HBK Wealth Management
Haire · Bohmer · Kilcoyne

WEEKLY ECONOMIC COMMENTARY

This Week's Economic Review and Outlook

March 2014

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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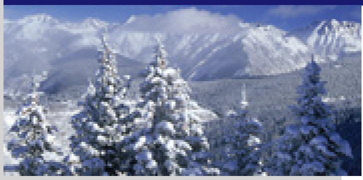


Weekly Economic Commentary | Week of March 10, 2014

Highlights

- In early 2014, harsh winter weather has replaced policy uncertainty as the biggest weight on the economy.
- Our Beige Book Barometer decreased to +62 in March 2014 from +76 in January 2014, as weather received 119 mentions.
- The Affordable Care Act continues to be a key concern for Main Street.

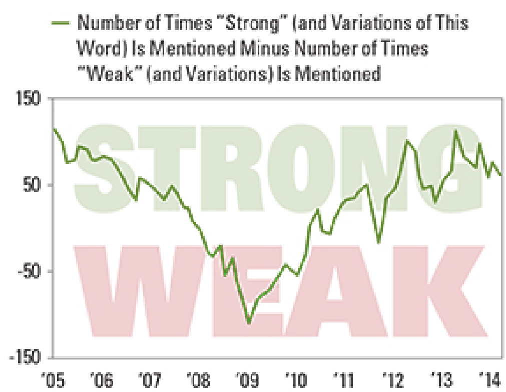
Beige Book: Window on Main Street
Still Growing, With Limited Wage and Price Pressures

The Beige Book is a qualitative assessment of the U.S. economy that we believe is best interpreted quantitatively by measuring how the descriptors change over time. The latest edition of the Federal Reserve's (Fed) Beige Book once again described the economy as increasing at a "modest-to-moderate" pace, with price pressures described as "subdued" and noted that wage pressures remained "stable" for most districts. The modest-to-moderate description of the overall economy has now been used in the last seven Beige Books, and in eight of the past nine dating back to March 2013. The Fed's Beige Book -- a qualitative assessment of economic and financial conditions in each of the 12 Federal Reserve districts -- was released last Wednesday, March 5, 2014, ahead of the March 18-19, 2014, Federal Open Market Committee (FOMC) meeting.

Weather Weighs on Growth

To provide a snapshot of the sentiment behind the entire Beige Book collage of data, we created our proprietary Beige Book Barometer (BBB) [Figure 1]. The barometer ticked down to +62 in March 2014 from +76 in January 2014. At +62, the latest reading remains well below its recent peak (+112 in April 2013), but the +62 reading is consistent with the Beige Book Barometer readings seen in the middle of the 2001- 07 economic expansion in the United States.

1 Since Peaking in Early 2013, First Policy Uncertainty and Now Weather Have Pushed Our Beige Barometer Lower



Source: LPL Financial Research, Federal Reserve 03/05/14

Weather was mentioned an incredible 119 times in the latest Beige Book, and the mentions were almost always in a negative context. To put the 119 mentions of weather in the March 2014 Beige book in historical context, weather was mentioned only 48 times in the Beige Book released just after Superstorm Sandy hit the east coast of the United States in October 2012. Weather was mentioned a total of 61 times in the three Beige Books released during the unusually cold and snowy winter of 2010-11. On balance, the 119 mentions of weather in the latest Beige Book -- along with 31 of the word "cold," 24 of "snow," and 35 of "severe" -- suggest that the weather's impact on the economy in the early part of 2014 was widespread and significant.

Beneath the Ice and Snow

A closer look at the mentions of weather or associated words, finds that beneath all the ice and snow, the economy is likely poised to accelerate -- once weather returns to normal. For example, in a section discussing manufacturing and auto output, the Beige Book said,

> Auto production was strong in Chicago despite weather-related slowdowns in sales, and Cleveland reported auto production to be higher than a year ago. Most Districts were optimistic about the future and expect manufacturing activity to rise in the coming months.

