

Cold Weather and a Cold War!

Following some pretty dramatic gains in 2013, the first quarter of 2014 generally saw lackluster returns in most global markets as cold weather and a cold war like move stifled market expectations. US stocks gained slightly less than 2%, while developed international markets rose slightly less than 1% and emerging markets declined. Consolidation after a good year isn't surprising. Considering difficult weather, the Fed Tapering, a Russian invasion and the emerging markets concerns, we think the market showed great resilience by posting gains in the face of those challenges. If we have a near term concern it is that we are entering the political season in the US. The stock market could only mark time until we get a clearer vision of what the US elections bring.

Anyone who lived in the Midwest or East Coast during this winter knows that weather impacted the economy, suffering through the worst winter in 20 years. Not surprisingly, this caused an economic soft patch in the quarter as the December employment payroll growth was the weakest since 2010. This kicked off a string of mixed economic data. Coupling that with the fear of the Fed Tapering bond purchases led to the market declining almost 6% peak to trough from Mid-January until early February. Following the selloff, the US markets rose to new highs as growth expectations recovered and investors coped with the Fed actions. Pent up demand for houses, cars and capital equipment remains high and should lead to a reacceleration.

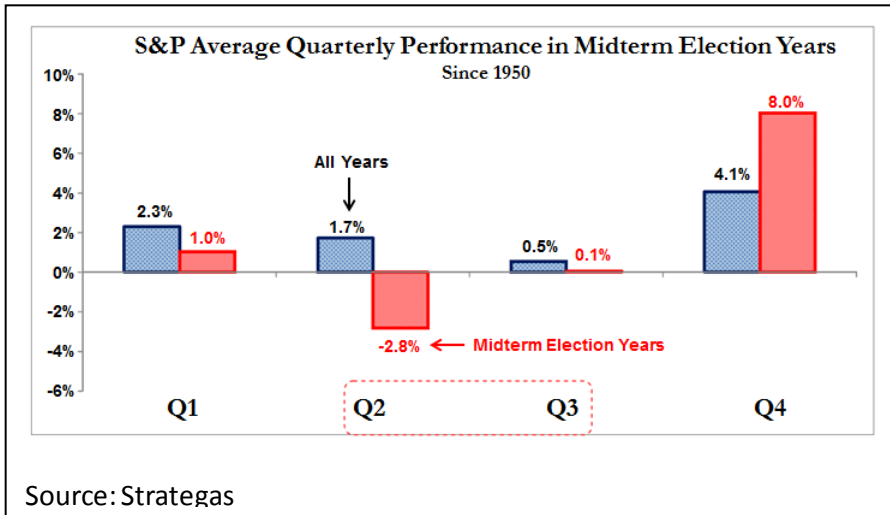
Geopolitical events impacted confidence during the quarter. After their recent winter Olympics, Russia immediately invaded and then annexed Crimea. This led to sanctions and denouncements in the United Nations, but the impact to markets was fleeting. Of more importance was the Chinese decision to allow their currency to float more freely versus the US dollar. The currency weakened by almost 3% after Chinese manufacturing weakened in late January, ending a one way trade of Yuan appreciation.

International Developed markets started the year at multi-year highs and declined through early February as worries about US and Chinese growth worked their way into markets. Interestingly, the World Bank raised global economic growth forecasts in January for the first time in three years. They increased Developed Markets growth expectations while trimming them for Emerging Markets. The Bank of England postponed tightening as low inflation, and adequate but not robust economic growth continues. The European Economy is showing signs of growth recovering as well, and the prospects for rates remaining low. Inflation is too low in Europe, so the ECB needs to take some action to bolster growth in our opinion. In contrast, many EM central banks are tightening policy and trying to lower available credit to head off inflation.

As we look forward, we urge investors to look for several things in the upcoming quarters:

- Developed markets should continue their economic recovery with the ECB taking some action.
- The US should see a reacceleration of growth.
- We believe concerns about Russia will be short lived.
- Chinese growth is slowing, though some stimulus programs are likely.
- Market expectations for US rates should rise as tapering continues.

