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Sandpiper Capital

Gleanings

Market Returns Annually and Through Ten Years Ending 3/31/2013

Index	2011	2012	YTD	10 Yrs
S&P 500	2.1	15.9	12.5	**8.5%**
ML 1-5 yr Gov't/Corp	3.1	2.5	.3	**3.6%**
EAFE (Dev Fgn Mkts)	-12.2	17.2	5.0	**9.7%**
Gold	10.1	7.1	-3.6	**16.9%**

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"*Good* Volatility"

By now you're getting used to hearing media types talking about the stock market making new highs, and yes, you can see from the Chart 1 at right that the S&P (the red line) *is* trading at five year highs. And, as is typically the case for market observers at this juncture, most commentators take the recent bullish sentiment to be, well.., bullish. Individual investors agree, with new investments into stock funds during January reaching levels not seen since April of 2000. I don't think that it is overstating the obvious that some perspective on this advance is required.

The black line on Chart 1 shows the growth of the U.S. economy (GDP) over the same 16 ¼ year period. You will note that both doubled over that span for an annual growth rate of 4.3%. However, the swings for the market around that 4.3% trendline (i.e.; the volatility of those returns) have been enormous, with several up 100% and down 50% gyrations. Are the up 100% swings somehow not real? No, it's just that while predicting that the long run growth of the market will approximate the long run growth of the economy is a pretty safe bet; predicting the future direction of the short term swings around that average is very, very difficult. We include Chart 2 in order to provide a more fundamental view of the market over the same 16 year span. This time we've charted S&P earnings against the growth of GDP. While recessions devastate earnings (and the market), you will note the same 4+% trendline growth rate. We believe that the recent rapid recovery in earnings is about to revert back to that long run growth rate. Much of the current excitement about the market has come from extrapolating the experience of the recent past out into the future. Those looking for double digit growth will probably be disappointed. As the year progresses, current lofty earnings projections will likely be revised downward, a process that could quickly reignite the fears that cause that bad sort of volatility.