The above example represents a common theme in the Beige Book: citing poor weather as a factor for weakness in the current period, but pointing to underlying optimism once the weather normalizes.

2 Bad Weather Has Replaced Fiscal Uncertainty as the Biggest Drag on the Economy

	Weather	Shutdown/Fiscal/Sequester/Debt Ceiling/Uncertainty/Confidence	Affordable Care Act/ Health Care
03/2014	119	18	29
01/2014	21	26	32
2013 Avg	112 (14 per Beige Book)	520 (65 per Beige Book)	176 (22 per Beige Book)
	Weather is trending up.	Words surrounding government policy and spending are trending down.	ACA/health care remain fairly steady.

Source: LPL Financial Research, Federal Reserve 03/05/14

Winter Weather Wipeout

"The weather was cited to have caused utility outages, disrupted supply chains and production schedules, and resulted in a slowing of sales to affected customers."

"The direct effect of the storms was the loss of several days of production in February. In addition, demand fell both because some of their products are intermediate goods for other plants in afflicted areas and because end users demanded less."

"General merchandise retailers report that sales were below plan and down sharply from a year earlier, due to unusually harsh weather in January and early February."

"Freight executives reported that it is difficult to gauge changes in shipping volume due to supply chain disruptions attributed to severe weather."

"As with general retail, some of the service sector revenue will not be recouped after the snow has melted. For example, staffing firms cite the loss of billable hours that will not be made up."

While weather dominated the March 2014 Beige Book, the uncertainty and lack of confidence around fiscal policy (fiscal cliff, debt ceiling, sequester, government shutdown) that dominated the Beige Book for most of 2013 began to fade. In the March 2014 Beige Book, there were just 18 mentions of the words noted above after 26 mentions in the January 2014 Beige Book. These words were mentioned 65 times, on average, in each of the eight Beige Books released in 2013. As we wrote in our *Outlook 2014: The Investor's Almanac*, we continue to expect concerns over government policy to fade over the course of this year.

Good weather or bad, the Affordable Care Act (ACA), and health care in general, has remained a consistent source of concern among respondents to the Beige Book. The ACA received 29 mentions in the March 2014 Beige Book, close to the 32 mentions in the January 2014 edition. On average, the ACA/health care saw 22 mentions per Beige Book in 2013. We continue to expect this topic to appear frequently in the Beige Book in the quarters ahead as businesses and consumers adjust to the rollout of the legislation.

3 Beige Book Word Clouds

Source: LPL Financial Research, Federal Reserve Beige Book 03/05/14

Source: LPL Financial Research, Federal Reserve Beige Book 01/15/14

Wage Pressures

Wage pressures were described as "stable" for most districts in the latest Beige Book, although there were scattered mentions of upward pressure on wages in certain areas and among skilled workers in certain regions of the country. The reference to scattered wage pressures and lack of workers in certain skilled occupations has been a consistent refrain in the Beige Book for over a year now. Fed Chair Janet Yellen, and the rest of her FOMC colleagues, are watching wages closely (see the *Weekly Economic Commentary: Janet Yellen's Employment Report* from March 3, 2014). While wage increases have moved beyond scattered reports in just a few industries, the bond market will likely keep a close eye on this component of the Beige Book in the coming months and quarters as it gauges whether or not the Fed is "behind the curve" on wages, and, in turn, inflation. We'll take a closer look at how wages and prices are described in the Beige Book in an upcoming edition of the *Weekly Economic Commentary*.

For now, the Beige Book describes an economy that is still growing slowly, with limited wage and price pressures, which suggests that the Fed can remain accommodative. However, the underlying Beige Book tone suggests when the weather returns to normal, the economy could accelerate -- forcing the Fed to begin thinking about removing some of the accommodation sooner than the market now thinks is likely.

