ParenteBeard
WEALTH MANAGEMENT

Is This the Breakout?

Despite the negative implications of the government shutdown in October, businesses and consumers ignored the Washington brinkmanship and led a huge economic surge in the third quarter of just over four percent annualized GDP growth. Business inventory accumulation accounted for over 1.6 percent of the total growth. Nonetheless, surprising strength in consumer spending and exports and building momentum in business shipments and production accounted for the unexpected expansion in the third quarter. These trends continue in the fourth quarter leading us to raise our expectations for fourth quarter and full year 2013 economic growth to a range of 2.5 to 3 percent.

The outlook for 2014 is also positive. There are a number of relevant factors at play. Job growth in the U.S. has increased to an average of 200,000 jobs per month from the earlier level of 180,000 for most of 2013. Manufacturing in the U.S. is running at pre-recession levels, led by durables related to auto and housing sectors. U.S. exports are reaching record levels led by increasing energy production. The world economy is now strengthening, with accelerating growth apparent in Japan, Europe, the U.S. and in a number of emerging nations. Accordingly, the International Monetary Fund projects that the global economy will expand 3.6 percent in 2014 after expanding closer to three percent in 2013.

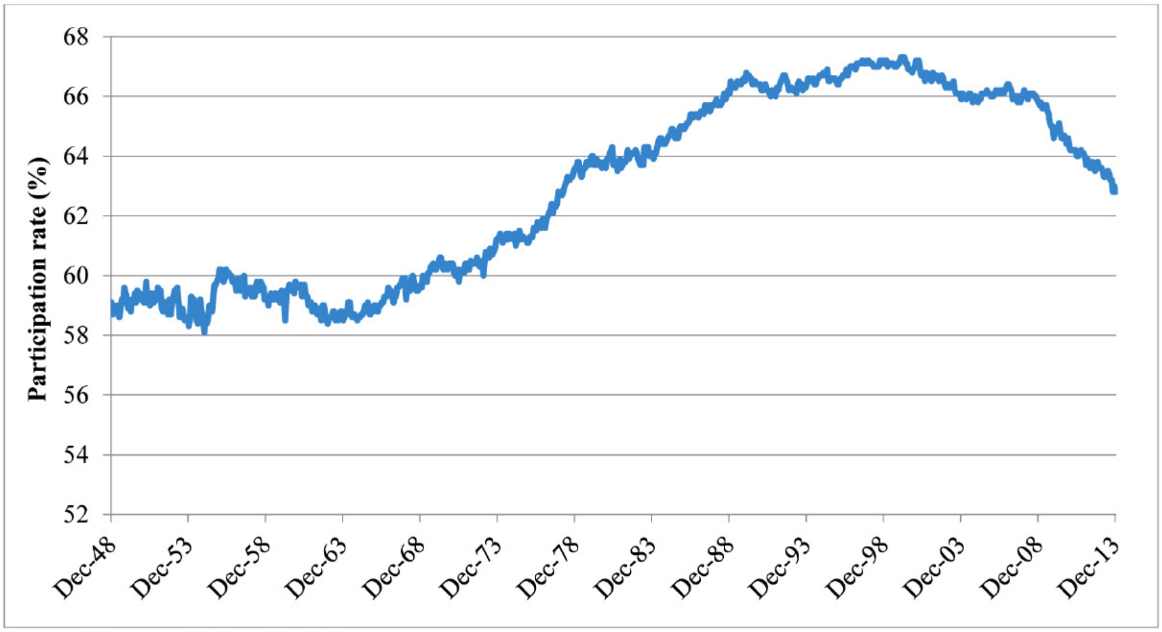
There are other tailwinds that more specifically impact the U.S. economy. The nation now enjoys greater certainty regarding its federal budgetary and Federal Reserve monetary policies. The federal government passed a budget that guides spending into 2015. In addition, the Federal Reserve announced in December that it would begin to taper its bond purchase program beginning in January and more importantly, promised to keep interest rates at current levels for the foreseeable future. These actions remove uncertainty that have negatively impacted consumer and business confidence. With economic growth now accelerating both nationally and globally, corporate America may have an opportunity to grow earnings at home and abroad.

So is this the economic “breakout” economists and analysts have been looking for since the economic recovery began in 2010?

While Americans with significant financial wealth have more than recovered from the stock market collapse of 2008-09, the economy remains depressed for many wage-earning families as well as for those who remain among the long term unemployed. While it is true that unemployment fell to 6.7 percent in December, the lowest rate recorded since November 2008, the decline was primarily attributable to the 347,000 people who left the labor force. Only 62.8 percent of Americans presently participate in the labor force, the lowest proportion since April 1978.

ParenteBeard
WEALTH MANAGEMENT

*Exhibit 3: Civilian Labor Force Participation Rate, December 1948 – December 2013**



Source: Bureau of Labor Statistics
* Population Age 16+

After a series of economic reports that easily exceeded expectations, including third quarter 2013 GDP, employment and consumer spending, the sustainability of the recent gains in consumer spending remains a question. The outlook for consumer spending continues to be clouded by the facts that fewer people are working and fewer people are working in high paying jobs. So while the nominal unemployment rate is below seven percent, the actual unemployment rate, including part time and discouraged workers is nearly twice that rate. As a result of the aggressive cost control measures of business and the continuing surplus of labor, wage income is growing at approximately the rate of inflation and heightened consumer spending is being subsidized by reductions in consumer savings. In the past months of October and November, consumers withdrew over $100 billion in savings to support the increase in spending in those months. While this can fuel "spurts" of consumer spending, as we have seen in the holiday period in the fourth quarter, it cannot sustain an extended uptrend in consumer spending.

In addition, we are concerned about the impact of the implementation of the Affordable Care Act and the potential of rising interest rates on the level of consumer spending in 2014 and 2015. Indications of significantly higher healthcare costs to consumers from higher insurance premiums, higher insurance co-payments and higher insurance deductibles could strain consumer finances and result in a suppression of consumer spending. The long period of low interest rates has fueled a surge in consumer spending for expensive durables such as autos and housing and more recently furniture and appliances that are financed. A rise in interest rates would be a restraint to those purchases. Those durables purchases are largely responsible for the very strong growth in manufacturing and the improvement in the economy seen since the second half of last year.

Despite these potential challenges to the 2014 economic outlook, we are optimistic the backdrop for improved economic growth this year is more positive than it has been the last three years. As a result, we now expect U.S. economic growth this year of 2.5to three percent. The key remains the consumer and his income growth. If the consumer stumbles and retrenches, so will business and we will have to adjust our expectations. For now, there appears to be weather clearing on the horizon.