DELTA
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Economic Comments

After 8 years in charge of the U.S. central bank, the Federal Reserveôs chairman is stepping down. However, in his swan song, Mr. Bernanke has become more bullish on the direction of the U.S. economy. In early January, he shared the belief that ñthe combination of financial healing, greater balance in the housing market, less fiscal restraint, and, of course, continued monetary policy accommodation bodes well for U.S. economic growth in coming quarters.ò His statement echoed the most recent Federal Open Market Committee meeting in December where the central bank announced its intention to start reducing its current bond purchase program by $10 billion/month.

Slightly leavening this optimism, the FOMC also shared its intention to hold overnight interest rates at their current near zero levels longer than previously indicated - at least until unemployment declines below 6 1/2 percent. With unemployment having declined by almost one percentage point in the last 12 months, this statement was meant to comfort jittery investors that the Fed was not being too rushed in removing its monetary intervention.

Also slowing the Fedôs moves has been dormant inflation; if anything recently, the specter of negative price increases, i.e. deflation, has been creeping back into view. It should be kept in mind that deflation is especially injurious to an economy as it both sharply penalizes borrowers and discourages spending as prices decline. A classic example of the invidious effects of ongoing price declines would be the economic struggles of Japan over the last 20 years. With most measures of inflation currently running slightly beneath 1.0%, and with current economic thought that inflation of around 2.0% is economically optimal, some analysts now believe that short-term interest rates should remain depressed into early 2016.

In the face of a continued decline in oil imports (courtesy of the ongoing fracking boom) and record exports, the U.S. trade deficit declined to $34 billion in November - the lowest level since October 2009. This news came on top of very robust 3rd quarter GDP growth of 4.1% - only the second time since the recovery began in 2009 that quarterly output grew at a rate greater than 4%. With this tail wind, and despite the Federal governmentôs shutdown for 16 days in early October, analysts are now projecting that the economy grew 2.9% in the final quarter of the year.

Helping support the recent strength has been a pickup in manufacturing with the Institute for Supply Managementôs factory index running at almost a 2 1/2 year high. In November, U.S. industrial output surpassed its pre-recession levels for the first time - an added sign of the growing momentum of the economic recovery. Factory orders, as reported by purchasing managers, are also at 3 1/2 year highs as well. Meanwhile, the economy has added an average of

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200,000 jobs/month since late summer with unemployment having declined to a five year low of 7.0% at November end ï and down appreciably from the 7.8% level seen at the beginning of the year.

Largely shrugging off the recent political squabbles of October, and despite weak income growth, Americans stepped up their spending as the year closed. Although income growth grew only 0.2% in November, personal consumption climbed by 0.5% as Americans dipped into savings to maintain spending. Egging on consumers has been an easing in gasoline prices, the yearôs remarkable stock market performance and a pickup in job creation.

Further fueling Americansô spending has been dormant inflation - which allows their dollars to buy more items. With inflation running around 0.9% year over year, the inflation boogey monster for the time being is staying hidden beneath the central bankôs bed. On the backs of this good news, consumer sentiment (as measured by the Thompson Reuters/ University of Michigan index) returned to 6 year highs. In looking back at the past decadeôs economic performance, there are two very different perspectives that can be taken. Since the start of the 2001 recession, U.S. economic growth has averaged only 1.8% - the slowest growth rate over a 12-year period in the post World War 2 era. The recent period has been negatively impacted by slowing population growth, reduced labor productivity gains and declining labor market participation rates.

Looking at the data from another perspective, the U.S. has done relatively well. A recent study by Harvard economists Reinhart and Rogoff indicates that with economic activity having returned to pre-Financial Crisis level in less than 6 years and having declined by only 5% at its worst, the U.S. declined less severely and has come back more quickly than has typically been seen after a major financial crisis.

No matter the interpretation of the past decade, and as we look forward, economists have become increasingly bullish about the upcoming yearôs prospects with consensus estimates currently running around 3.0%. Breaking free of the recent sluggish growth is reliant on several key factors: 1) increasing levels of business investment; 2) an ongoing truce in the recent bloody bi-partisan political fights of Washington DC; 3) a continued recovery of the housing market - even in the face of now rising interest rates; and 4) relative stability overseas. However the situation turns out, the ride is sure to be interesting!