How the Barometer Works

The Beige Book Barometer is a diffusion index that measures the number of times the word "strong" or its variations appear in the Beige Book less the number of times the word "weak" or its variations appear. When the Beige Book Barometer is declining, it suggests that the economy is deteriorating. When the Beige Book Barometer is rising, it suggests that the economy is improving.

Beige Book: How It Works

The Beige Book compiles qualitative observations made by community bankers and business owners about economic (labor market, prices, wages, housing, nonresidential construction, tourism, manufacturing) and banking (loan demand, loan quality, lending conditions) conditions in each of the 12 Fed districts (Boston, New York, Philadelphia, Kansas City, etc.). This local color that makes up each Beige Book is compiled by one of the 12 regional Federal Reserve districts on a rotating basis -- the report is much more "Main Street" than "Wall Street" focused. It provides an excellent window into economic activity around the nation using plain, everyday language. The report is prepared eight times a year ahead of each of the eight Federal Open Market Committee (FOMC) meetings. The next FOMC meeting is March 18-19, 2014.

The previous word clouds or text clouds, which are a visual format useful for quickly perceiving the most important words in a speech, text, report, or other transcript, are culled from the Fed's Beige Books published last week (March 5, 2014) and the prior report (January 15, 2014). In general, the more often a word appears in a speech, text, report or other transcript, the larger that word appears in the word cloud. The word clouds show the top 50 words for each of the two Beige Books mentioned above. Similar words are grouped together and common words like "the," "and," "a," and "is" are excluded, as are words that appear frequently in all Beige Books (federal, district, loan, level, activity, sales, conditions, firms, etc.).

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock investing involves risk including loss of principal.

The Federal Open Market Committee (FOMC) is the branch of the Federal Reserve Board that determines the direction of monetary policy. The eleven-person FOMC is composed of the seven-member board of governors, and the five Federal Reserve Bank presidents. The president of the Federal Reserve Bank of New York serves continuously, while the presidents of the other regional Federal Reserve Banks rotate their service in one-year terms.

This research material has been prepared by LPL Financial.

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Tracking #1-253513 (Exp. 03/15)

Weekly Market Commentary | Week of March 10, 2014

Highlights

The ECB made a big bet last week that the Eurozone economy is picking up fast enough to avoid the need for any further stimulus. We are not so sure. Until some key catalysts emerge, the risks to stocks in Europe may outweigh the rewards.

Europe's Big Bet

Bond yields have fallen this year, but they began to rebound in the United States in the latest week as the glass-half-empty bond market realized the all-time high stock market may have it right. But this was not the case in most of Europe. The ongoing decline in European government bond yields continued last week and is striking when considering how fast they were rising two years ago. What a difference a couple of years can make. The 10-year Italian and Spanish bond yields dropped to near all-time lows at the end of last week, while Greece's 10-year -- once over 35% -- fell below 7% [Figure 1]. Problem solved? Not exactly.

1 What a Difference a Couple of Years Can Make

Source: LPL Financial Research, Bloomberg data 03/10/14

Past performance is no guarantee of future results.

The countries once derided in the financial press for overspending PIIGS (Portugal, Italy, Ireland, Greece, and Spain) and thought deserving of their double-digit borrowing rates, could now be believed to be among the GAUDS (Germany, Austria, United Kingdom, Denmark, and Switzerland) and their low single-digit yields. As we have highlighted several times over the past two years, bond yields have receded as the risk of financial crisis has passed. But the situation in Europe is slowly transforming into an economic crisis in the form of a potential lengthy stagnation. We had anticipated Europe could shake off this risk and produce better growth this year -- and it still may -- but the risk of a setback rose last week.

The risk can best be seen in prices. Central bankers around the world, including the U.S. Federal Reserve (Fed), the European Central Bank (ECB), and the Bank of Japan (BOJ), have a clearly stated goal of 2% inflation to motivate spending and lift wages while leaving a buffer above zero when growth inevitably slows again. While the inflation rates in the United States and Japan are just below that and rising, the pace of inflation in the Eurozone has been under 1% since October 2013 and is still decelerating.

