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## Market Review & Update

AUTUMN 2013

Time for a cheesy holiday analogy...

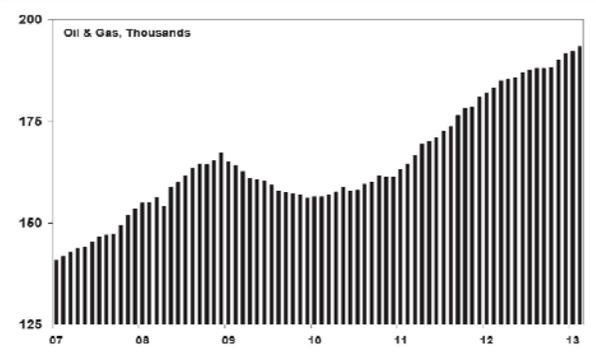
We've just finished earnings season, which, throughout this recovery has been the star guiding the way forward. And like a dutiful Magi, the Dow Industrials, the Standard & Poors 500 and the Nasdaq have climbed to notable highs, reaching 16000, 1800 and 4000, respectively...

It is important to once again pay homage to the powerful role earnings have played in this recovery journey. Real business has continued on a very global scale. This was additionally aided by highly cooperative central bankers keeping interest rates supportively low. And if you tune out the hyperbole on the news outlets for the moment, recall that the truly big worries over the past few years: a terminally ill Euro Zone; possible contagion in China weakening their huge growth catalysts; and a US economy slinking back toward recession, all failed to manifest and metrics continue to show gradual improvement. Areas in the Euro Zone are showing positive GDP activity, China is evidencing signs of rebound and the US GDP, which spent much of the last year around 2%, seems on a path toward 3% for 2014. The increased coincidental confidence has earnings estimates up, averaging about an 8% increase for the New Year. Anticipation of the improvement has also allowed for a bit of P/E expansion in a market where valuations remain quite average on an historical basis. The markets also gave a friendly welcome to Janet Yellen as the new head of the Fed. She is widely viewed as a steady, calming presence much in the camp of her highly regarded predecessor. Absent the oft cited exogeny, the markets are on a path for one of the best periods since 1967.

That story sounds so nice that we'd most certainly be remiss if we did not turn the volume up on the hyperbole for a moment to stare at the polar opposite story which, while winning the decibel war, proved to be shameful, yet irrelevant from the markets' perspective. Washington, like the inebriated uncle at the family party, exhibited inappropriate behavior that unfortunately captured the attention of the world. Feel free to peek at the Latest cover of The Economist magazine... If they only weren't so insistent on making the uncle so very plural. An Executive Branch saying almost anything to avoid a true posture of leadership, being continually challenged for the title of Most Ineffectual by a Legislative Branch that seems to have forgot that they are hired to legislate. Their gift to us was to simply never stop their political campaigns... And as we're witnessing, governing by campaign slogans simply doesn't work. I remember once saying that governments don't do large, revolutionary things very well, citing a quote from George Will who often notes that the founding fathers created checks and balances to save us from ourselves. Well, the government decided to "manage" 18% of the US economy –healthcare (and the fact that healthcare has become such a bloated expense that it even is 18% of the economy is certainly destined to be a future rant...) and aren't they off to a great start.

Ok, they haven't earned the respect to ruin anything about any of our holidays, so back to better stories. There are some things on the horizon that have the potential to be catalysts that have not been factored into future growth projections or the potential duration of this recovery. One of growing significance is the energy story in the US. In addition to nationwide discoveries of gas and oil in places we were heretofore unable to reach, a purported discovery of a deposit in Texas rivaled in size by only the Saudis, have the potential for job creation estimated in the millions, notwithstanding the faux moratorium in this fair state cleverly masquerading as a long term study. (see Figure 1). In addition to the jobs

Employment in Energy Extraction



Source: Bureau of Labor Statistics

benefit, the drop in energy prices is also a positive for the domestic economy. Recall that a one cent drop in the price of gas represents one billion dollars in discretionary spending potential. Jobs in general have been the focus of the Fed's actions. With stated unemployment around 7.5% and a real rate much higher when factoring in the three decade low participation rate, there is much room for improvement and those six words are an odd positive for outlook purposes. If unemployment were materially lower there would not be much ability to improve things from here and the coincidental inflation levels would be much higher. So, the ability to put people to work should be viewed as a potential positive for the future. It would seem obvious that the key to that job number is our old friend, the oft mentioned record corporate cash. A few people in the legislative branch are actually working quietly (they wouldn't want it to leak out...) on some tax overhaul that would include some repatriation benefits for that cash, much of which is earned and sitting offshore. Should companies become incented to spend that money domestically, it would create the historical pattern of more jobs, improved housing activity and the resulting consumer activity.

I'm surprised it isn't in the news more, but keep a close eye on the Chapter 9 bankruptcy in Detroit. How it's handled is likely to reverberate nationwide. There are many Detroit's in the cities, towns and counties in this country, who, like GM made promises long ago based on hubristic assumptions that have grown into terminal illnesses. I was recently driving on the thruway and was passed by a Toyota Rav 4 with soiled Michigan plates emblazoned with the motto "the world's motor headquarters", which answers the question, "just how much irony can a small Japanese SUV haul?"

So, in general, if you turn off the 37 news channels, there is a palpable amount to be thankful for during this holiday season. We'd like to leave you with a picture of holiday history. There is a great website and publication, Heritage Press, go there. They have an immense collection of historically significant photos of this area. This photo, borrowed from their collection is of the Chippewa Ellicott Market, nestled twixt St Michael's Church and the Electric Tower (now the parking lots behind the Market Arcade Theaters). Note the evergreens lined up for sale. Our best wishes to you for what looks to be a promising New Year!!

We'll talk to you soon...



C. 1900 photo of the Ellicott Street side of the market, possibly taken at Christmas time; note the cut evergreens lined up. Image source: Heritage Press