July 2013

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Economic Comments

The Fed Reserve has spoken, and the markets have listened, sort of. Following the June meeting of the Federal Open Market Committee (the FOMC), the central bank shared its belief that both the economy and labor markets, although weak, are continuing to improve.

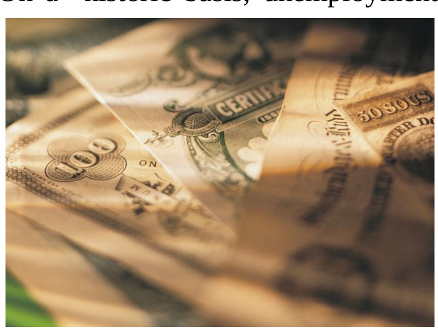
The current Fed policy of purchasing $85 billion/month of mortgage bonds and U.S. Treasuries is to continue for at least several more months in an ongoing effort to depress long term interest rates. Importantly, the meeting notes indicated the bankôs belief that inflation is anticipated to remain relatively dormant at its current 2.0% rate.

Instead of focusing on these fairly positive comments, analysts seemed to concentrate on other remarks made by several Fed board members that the central bank will start removing some of its monetary stimulus if and when labor markets show sufficient recovery. Although this statement has been made multiple times in recent months, this iteration was taken as a foreshadowing of the imminent end of the current easy money policies.

Turning to political Washington, our countryôs elected hacks have been most recently focused on immigration overhaul and the ongoing Snowden related national security leaks. Before too long, attention will, by necessity, return to the debt ceiling. Barring further action, the existing federal debt ceiling will likely be breached before November of this year. The continued uncertainty over Federal finances has had an appreciable negative economic impact. The most recent budget/debt battle at year-end 2012 caused a substantial decline in job creation as companies re-trenched in the face of uncertainty.

For the upcoming debt ceiling fight, there remain three likely scenarios: 1) a grand compromise where both parties can claim success; 2) a financial fiasco where the servicing of the nationôs debt grinds to a halt; and 3) a small compromise that kicks the debt football down the field again. Unfortunately, the odds lie with option 3é .. and so the dysfunction of our nationôs so-called leaders continues.

Looking to recent economic data, it remains mixed. Unemployment readings have stayed at 7.6% for the last couple of months. On a historic basis, unemployment



has not remained at these levels (7.5+%) for this length of time since the 1930s. Surprisingly though, many analysts are anticipating more robust/healthier economic growth in 2014 and 2015. Even the nonpartisan Congressional Budget Office has recently increased its estimates of projected growth. The improving economic outlook is one pillar behind the stock marketôs sharp advance this year. Helping support this contention has been the greater than anticipated economic resilience in the face of Januaryôs tax increases and the sequestration driven spending cuts.

Additional support to this brighter picture has been the ongoing surge in U.S. oil and gas production. Through year end 2012, domestic oil production increased by more than 800 thousand barrels/day. Besides increasing the countryôs energy security, this new production has resulted in a sharp reduction in natural gas prices and more stability in international oil prices. A number

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of economists believe that growing hydrocarbon production will yield appreciably cheaper domestic energy and act as a bedrock to resurgent U.S. economic activity.

Despite recent optimism by both consumers and investors, other indicators of the health of the economy have been mixed. Average weekly hours and average hourly earnings, for instance, have shown little improvement in recent months, according to the Labor Department. Wages have risen by only 2% from the prior year, barely outpacing recent inflation. Holding back hourly wage growth has been the fact that many of the jobs being created are low wage retail jobs and that a large number of jobs being lost are higher wage government jobs.

Consumers continue to see the glass to be more than half full as the Conference Boardôs Consumer Confidence Index reading spiked to 81.4 - its highest level since January 2008. A key driver behind this increase was the perception that the labor market is continuing to improve. Some recent data would support this idea. The most recent June payroll report showed 195,000 jobs created - a modest increase over the recent average of 175,000.

The employment data is more nuanced though than suggested by the recent buoyant confidence surveys. Hiring remains flat with nearly 12 million workers left stranded by the recession and its aftermath. With the current rate of job creation, historic levels of unemployment, near 5%, will not be reached for at least five more years.

Looking deeper, and while the rate of short-term unemployed has returned to pre 2007 levels, the picture for the long-term unemployed is much less rosy. The number of people who have been out of work more than 27 weeks is now more than 250% higher than the levels found in 2007. Using a broader view of employment, the labor participation rate which highlights the number of employed workers relative to the total level of available workers, shows a more grim scenario. Having averaged in excess of 66% in the early 2000s, the labor participation rate is now averaging around 63.5%.

As we alluded to earlier, there are reasons to believe that the economic picture is continuing to show gradual improvement despite the weak level of job creation. The only certainty we see is the need for our nationôs politicians to come together to act as national leaders. It is imperative that they start working together to create a sustainable federal budget and deficit so as to remove a critical risk to continued economic expansion.