Last week, rather than making a move at its meeting to cut rates or take other actions, the ECB took a gamble that the economic momentum in the Eurozone may be self-sustaining enough to turn prices higher on its own. The status quo announcement was accompanied by the release of the ECB's forecast for inflation in the coming years, showing it expects inflation to remain below 2% through 2016. Not only has the ECB refrained from any new stimulus, it has been outright shrinking the bonds on its balance sheet for over a year now, in contrast to the Fed, which is just starting to slow the growth in the bonds on its balance sheet by tapering its pace of bond buying [Figure 2].

2 ECB and Fed Taking Different Paths

Source: LPL Financial Research, Bloomberg data 03/10/14

Past performance is no guarantee of future results.

The problem for Europe is an elevated risk of economic stagnation, a rise in the value of the euro hurting exports, and very low rates of inflation making it very hard for countries to address their debt and pension problems. Despite years of austerity in the form of tax hikes and spending cuts, Eurozone government debt-to-GDP (gross domestic product) has risen to a record 93%, up 4% from a year ago, according to Eurostat, the official statistics office of the European Union (EU). Higher inflation is necessary for the Eurozone to avoid what Japan has experienced -- a high debt and pension burden coupled with flat inflation and economic growth for much of the past two decades.

We remain hopeful that in 2014 Europe can overcome its weaknesses and have a better chance for returns competitive with U.S. markets than last year. Here are the catalysts we are looking for to turn more positive on European stocks:

- **Lower expectations for earnings growth** -- The current earnings expectations are likely to be disappointed. The consensus of analysts' estimates for European company earnings are for 12.2% growth in 2014. This seems high given prospects for only about 1% GDP growth, especially compared with the consensus for the United States, which now aligns with our outlook for 8.8% earnings per share growth for the S&P 500.
- **Lower valuations** -- Although European stocks usually trade at a discount to U.S. stocks due to a different sector mix and slower growth, at a forward price-to-earnings (PE) ratio of 13.3, compared to 15.8 for the S&P 500 Index, the discount is not sufficiently pricing in the greater risk of economic stagnation.
- **Inflation picking up back above 1% and rising** -- A key sign that the risk of deflation is receding.
- **ECB action** -- If the euro moved toward $1.45 or longer-term inflation expectations fell, it may prompt a move by the ECB to reduce the risk of stagnation, which markets would welcome.
- **Loan demand picking up** -- Signs that business loans are increasing, rather than the declines indicated in the surveys, would be a welcomed sign that the bridge is being made between recapitalizing the banks and getting them lending again.

Personalizing the Challenges

Many of the Eurozone's problems are structural. Although some challenges are posed in peripheral economies like Italy, a core country like Germany is not immune from its own challenges as it seeks to rebalance its dependence on exports. While this can be illustrated with statistics, it may be helpful to personalize the structural challenges facing the Eurozone with an example.

If you are 21, you are unlikely to buy a car in Italy:

- **You can't get a job** – The unemployment rate is a record 43% for those under 25, and in the south of Italy it has soared past 50%.
- **You can't get a loan** – More European banks have been tightening lending standards than have been easing them every quarter since the start of the financial crisis, according to the ECB's quarterly Euro Area Bank Lending Survey.
- **You can't afford gas** – At the current price of 1.7115 euro/liter, the cost of gas is equivalent to $9 a gallon.
- **You can't get insurance** – About 1 in 15 Italian cars are involved in a claim each year, according to the Italian Insurance Association, ANIA. This is twice as many as France, which has a similar number of drivers. Each claim was much higher as well, resulting in very high premiums.

