ECONOMY: Q1 GDP Falls Further

Q1 GDP was again revised downward, but optimism remains for a stronger Q2.

Q1 GDP DISAPPOINTS....AGAIN?
The Commerce Department sharply lowered its assessment of first-quarter economic growth from an earlier reading of -1.0% on an annualized basis to -2.9%. The first quarter of 2014 was the worst for U.S. GDP performance since the first quarter of 2009, and occurred amid the backdrop of an improving labor market and increasing business activity.

IMPACT ON 2014 GDP
With such a rough Q1, growth will have a hard time exceeding 2.0% for 2014. Even with an optimistic estimate of nearly 3% the rest of the year, GDP will expand only by an average of 1.5%.

CONSUMER CONFIDENCE HIGH
The Conference Board’s Consumer Confidence Index increased in June. “Consumer confidence continues to advance and the index is now at its highest level since January 2008 (87.3). June’s increase was driven primarily by improving current conditions, particularly consumers’ assessment of business conditions. Expectations regarding the short-term outlook for the economy and jobs were moderately more favorable, while income expectations were a bit mixed. Still, the momentum going forward remains quite positive.”

REPORTS ON BUSINESS
According to the Institute for Supply Management (ISM), economic activity in the manufacturing sector expanded for the 13th consecutive month. Respondents noted that business conditions continued to improve. The non-manufacturing sector expanded in June for the 53rd consecutive month. Respondents’ comments varied by industry, but the majority indicated that steady economic growth is continuing.

UNEMPLOYMENT RATE FALLS AGAIN
Despite fairly flat economic growth, job gains have continued and have accelerated in recent months. The improvement in job growth dropped the unemployment rate to a new cyclical low of 6.1% in June.

HEADING TOWARDS “FULL EMPLOYMENT”
The unemployment rate has trended downward by about 1 percentage point per year over the past few years. If the current rate of decline continues, the unemployment rate would stand near 5% next summer, below the roughly 5.5% level the Fed considers to be consistent with full employment.

SLOW EUROZONE RECOVERY
European GDP only grew at an annualized rate of 0.7% in the first quarter. Moreover, industrial production reports for most European markets fell meaningfully in May, with many markets down by close to 2%.

Déjà Vu?
One of Portugal's leading financial institutions, Banco Espirito Santo SA, fell 32%, amid accounting irregularities at its parent company. The problem intensified when interest payments on some short term debt securities were delayed. It has been more than a year since fears about the health of a European bank rattled markets.

ECB ACCOMMODATES
The European Central Bank (ECB) left interest rates unchanged, a month after it enacted another round of stimulus measures to rekindle growth in the Eurozone. The ECB’s move was widely expected, but investors still drew comfort from ECB President Mario Draghi’s pledge to keep rates low “for an extended period of time.”

CHINA STABILIZES
Recent data showed Chinese factory output rose in June, indicating that the targeted stimulus measures that Beijing implemented this spring have stabilized the economy. This further eases worries about a slowdown that rattled markets earlier this year.
GLOBAL EQUITIES: Global Markets Strong

U.S. EQUITIES – SLOW BUT STEADY
The day-to-day market has continued to be slow but steady. The S&P 500 continued to gain, as it posted eight new closing highs over the 21 trading days in June. For the month, the market posted its fifth consecutive gain, adding 2.1%, to close the second quarter with a 5.2% increase. It was the sixth consecutive quarterly gain, an event that had not been seen since 1998, with the index posting a 37.45% gain over the 18-month period. Volatility, measured by the VIX Index was low, closing the month at 11.57, slightly half the historical 20.09 average.

Q2 GDP WILL BE IN FOCUS
The restated first-quarter GDP, which came in at an annualized growth rate of -2.9%, was the worst level in five years. However, the weather was poor in Q1 2014 and the negative growth was only for one quarter, with the hope that Q2 2014 will make up for it. There is optimism for a stronger second quarter, and if earnings disappoint, this could be the trigger for the correction that has been widely expected.

DEVELOPED EUROPE DOWN
Developed European markets underperformed in June. Although economic growth appears to be gradually improving, concerns remain over the slow progress toward economic reforms by some member states, elevated debt loads, high unemployment, and declining inflation. The European Central Bank (ECB) announced further stimulus measures in an attempt to revive growth and spark inflation.