Analyst Corner

While established industrial companies are subject to the whims of the economic cycle, we believe that Dover Corp (*NYSE: DOV*) is particularly well suited to the current macro environment. The diversified manufacturer spreads its activities across several niche markets. While it has more than 40 discrete businesses, the company excels at both product innovation and long-term customer relationships. Equally important, management has been adept at deploying capital with very attractive returns to investors while maintaining a high quality balance sheet. Moreover, between share repurchases and regular increases in its stockôs dividends, investors have been given many reasons to be satisfied. As such, our analysis indicates that investing in Dover, may be a worthwhile opportunity over the next several years for the client in need of more industrial exposure.

Market Comments

Starting with Fed Chairman Bernankeõs comments on May 22nd, it has been a contrary time for the financial markets. Good economic news has been greeted poorly with the marketsô excitement reserved for poor economic news. All of this is the unintended result of Mr. Bernankeõs observation that the central bank might slow down its current easy money posture if there was continued improvement in the economy.

Simply put, his statements were just a repeat of the bankõs often stated position that the current easy money policy was never meant to be permanent; rather, it was, and is, the Fedõs intention to remove the very easy money policy once it appears that the economy is on a sustainable growth track. Investors appear to be focused on the fact that the so-called easy money party could be over sooner than some would like rather than being excited that the economy is close to coming off the Fed Reserveõs monetary life support system.

With overnight interest rates having effectively been zero for the last several years, there is only one direction that rates could and can goé ..up! For the last several years, the happy fact of life for borrowers has been that interest rates, on the whole, have continued to head lower. Imagine their surprise recently when the benchmark 10 year Treasuryõs yield surged by slightly more than one percentage point to 2.66% - its highest level since August of 2011. The rapid surge in bond yields produced the biggest monthly bond losses in over 9 years. Prior to this recent activity, generally speaking, interest rates have been on a continued decline since the early 1980s when the 10-year Treasury peaked at an almost 16 percent yield.

This past monthõs rapid climb dealt sharp losses to lenders, i.e. fixed income investors, within days. As investors braced themselves for a new era of rising interest rates, global bond, currency and stock markets experienced spasms of turmoil.

Since its most recent peak on May 21st, the stock market has been favoring the defensive sectors such as consumer staples, healthcare and utilities. Driving this surge have been concerns over the economic growth as well as a search for alternatives to low-yielding bonds. As a result, these sectors look more expensive than typical relative to more economically cyclical sectors such as industrials, consumer discretionary and energy. While still fans of stocks in general, we believe that a rotation away from the more stable sectors and towards the more cyclical areas is likely.

Looking more broadly at the markets, and even in the face of the recent stock market advances, we find the markets to be reasonably valued. Todayõs earnings multiples are less than half of those of the frothy market of 1999 and profits are wide spread with most stock sectors reporting record profits. Finally from a contrarian perspective we find it comforting that ordinary retail investors are not excited about the current market levels. If they were, we would be more concerned.

For the coming months, we believe that the taking of prudent risks will be the name of the day. The markets could well continue their recent advance but changes in individual portfolios should be driven by long term client needs rather than the day to day vagaries of the market.

Performance as of 6/30/13

	Close	Month	YTD	1 Year
DJIA	14,932.41	-1.25%	15.20%	18.87%
S & P 500	1,606.28	-1.34%	13.84%	20.61%
NASDAQ Comp.	3,433.40	-1.52%	12.71%	15.95%

	Quarter end yield	Prior Year end yield	Yield 1 year ago
10 yr. U.S. Treasury	2.48%	1.76%	1.66%

Planning Thoughts

Every U.S. paycheck has a line item deduction for FICA - the Federal Insurance Contributions Act. This tax funds a government entity most of us are familiar with, the Social Security Administration. This pension program was established in the depths of the Great Depression by President Roosevelt. When the program was first established, the age to commence receiving full benefits was set at 65. Interestingly though, less than 50% of male wage earners were anticipated to be alive by the time they were eligible to receive this earned benefit.

Commencing in 1972, the old age benefit was sharply expanded by the addition of Cost of Living Adjustments (COLAs) to adjust for inflation. With Americanøs life spans having sharply increased in the 78 years since the programøs creation, the full retirement age has been pushed back only 2 years (and as opposed to the 11+ years that would be required to keep pace with the increase in life spans) The result is a pension that is not being fully funded to meet future obligations and which Congress is reluctant to modify to put on a permanently sound financial footing.

On a more personal basis though, there are a number of means to optimize a Social Security benefit for an individualøs unique situation. One especially interesting solution can be to delay the start of benefits so as to maximize current income. If you or your spouse are close to initiating your Social Security benefit(s), and would like some additional insight into your options, we would be happy to help you assess your situation.

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