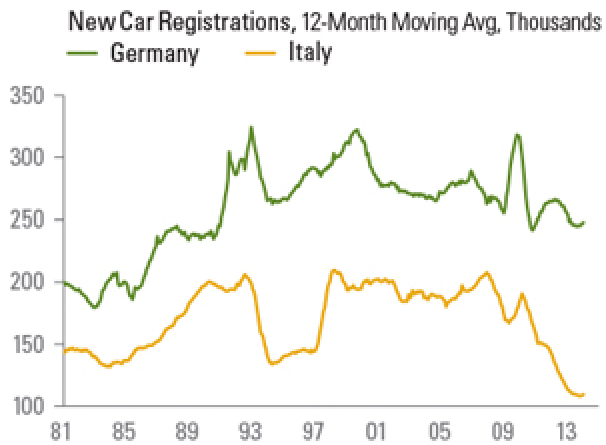
As a result, though it has shown recent signs of picking up, the 12-month average of new car registrations in Italy is now the lowest since data started being recorded.

If you are 21, you are unlikely to buy a car in Germany:

- **You have a job** – Germany youth unemployment is a very low 7.6%.
- **But you prefer to save, not spend** – The German savings rate is 10% (compared to 4% in the United States).

As a result, the 12-month average of new car registrations in Germany has been flat for years.

3 Car Buying Slumping in Europe



Source: LPL Financial Research, Bloomberg data 03/10/14

Despite inflation being in the ECB's "danger zone" and rising debt burdens, the ECB made a bet last week that the Eurozone economy is picking up fast enough to avoid the need for any further stimulus. We are not so sure. Until some of the above catalysts emerge, the risks to stocks in Europe may outweigh the rewards.

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

The P/E ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher P/E ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower P/E ratio.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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When Should You Collect Social Security?

The longer you wait to start collecting, the higher your monthly payment will be.

A growing number of Americans have been forced to delay their planned retirement date due to job and savings losses suffered during the most recent recession. According to a survey, nearly one-quarter of workers said they have resolved to retire later due to concerns about outliving their savings and fears of rising health care costs.[1]

Postponing retirement not only means working longer, but also delaying when you start collecting Social Security. Currently, workers can begin collecting Social Security as early as age 62 and as late as age 70. The longer you wait to start collecting, the higher your monthly payment will be. Your Social Security monthly payment is based on your earnings history and the age at which you begin collecting compared with your "*normal retirement age*." This *normal retirement age* depends on the year you were born.

Normal Retirement Age

Year Born	Age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 or later	67

Those choosing to collect before their *normal retirement age* face a reduction in monthly payments by as much as 30%. What's more, there is a stiff penalty for anyone who collects early and earns wages in excess of an annual earnings limit ($15,120 in 2013).

For those opting to delay collecting until after their normal retirement age, monthly payments increase by an amount that varies based on the year you were born. For each month you delay retirement past your normal retirement age, your monthly benefit will increase between 0.29% per month for someone born in 1925, to 0.67% for someone born after 1942.

Which is right for you will depend upon your financial situation as well as your anticipated life expectancy. Consider postponing taking your Social Security benefits if:

- You are in good health and can continue working. Taking Social Security later results in fewer checks during your lifetime, but the credit for waiting means each check will be larger.
- You make enough to impact the taxability of your benefits. If you take Social Security before your normal retirement age, earning a wage (or even self-employment income) could reduce your benefit.
- You earn more than your spouse and want to ensure that spouse receives the highest possible benefit in the event that you die before he or she does. The amount of survivor benefits for a spouse who hasn't

earned much during his or her working years could depend on the deceased, higher-earning spouse's benefit -- the bigger the higher-earning spouse's benefit, the better for the surviving spouse.

Consider taking your benefits earlier if:

- You are in poor health.
- You are no longer working and need the benefit to help make ends meet.
- You earn less than your spouse and your spouse has decided to continue working to help earn a better benefit.

Whenever you decide to begin taking your benefit, keep in mind that Social Security represents only 36% of the average retiree's income.[2] So you'll need to save and plan ahead -- regardless of whether you collect sooner or later.

[1]*Source: Employee Benefit Resource Institute, 2013 Retirement Confidence Survey, March 2013.*

[2]Source: Social Security Administration, "Fast Facts & Figures About Social Security, 2013."

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