

**The Rikoon Group
2218 Old Arroyo Chamiso
Santa Fe, NM 87505**

Spring Commentary 2014

The Markets

The pace of the first quarter of 2014 was tepid at best. Investors are unsure whether the economy is growing vibrantly or not, or whether the continued artificial respiration efforts on the part of the Federal Reserve Bank are enough to keep the US from slipping back into recession. Nonetheless, corporations are still making money and the ultra-low interest rate environment created by the Fed leaves investors with few choices other than stocks and real estate.

Stock market indexes in the US moved up marginally, with the total US stock market gaining 1.5% during the first three months. The Dow Jones Industrial Average fell 0.7% with utility companies paying decent dividends rising the most with an 8.5% return. The NASDAQ technology index advanced .5% while small caps gained .8%. Biotech companies were the best-performing sector, up 11% while gold and silver rose strongly if silently, up 6.8%. The Standard & Poor's 500 is selling at approximately 15 times next year's expected profits, which compares to an average of 13.2 over the past five years and 13.8 over the past 10 years. While the S&P 500 had its fifth consecutive quarterly gain, the market seems to have run out of gas, though automakers led the first-quarter rally both here and abroad.

A big surprise to many investors was the favorable performance of the bond markets. Short-term investment grade bonds rose 0.5% while longer maturity US government bonds gained 1.8%, even in the face of the ongoing curtailment of the Fed's purchase of bonds for the government's own accounts. In other markets, the commodity index fell 1.34% as global economic growth rates trended downwards. Crude oil was relatively stable, gaining 3.2% since the first of the year, while natural gas rose in step with oil, up 3.3%.

Overall, US investors spent the first quarter digesting gains garnered in 2013. They welcomed the news of very moderate economic growth and also benefited from the continued flow of money from overseas due to uncertainty in the rest of the world. The new Fed chairman pledged to keep interest rates low for an extended period of time, throwing out her predecessor's comments that when economic statistics showed a certain amount of growth, the Fed policy of buttressing the economy would end. From here on out, it's full speed ahead for the government engines!

Overseas, the global index of all non-US companies gained 0.2% during the first quarter, with Canada's resource rich market up 5.2%. Mexico, now undergoing profound political and structural reform, fell 5.3%. Paradoxically, Italy rose 14.4% with the best performance among all continental European stock markets while their joblessness rate reached a record of 13%. This official statistic should probably be doubled to get a more realistic sense of what it's like on the streets of Italian

cities where the unemployment rate among young people exceeds 25%. Greece and Portugal also saw their stock markets surge by over 14% so far this year.

The Economy

American factories recorded increased activity during the past three months, connoting a slightly expanding economy. This is in stark contrast to other countries such as China, the world's second biggest economy, which saw its manufacturing level fall to the lowest level since last summer. Europe, on a region wide basis, is stalled out with little change in their economic activity. The United Kingdom's factory production dropped to an eight-month low even while real estate prices in the City of London continue to rocket higher.

The divergence between the manufacturing economy and employment levels persist throughout the developed world. The new Federal Reserve chairman, Janet Yellen, accurately said that even though the central bank's unprecedented accommodative activity policies have helped out corporations, many Americans are not back to work anywhere near the levels seen before the great financial crisis that began in 2007. There are approximately 10.5 million unemployed Americans and a large portion of persons recently employed are underemployed, meaning they are working for low wages without job security. Labor force participation, which means the number of people actively looking for work, continues to fall. People who are out of work now tend to be unemployed for a long time. As a result, the government's open market committee has kept benchmark interest rates near zero since December, 2008 and this serves to minimize overall borrowing costs to the government. Easy money policies have quadrupled the government's debt shown on our nation's balance sheet to 4.5 trillion dollars.

