DMS

Discretionary **M**anagement **S**ervices, LLC

What We Are Telling Clients

By James F. Dykstal, CFA, Portfolio Manager, July 2013

Below is a summary of our views on the economy and markets, which we are sharing with discretionary clients. In essence, we view that the risk in risk assets is underappreciated – especially in domestic stocks, both large and small cap. Some sectors have already corrected and we view those more favorably in the longer term.

Economic Outlook

- First quarter 2013 GDP growth was 1.8%, up from 0.4% fourth quarter 2012. Our expectation is that when we see second quarter preliminary GDP, it will show signs of slowing from the first quarter pace. Overall, we expect GDP growth to maintain a pace of between 1.0% to 2.0% for 2013 and into 2014.
- Inflation will continue to be modest as unemployment remains above longer-term averages. Wage growth will continue to be stagnant. Commodity prices will be contained due to slowing growth in China and slow/modest growth in developed nations.
- Residential real estate has been recovering. By some measures, housing affordability is at a 40-year high, due to modest rates and home prices. Housing starts grew at 30% from a year ago, but levels are still historically low.
- The Fed will continue asset purchases until at least 2014, as inflation is modest and employment growth is slow.
- The European economy appears to be slowly recovering from recession, but risks remain. Growth is at a pace less than U.S. growth. The U.S. dollar will be relatively strong to the euro and the yen.
- Economic growth in emerging markets will lead developed markets, even with slowing GDP growth in China, as consumers in emerging market countries continue to increase their percentage of global consumption.

Strategic Market Outlook

- Corporate earnings growth will remain limited for some time at a low single digit pace, due to ongoing debt and demographic issues among consumers.
- The downside risk of the stock market is increasing as the market appears to be fully valued. The current S&P 500 P/E on trailing earnings is 16 times as compared to a long-term (life of the index) average of 15 times.
- Stock volatility will be strongly influenced by global macro events such as the Federal Reserve's "tapering" decision, economic slowing in China or a new sovereign debt crisis in Europe.
- U.S. Treasury bond yields will trend slightly higher. Investors will continue to invest in higher yielding corporate bonds.
- Larger cap and higher quality U.S. equities offer relative safety to other domestic equity classes. Emerging market stocks, while more volatile, will benefit from stronger economic growth in those countries and below average valuation.

Current DMS Tactical Positions

- Equity exposure remains underweight in favor of lower volatility fixed income assets.
- Within equities, the focus is on lower beta stocks of large, high quality, dividend paying companies.
- Within equities, small cap stocks remain underweight.
- International stocks remain underweight due to concerns of European debt troubles and the prospect of lackluster economic growth.
- Among international equities, emerging markets stocks are relatively attractive as those countries lead in global economic growth. Asian markets are favored relative to Europe.
- Within fixed Income, credit is overweight compared to Treasuries. High yield is viewed favorably. Duration is somewhat shorter than benchmark duration.

If you are interested in more information, please call Tom Woolwine, President, at (913) 981-1345 or email, twoolwine@dms-demarche.com.