Chart 1

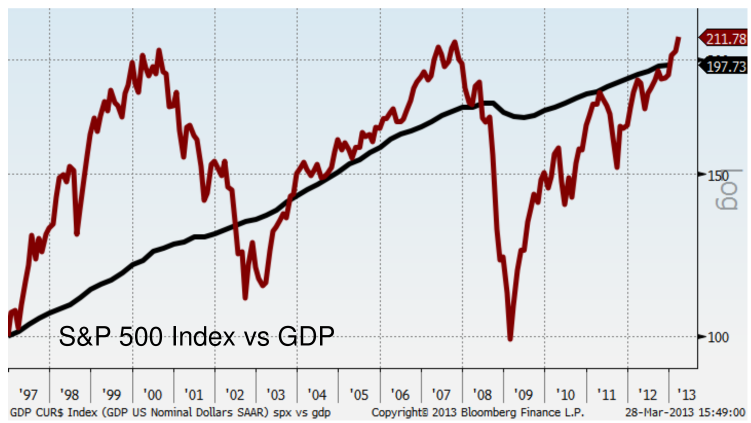
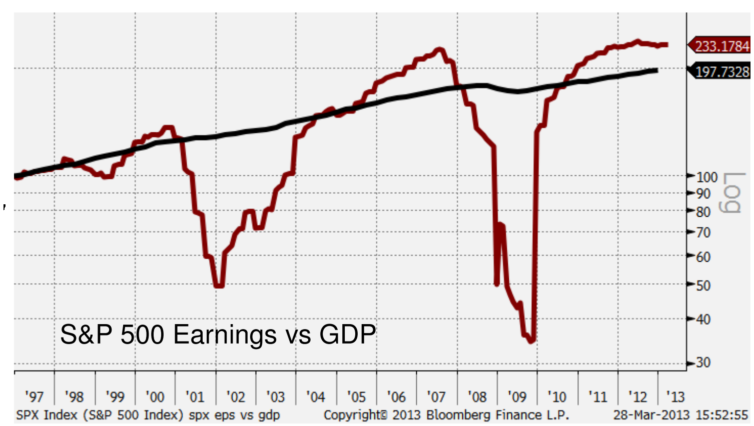
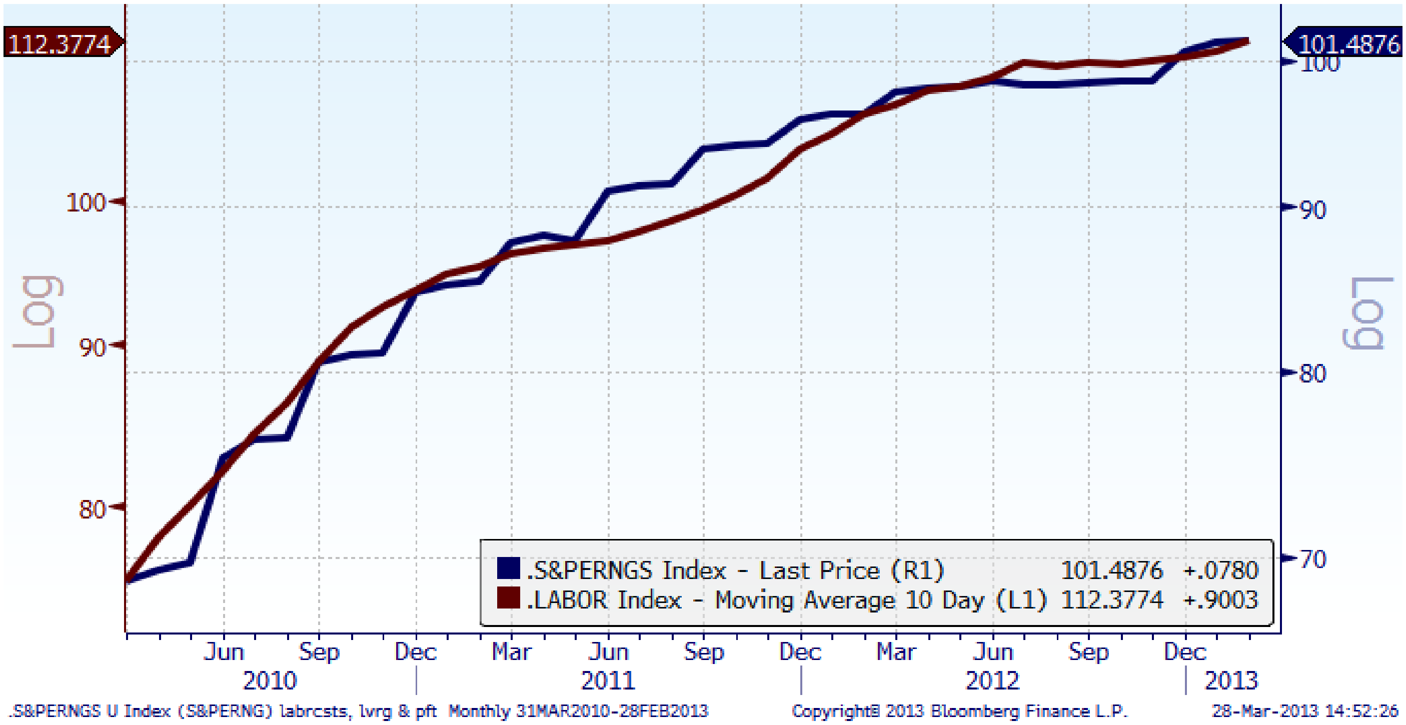


Chart 2



> *"Are the up 100% swings somehow not real? No, it's just that while predicting that the long run growth of the market will approximate the long run growth of the economy is a pretty safe bet, predicting the future direction of the short term swings around that average is very, very difficult."*

Our conservative view towards earnings is based upon the relationship between layoffs (labor cost savings) and profits. As the economy has improved, businesses have been unable to squeeze any more productivity from their much reduced workforce. With labor costs firming, profit growth has slowed. And as borrowing costs have been rising, the ability to leverage growth with finance is also disappearing. Our labor index in red below reflects that flattening.



Another factor driving current market enthusiasm is the incipient housing recovery and its potential to help fuel consumer spending. The conundrum however, is that as the economy improves, interest rates rise in anticipation of the Federal Reserve becoming less accommodative. That rise in rates, (shown in an inverted scale in black below) combined with tight credit and a record supply of foreclosed housing overhanging the market has already begun to push the prices of existing housing (a five month average represented by the green line) back towards last year's lows.