As noted above, reports from China show weakness in its domestic economy and so their leaders must contemplate how and where to add stimulus. In late 2013, China consumed only 2/3rd's of its normal amount of cement and is exporting more steel than its seven largest competitors combined, probably at a net loss. China's excess capacity exceeds the joint steelmaking capacity of both the EU and Japan. Chinese rents in key urban areas are close to twice that of major American metropolitan areas. Chinese corporations, households, and government entities have tremendous excess liquidity invested in their property markets, which has driven prices to unsustainable levels. Chinese banks have bad loans on their books to the tune of their total capital and if they were honest about which assets were worthless, their entire financial industry would be out of business. Many analysts feel that China is an enormous risk to the global economy as opposed to being its future engine.

Notwithstanding their domestic trials, Chinese investors continue to buy foreign assets, particularly US real estate. State-owned Greenland Holding Group, based in Shanghai, recently purchased a 70% stake in the \$5 billion Atlantic Yards Development Project in Brooklyn. This follows on the heels of a \$1 billion residential and entertainment project investment in downtown Los Angeles. The Chinese, like newly minted Russian billionaires, are quick to move money out of their domestic economies when permitted to do so. This has driven up prices in certain US real estate prices, evidence of the global nature of financial markets.

Sales of existing co-ops and condominiums in New York City rose 35% during the first quarter of 2014 as the median price climbed 19%. The average price per square foot of dwellings sold rose 24%, the highest in 25 years of record-keeping. Interestingly, about 50% of the deals during the first quarter were completed with cash, and the price level for all units sold is approximately where it was before the real estate implosion of 2007.

General Topics

This is the first quarterly commentary which does not reprint any New Mexican articles which I previously wrote on a monthly basis. In their place, I will cover two topics, the first being the economic impact of climate change and the second, a summary of an amusing and useful article adopted from a soon to be published book, "The Curmudgeon's Guide to Getting Ahead" by Charles Murray.

Climate change is a reality. We all experience its effects and will be subject to more extreme swings in temperature and precipitation levels depending on where we live. Scientific debate and political discussion aside, I think it is worth noting that without question, the amount of fresh water available for agriculture purposes is declining worldwide. This will result in higher prices for all kinds of food as well as further stressing poverty-stricken populations, and there will be a continuous escalation of costs to deal with storm surges and drought. Some people and companies will thrive or relocate while others will not have those options available.

The pressure that climate change will exert on basic infrastructure, notably transportation and power networks, will be considerable. It is difficult to accurately project future costs to keep information, goods and people flowing in a commercially viable way. No one is particularly prepared for these changes and the occasional experience of extreme events such as Hurricane Sandy may or may not create a mindset that promotes preparing ahead of time for uncertain but likely disruptions. The United Nations report estimates a cost of 100 billion dollars but this is pure speculation.

Besides affecting land-based agriculture, climate change will impact commercial fishing. By the end of this century, the global stock of fish is projected to decline. Grain production is already being negatively impacted by warmer temperatures as wheat harvests have declined by about 2% per decade and maize by 1%.

The impact and cost of dealing with intense heat waves, wildfires in the West, and the possibility of increased food and waterborne illnesses due to changing environmental conditions are otherwise unknown. Many hope that temperature increases will be limited to 2° from the base level observed in 1880, but it is impossible to say if this is feasible. It is well documented that there are retreating glaciers in East Africa, the Alps, the Andes and our own Rocky Mountains. There are warning signs that damages to coral reefs and the retreat of the Arctic sea ice may be irreversible and if so, the result will be a large proportion of land and freshwater species facing extinction. It is true that some areas of the world will be able to increase food production under warmer temperatures. There will be winners and losers but the great majority of negatively impacted people and species will be those already living under stressed conditions.

It is hard to imagine that any coordinated response can be orchestrated without government intervention even though governments are notoriously inept at anticipating change and taking proactive measures that are effective without a long lead time. This conundrum points to a great challenge which hopefully our young people will rise to deal with in a creative and cooperative way.