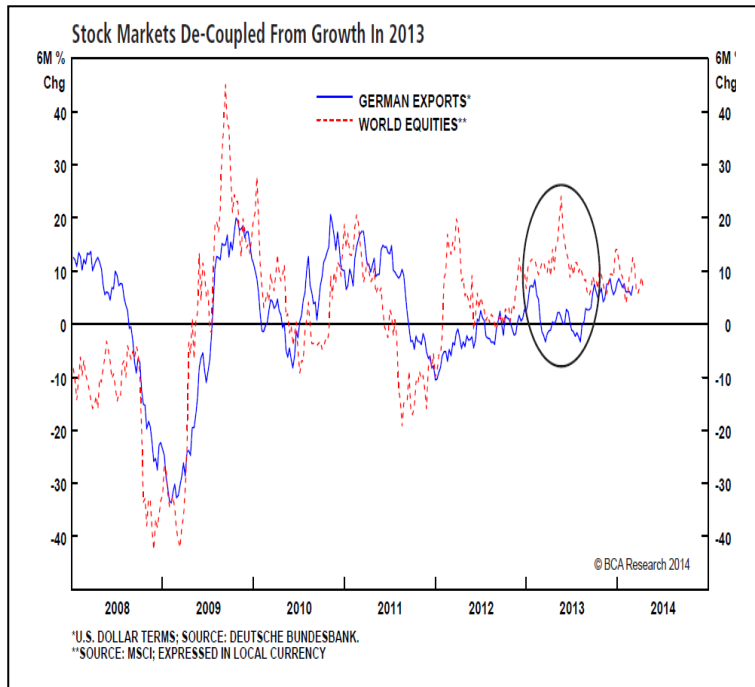
What US Midterm Elections could mean



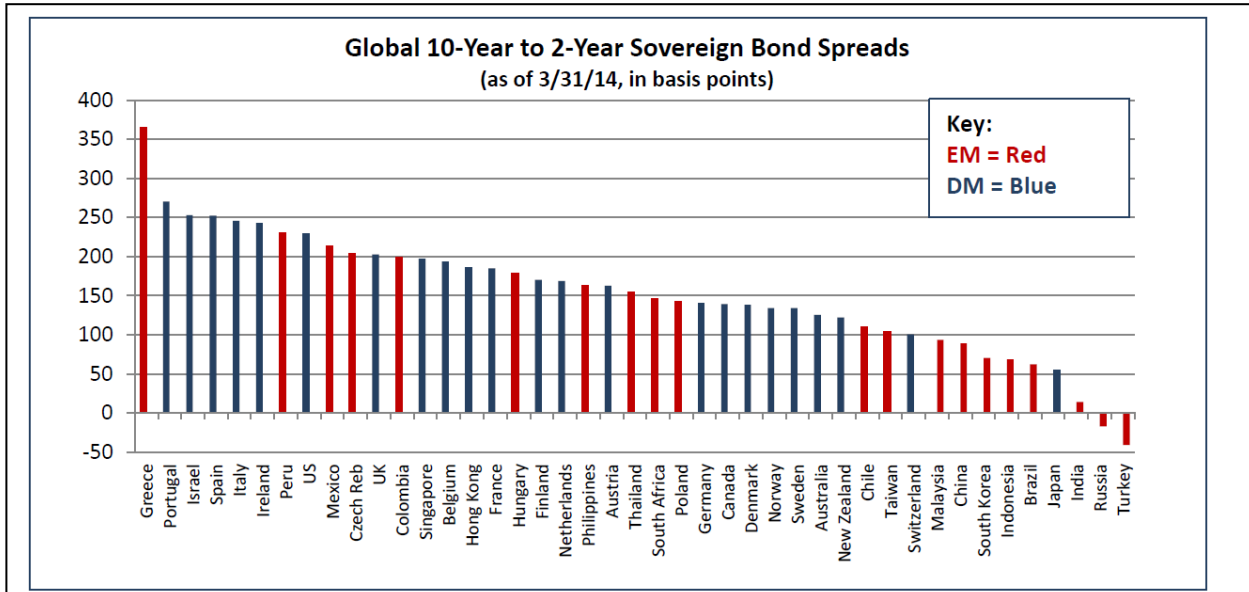
We hate to start by pointing out challenges, but investors need to recognize that history suggests the market remains range-bound and volatile until late in the year during midterm elections.

Global Growth should drive markets higher over time

German exports are a good proxy for the health of the world economy. Last year, despite those exports declining, markets did well on the back of US QE. As those exports recover, world equity market should continue to remain firm. This should be bolstered by the IMF recently raising their estimate of worldwide growth.



