SLOCUM, GORDON & CO. LLP
INVESTMENT MANAGEMENT AND COUNSEL

VIEWPOINTS

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This Economic Commentary is designed to present the Firm's current views on timely topics that we feel may be of interest to our clients. Viewpoints is also available electronically on our website: slocumgordon.com.

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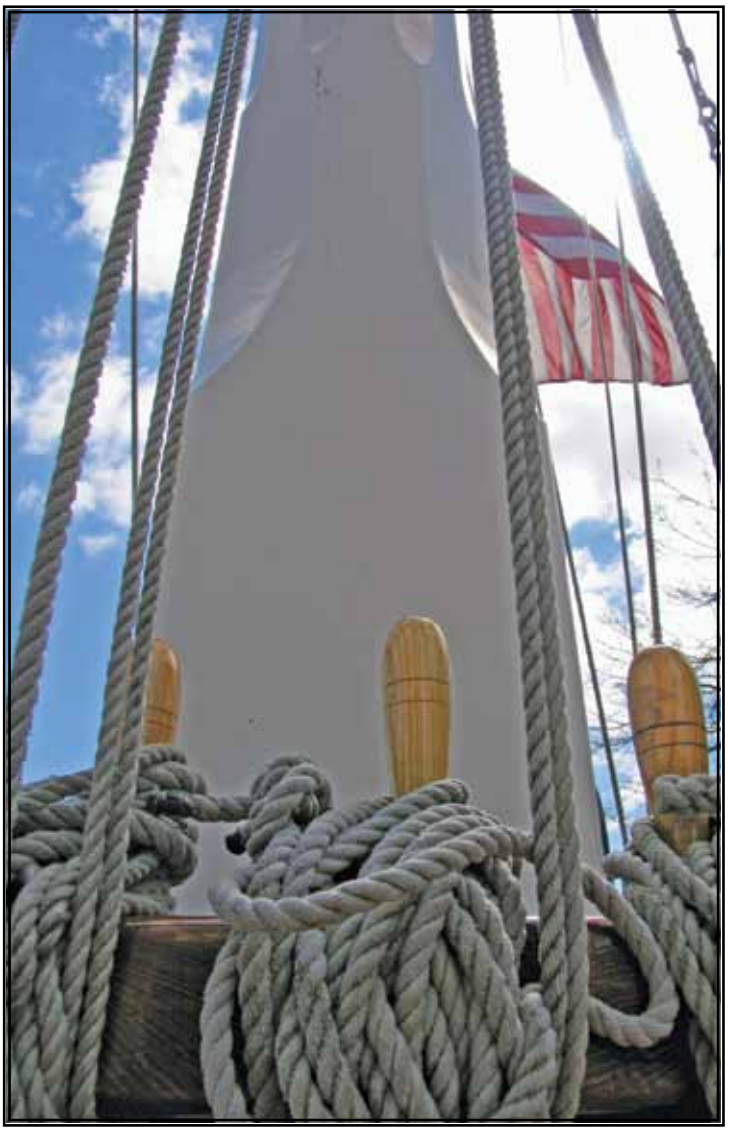
Are we there yet? That is the constant refrain parents hear from impatient children from the back seat of a car trip that to them seems endless no matter how long the elapsed time has been. After too many hours underway, the next legitimate question may be: *will we ever get there at all?* Well, five years into the long-promised economic recovery, global participants are still wondering in a similarly impatient way where the growth is, why it has taken so long to appear, and whether we will see anything akin to full employment ever again. So many factors impede on a simple answer, but we are of the opinion that what this tepid recovery (compared to traditional post-war experience) lacks in strength, it will make up in length for one basic reason: persistently low interest rates because of minimal inflation pressures.

When the Internet was commercialized and the dot-com bubble was forming back in the 1990s, technology seemed to have limitless potential, which is always a clarion call for companies to jump in for their share of the profits. As it happened, too many players jumped in at once, creating enormous over-capacity, and the whole thing came to a screeching halt. What did result, however, with the introduction of commerce on the Internet, was a powerful new deflationary force that continues to this day. No matter what you might want to buy, it would seem that there is always someone somewhere on the globe who is willing to sell that item to you for a cheaper

price. In the manufacturing world, there is currently no shortage of supply of almost any raw material, and immediate or just-in-time delivery mitigates the expensive problem of over-stocking inventories. Corporate managements are much more sensitive to operating costs that impact bottom line earnings.



Automation, outsourcing to cheap labor in developing countries, high costs for employers from increased regulation, taxes, and uncertainty (particularly with the onset of Obamacare), and the proliferation of Internet commerce, all have contributed to an increase in the core unemployment rate in the US and other industrialized countries. While inflation is usually associated with higher prices of goods that we buy, it has its root in higher wage costs that traditionally occur as an economic recovery matures and eventually tends towards overheating. With those higher labor costs, prices increase, inflation picks up steam, and then the Fed steps in by tightening the Federal Funds rate, bringing all other interest rates up along with it.

The timeline for that "normal" business cycle has varied over the years, however the inevitable outcome of those higher, punitive interest rates is recession, where prices comes back into equilibrium

allowing the whole process to start all over again. So when our impatient global traveler wonders if we are there yet after five years of this so-called recovery, the real answer is that this time we do not really know because we have been in unchartered water ever since the first wave of the Fed's policy of Quantitative Easing (near-zero interest rates) back in 2008. The recovery we have experienced has been erratic, vulnerable, and unimpressive compared to previous post-war statistics, but it continues regardless and will probably last a lot longer as a consequence of its gradual inclination.

The lack of definition in the recovery and the continuing regime of low interest rates has required a rather unconventional approach to managing money. First, we have chosen to seek out more secure dividend-paying equities as our main priority, eschewing new bond purchases in this low rate environment. This has lifted our equity allocation to a higher-than-normal level as some of our stocks tend to have bond-like characteristics (utilities and telecom). Second, to take advantage of whatever recovery does occur, some exposure to cyclical industries is warranted (industrials and technology). This barbell approach to our strategy may seem to anticipate two opposing scenarios, growth on one hand and no or slow growth on the other. We consider this a hedge if only one of the two scenarios occurs. Third, we have retained some cash reserves despite their minimal contribution to performance just because having some dry powder in a volatile world makes good sense.

As we maneuver through the vagaries of the economy and the markets, we believe our economic view, asset allocation, and security selection continue to offer opportunity for patient investors with reasonable expectations. The Firm's management style does not employ a "model" portfolio as each client account is unique and stands on its own, but there is certainly commonality among securities in many of our clients' accounts, depending on the point in time when a client opens a relationship with us and the client's particular objectives and risk parameters. As a time-tested approach to portfolio management, seeking to maximize the return while at the same time minimizing the risk seems to be a good investment strategy for all seasons. So, while our global traveler may remain frustrated looking for statistical evidence of a strong economic rebound, as long as this recovery remains on track, equities should continue to be productive investments. However, even at the opera, it is always a good practice to know where the exits are.