater that was once the peak of a mountain. Well, now I no longer have to wonder.

We spent the night at "Climber's Bivouac," a collection of about seven camp sites at the trailhead. For those of you who have not made the climb, I highly recommend it. It's a five mile hike to the summit with 4,000 feet of



Photo by James Pafundi

elevation gain, and it makes for a grind of a trek. But somehow, it doesn't really get to you, because the beauty that surrounds you forces you to stop, catch your breath, and take in your surroundings.

You spend the first mile or two winding through old growth forests only to break out into a more sparse landscape at the 4800 ft level. From there, you simply follow a spine of lava up the next 2000 ft. The rock gives you good traction and makes the climbing a little easier. Then the big rocks give way to fine volcanic sand for the last 1000 ft to the crater's rim.

At the top it was a little windy, but just beautiful. After a half an hour at the summit and all the pictures we could bear to take, we headed back down. All in all, it took us about four and a half hours to ascend and three hours to descend. It was a truly spectacular day.

## Book Corner

by James Pafundi

Most new products fail. So do most small businesses. In fact, we have all experienced a setback in our life a time or two. But what about those people who always seem to manage to dust themselves off and get back on that proverbial horse? According to Megan McArdle, author of *The Up Side of Down: Why Failing Well is the Key to Success*, if you can harness the power of failure, you're a lot closer to that ultimate success.

Drawing on cutting edge research in science, psychology, and economics, McArdle teaches us how to recognize mistakes early and channel setbacks into future successes. This is a book written for a wide audience, taking insights from turnaround experts, emergency room doctors, venture capitalists, child psychologists, bankruptcy judges, and mountaineers into account and delivering an intriguing read that anyone can enjoy and learn from.



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