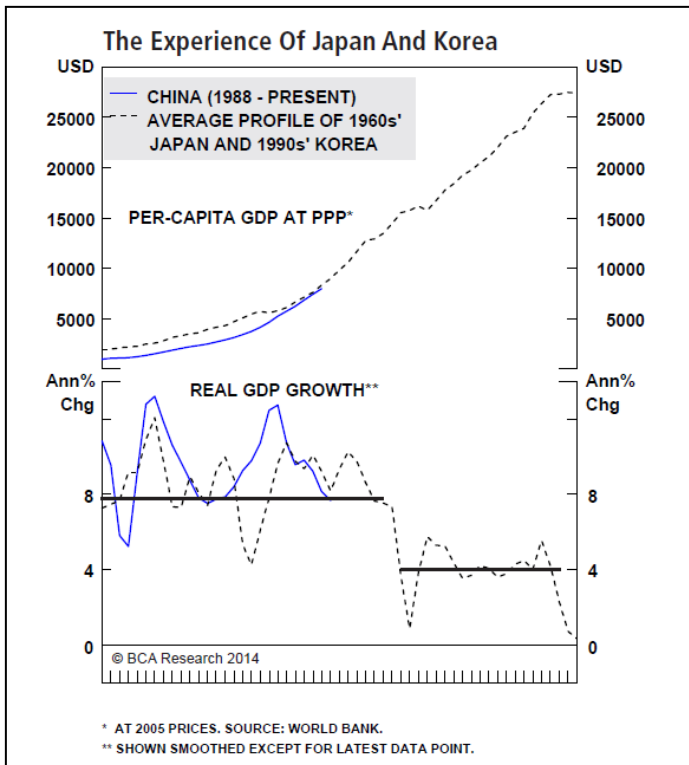
Yield curves suggest why the EM has seen pressure.



Source: Richard Bernstein Advisors LLC, Bloomberg

The difference between short and long term interest rates is a good predictor of future economic activity and market direction. Typically, when this yield curve is steep, the outlook is for economic activity to pick up and markets act well. When it becomes flatter or inverts, economies tend to slow and markets decline. Yield curves suggest many emerging markets are seeing growth slow, and their markets have been under pressure. If you look to the left of the chart above, this curve suggests peripheral Europe and the US have fairly constructive outlooks.

Look at this before you get too bearish on China

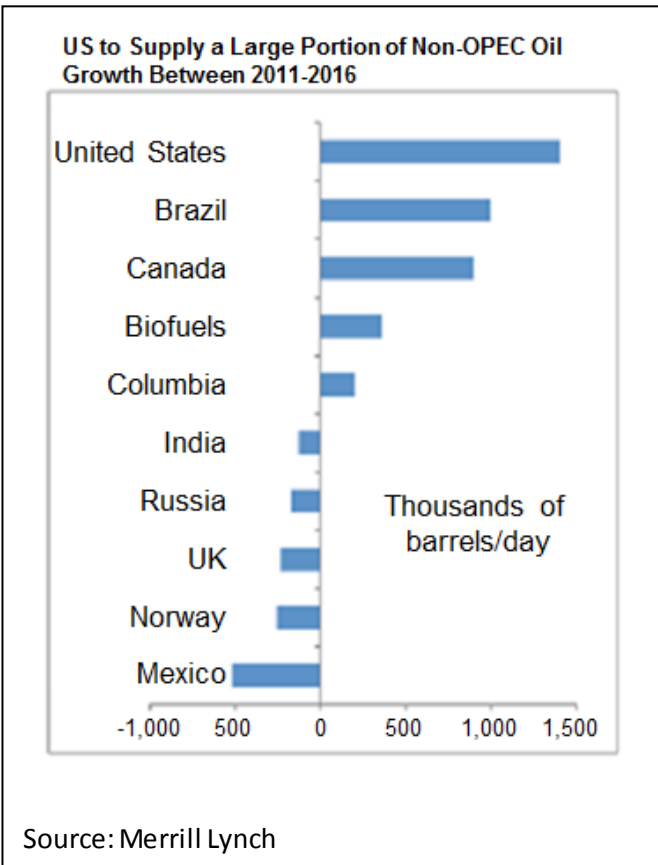


* AT 2005 PRICES. SOURCE: WORLD BANK.
** SHOWN SMOOTHED EXCEPT FOR LATEST DATA POINT.

Regardless of the current yield curve, China is tracking along the same development path that Japan took in the 1960s and South Korea experienced in the 1990s. In the chart to the left, China's Per Capita GDP over the past 25 years has tracked very closely with prior developing market experiences. If history is a guide, it appears GDP growth should track near seven to eight percent for the better part of the next decade. ***The scale of the chart at the left would take China from 1988 through 2045.***



Global Manufacturing is Expanding/ Energy Production Should Provide a North American Advantage



Source: Bloomberg and JP Morgan

Two important considerations for investors are manufacturing growth and energy production growth. Globally, purchasing managers indexes (PMI's) are rising (chart above), and should continue to do so given the conducive monetary environment and pent up demand.

Energy production is expected to rise as well (chart left) with much of the production growth coming from the US, Canada and Brazil. This should give a leg up to North American manufacturing, and keep some pressure on inflation as well.

As always, we are here to serve you. If you would like any additional information on any of these trends, please feel free to call us.

Jack White, CFA

Curt Scott, CFA

Jack Holden, CFA

Todd Asset Management LLC

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