EMERGING MARKETS STRONG RECOVERY
For the month, emerging markets again did better than developed markets, posting a 2.7% gain. The recovery in emerging markets has been substantial. After losing 0.4% in Q1, emerging markets roared back with a 6.6% gain in Q2.
LOW VOLATILITY BONDS
U.S. Treasury volatility, as measured by the Merrill Option Volatility Estimate (MOVE) Index, is currently at its lowest point since the Fed announced it’s intention to taper its QE programs in 2013.

STILL ON THE HORIZON
Capital appreciation in bond prices could start to fade if, as expected, the global economy accelerates, central banks raise rates and bond yields start to drift higher. Markets should begin to look forward to 2015 when a few key central banks, such as the Fed and Bank of England (BoE), are expected to begin hiking short-term interest rates.

ACROSS THE POND
Developed market government bonds had another strong month, fueled by stable economic growth and low to moderate inflation. Risk taking was also supported by the global expansion and easy monetary policy maintained by many central banks. The rally in European peripheral debt accelerated in early June after ECB President Mario Draghi announced additional monetary easing measures and rate cuts.

MUNI ISSUANCE INCREASES
While new issuance was stronger than in prior months, the favorable supply/demand dynamic that has driven performance YTD remained a tailwind in June. Issuance for the month was $34 billion, consistent with the five-year average for June. More notably, however, this was up 32% from last month. Issuance is now down only 16% compared to last year.

PUERTO RICO DEFAULT?
Troubled Puerto Rico returned to headlines when it passed a law that would allow public corporations to default on their obligations. The new law would apply to at least $22 billion of debt owed by public corporations, providing for an organized process through which debt can be cut or reduced.
**ALTERNATIVES: Real Asset Strength Continues**

### ALTERNATIVE INVESTMENTS

- **GLOBAL**
  - HFRX Global Composite: 0.9% / 1.8%
  - HFRX Absolute Return: 0.7% / 1.8%
  - HFRX Equity Hedge: 1.5% / 1.3%

- **EVENT DRIVEN**
  - HFRX Event Driven: 1.6% / 4.4%
  - HFRX Merger Arbitrage: 0.2% / 0.9%
  - HFRX Distressed: 2.3% / 6.7%

- **MACRO**
  - HFRX Macro: -0.7% / 0.1%
  - HFRX Systematic Diversified CTA: -2.7% / 0.1%

### REAL ASSETS & COMMODITIES

- **REAL ASSETS**
  - S&P Global Infrastructure: 3.8% / 16.0%
  - Alerian MLP TR: 5.9% / 16.3%
  - S&P U.S. REIT Index: 1.1% / 17.6%
  - S&P Global ex US REIT Index: 2.8% / 14.1%

- **COMMODITIES**
  - DJ UBS Commodity Index: 0.6% / 7.1%
  - DJ UBS Energy: 2.0% / 8.8%
  - DJ UBS Energy: -8.6% / 0.7%
  - DJ UBS Softs: -2.5% / 13.0%
  - London Fix Gold: 4.7% / 9.3%
  - London Fix Silver: 7.0% / 9.8%

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**BETTER, BUT FAR FROM THE BEST**

The HFRX Global Hedge Fund Composite registered a 0.9% gain for June, besting bonds but continuing to fall short of equity returns. Event Driven strategies, such as merger arbitrage and distressed assets, posted modest returns in June, and have been the better performing hedge fund sectors thus far in 2014. The Commodity Trading Advisors Index (CTA), commonly known as “managed futures,” eked out a small gain in June, but the trend following strategies have found it difficult to recoup losses suffered in February and March.

**COMMODITIES MIXED**

Gold, Silver and other metals posted sharp increases for the month as oil sustained early month gains on increased Middle East geopolitical tensions. Agricultural commodities experienced a volatile month on unexpected U.S. weather patterns, with large gains in Hogs, Cattle and Lumber offset by sharp declines in Wheat, Corn & Cotton.

**REAL STRENGTH IN REAL ASSETS**

Infrastructure and real estate continue to be two of the best performing sectors in the real asset space, and in the overall global markets.