Charles Murray's new book, "The Curmudgeon's Guide to Getting Ahead", will be published this April by Random House. While not an economic or market related topic, I think its ramifications for younger generations are important since they are the key to the future health of our economy and planet. Mr. Murray encourages them to consider marrying young because sharing experiences in ones mid-20s to early 30s establishes a base of commonality that serves one well later on in life. He recommends that people get to know a potential spouse by finding out about their passions, day-to-day lifestyle habits, and most importantly, their internal value system. The third of his five suggestions for living a good life is to not worry about gaining fame and fortune because most of us do not achieve huge external success. He quotes a world-famous music and film producer, David Geffen, who wistfully points out that anyone who thinks that money buys happiness, is someone who has never had a lot of money.

Fourth, Mr. Murray encourages young people to investigate their personal spirituality, whether through organized religion or not. He believes that some "people who are profoundly religious have, in addition to intelligence, judgment and critical faculties, the added benefit of possessing a disquieting confidence in an underlying reality behind the many religious dogmas". He feels people steeped in some kind of spirituality exhibit a kind of wisdom that goes beyond good judgment. Finally, he encourages everyone to watch the movie *Groundhog Day* often. The moral of that story is that someone can go from being a jerk to a fully realized human being if they have the opportunity to learn and relearn a few simple lessons.

Upcoming Events and Personnel News

Rob: We would like to welcome Lauren Pineda to The Rikoon Group staff. Lauren joins us with a colorful career which encompasses a degree at the Art Institute of Chicago and various enterprises around Santa Fe. Lauren was a star member of the Wood Gormley fifth and sixth grade basketball team back in the early 1990s, when my daughter Robyn allowed me to coach her and her classmates for two long seasons. Robyn has been actively pursuing acting jobs and traveling for much of the past three months.

After much ado, my daughter Hannah's assistance in Santa Fe has helped bring the 18 year egg tempera Chapel project near to completion. Hannah has also been assisting in the office as we move through the 2014 tax season. By the time we have our quarterly get together, I hope to have descended and ascended the walls of both the south and north rim of the Grand Canyon...we will see!

Juliana: In February, I spent a week with my mother in Winston- Salem. We even took a “road trip” to Chapel Hill, spend the night at the Carolina Inn and attended a musical at the historic Playmakers Theater. I loved being back on the campus of UNC if only for 1 night - Nothing like re-living your college years.

Jeff: The weather is warming up and so I am beginning to do more bicycling. I am looking forward to going to some music festivals this summer. In New Mexico, I am planning to go to the Silver City Blues Festival May 23rd-25th and the Rockabilly Festival in Tucumcari June 5th – 8th. It should be lots of fun.

Patricia: Well, it is that time of year again and although every Fall I say I have had enough gardening, I am anxious to get started. The asparagus is up and I see lots of garlic showing promise. You know where you will find me in off hours. If anyone is interested in a seed exchange this year, let me know and I will be sure to save some for you.

Emily: I have enjoyed the mild weather this winter, and in true New Mexico fashion, the winds have picked up just in time for spring tennis and soccer. It has been a very busy time around the office so I am greatly looking forward to trips scheduled in May to New York and Italy.

Lauren: The warmer weather makes it a challenge for me to stay inside but I am an avid weaver and have been spending a great amount of time tucked away in my little studio. I am looking forward to doing some more bicycling and hiking on the weekends and am excited to be beginning a new job here at The Rikoon Group.

Dana: With most of my family in CA, I pop back and forth on a regular basis. In May, I will be traveling with my children for a week of beach time in Mexico. I recently checked on my hives and am happy to report that the queens are all accounted for and are building up their brood nests for another bountiful season.

Local Tea & Conference Call-In Dates

The next Rikoon Group gathering will take place at our offices at 2218 Old Arroyo Chamiso in Santa Fe. The date is **Wednesday, May 14, at 3:30 PM**. Please bring yourself and a friend to gather around and listen to Rob’s comments on the markets and economy. If you are unable to join us on the 7th, please feel free to call in for a telephone version of the chat on **Thursday, May 15, at 3:30 PM, MST**. The call-in number is: 626-677-3000 and the Access Code is 425993. Please email us before the call if you’d like Rob to respond to your particular questions or areas of interest.