Analyst Corner

Highly sensitive to interest rates, real estate investment trusts (aka REITs) had a tough year with the sectorôs benchmark index rising a tepid 2 1/2 percent during 2013. With much of the interest rate news baked into the sectorôs stock prices, and with continued strong secular demand from healthcare, we believe that one medical related REIT in particular, HCP Inc. (NYSE: HCP) has an attractive valuation and prospects. With the company having a real estate portfolio of more than 1100 properties spread across the different segments of the healthcare sector, HCP has seen a strong advance in free cash flows over the last decade. Moreover, the company has attractively positioned itself with leases structured with built in pricing escalation clauses. With current dividends of almost 6%, and a substantial decline in HCPôs recent stock price, we believe that some HCP (and an apple a day) could help keep the doctor away and a portfolio in good health!

Market Comments

What a year for the U.S. stock market! Simply put, the Federal Reserve has both encouraged the purchase of riskier assets with its cheap money policies and finally convinced analysts that stronger economic growth is eminent. With an advance of more than 32% in 2013, Wall Street had not seen such enthusiasm for more than 15 years - and last seen when stocks advanced 31% in 1997.

Safe and boring was passé while stocks tied to economic growth were the place to be. The economically sensitive consumer discretionary sector surged by more than 43% while the staid low growth telecom sector was the market sector laggard with an advance of a relatively paltry 11.5%. Helping drive the large overall advance was the third round of monetary stimulus by the Federal Reserve (and also known as QE3), better than forecast corporate earnings during 2013 and increasingly optimistic forecasts for economic growth in 2014.

To put this past yearôs performance in a more historic context, the markets are only now recovering from the excesses of the 1990s - it was just 9 months ago in March that the Dow Jones Industrial Average started hitting new record highs. Moreover, it was only in December that the Dow passed its January 2000 record on an inflation adjusted basis (albeit excluding dividends). Meanwhile, the other major U.S. indexes such as the Nasdaq Composite and the S&P 500 remain appreciably beneath their own inflation adjusted records.

To shift focus to bonds for a moment, it appears that the bond bull market is finally dead. After a 30+ year run that started in September 1981, bond prices retreated handily during the year. With the Fedôs mid-December bond buying tapering announcement, the bankôs downward pressure on long term interest rates will shortly ease. Having already been drifting up from their record lows of late Spring, the 10-year Treasury finished the year with its yield slightly above 3 percent. For the year, the 10-year Treasury bondôs interest rate rose by more than 70%.

With this sharp move in interest rates, the interest rate yield curve is now very steep. Typically, a steep curve is indicative of either rising inflation or robust economic growth. As reported inflation remains quite low, let us all hope that the envisioned strong economic growth is fully realized.

In the face of the recent market run-up, there remains plenty to worry about with (until recently) sluggish economic growth, rich stock valuations, overly loose monetary policy and volatile markets. As the fifth anniversary of the bull market that was born in March 2009 approaches, investors continue to debate the staying power of stocks. With the broader market up more than 150% from its 2009 lows, and the S&P 500 trading at an above average 19 times earnings, investor concerns are increasingly focusing on the potential for a market pullback in 2014. Certainly, if interest rates were to take an unexpectedly large surge during the year, the markets could react negatively. That being said, the apparent brightening of the new yearôs economic picture is causing us to be cautiously optimistic for the near-term performance of stocks. Simply put, with interest rates at historic lows and bond prices recently falling, there are no ready alternatives to stocks.

Performance as of 12/31/13

	Close	Month	1 Year
DJIA	16,576.66	3.19%	29.65%
S & P 500	1,848.36	2.53%	32.40%
NASDAQ Comp.	4,176.59	2.94%	38.41%

	Year end yield	Prior Year end yield
10 yr. U.S. Treasury	3.03%	1.76%

Planning Thoughts

Historically, insurance was only bought for those risks whose occurrence would be financially devastating. To simplify, insurance is the transfer of a risk to another entity in exchange for a previously defined payment. In this sense, umbrella liability insurance is the ideal insurance coverage. The objective of this type of coverage is to protect against financially catastrophic lawsuits. For individuals, umbrella coverage provides protection that is in excess of specified other policies, typically homeownerôs and auto coverage, and primary insurance for losses not covered by these other insurance policies.

Besides covering such things as accidental death (via an auto accident, for instance), umbrella policies usually offer coverage for things such as slander or false arrest. However, as the occurrence of these type of losses is relatively rare, the cost of such insurance is remarkably inexpensive with annual premiums running less than several hundred dollars for a million dollars in coverage. As a general rule of thumb, individuals should consider purchasing umbrella coverage equal to their net worth.

If you do not already have this amount of insurance, we strongly urge you to re-evaluate this coverage immediately! We would be happy to help you better evaluate your situation - just give us a call.

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