Bourgeon CAPITAL MANAGEMENT
Investment Counselors

MARKET INSIGHTS

April 2014

"There's No Place Like Home"

— The Wizard of Oz, 1939

Mingled amidst the champagne toasts of the New Year were investor headlines touting synchronized global expansion. By the end of January 2014, once the hangover had cleared, we have been reading about emerging market stagflation and credit concerns, China slowdown worries, and geopolitical uncertainties in Ukraine/Crimea/Russia. Throughout the global turbulence during the first quarter, the US stock market has muddled through. The next earnings reporting period starts this month, and, looking past severe winter weather, we expect that for the US "there's no place like home."

US Economic Tailwinds Outweigh Headwinds by a Sizable Factor

Sometimes it's hard to tell the forest from the trees. Little bits of data become blown out of proportion, and broad trends are masked by noise. To help us Laura takes her notebook (old habits die hard) and writes a line down the middle. On top of the left side of the paper she writes PROS, and on the right side she writes CONS. Throughout her day, she writes down headlines that catch her eye and puts them in the appropriate column. She does this for news about company specifics, the economy, energy markets, geopolitical events, etc., in order to help see a trend. This quarter she took note of a similar, and more eloquent, analysis from Nancy Lazar, of Cornerstone Macro. Ms. Lazar's list of Tailwinds/Headwinds for the US economy was shockingly positive by a factor of almost 3:1. We like those odds, and agree with her conclusion that US economic growth should surprise on the upside. See Table 1.

Table 1
US Economic Headwinds vs. Tailwinds

14 Tailwinds	5 Headwinds
1. Signficantly less fiscal drag.	1. Unfolding EM currency/bond market crisis.
2. Lagged effects of stimulative Fed policy.	2. Unfolding China slowdown, with significant downside risk.
3. High and rising domestic corporate profits.	3. The likelihood of a Japanese contraction starting in Q2 related to tax hike
4. Low/slowing inflation.	4. Russia turmoil
5. Declining commodity prices.	5. Rising U.S. mortgage rates.
6. Less Washington/political turmoil.	
7. Banks' willingness to make loans.	
8. Rising house prices.	
9. Rising stock prices.	
10. Brodening impact of the Mfg Renaissance.	
11. Broadening impact of the Energy Reniassance.	
12. Improving trade balance.	
13. Narrowing/narrow corporate spreads.	
14. Reduced consumer deleveraging.	

Source: Cornerstone Macro

US Monetary Training Wheels are Off and We are Maintaining our Balance

Monetary training wheels in the US are off and our confidence in being able to keep them off is growing. The Federal Reserve has been tapering its quantitative easing since January. The FOMC remains confident in the US economic recovery, and has become more confident in their outlook for employment. Our new Fed Chair, Janet Yellen, recently remarked that "progress in the labor markets has been more rapid than we had anticipated, while inflation has been lower than the committee expected." And consumers and small business owners are confident as well. Consumer confidence, as measured by the Conference Board, is at its highest level since the end of 2007 (Table 2). Small business optimism has bounced back after the winter weather (Table 3). Corporate and business surveys from research firms ISI and Goldman Sachs remain firmly in expansionary territory. Additionally the index of leading economic indicators continues to improve.

Table 2
US Consumer Confidence is Up
March 2007 – March 2014

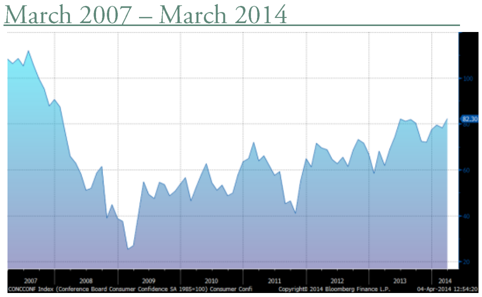
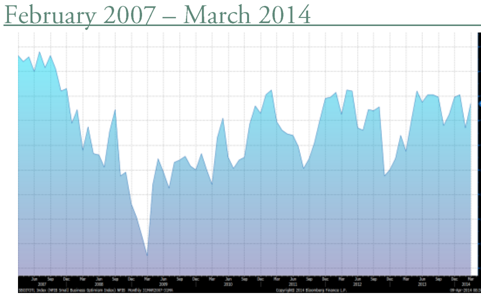


Table 3
Small Business Optimism is Up
February 2007 – March 2014



Source: Bloomberg, Conference Board, NFIB

Will Animal Spirits Come Back?

We have been waiting for animal spirits to come back, and with financial markets returning to normal (declining quantitative easing) and with confidence increasing, the chance for this to occur is also increasing. Some first signs would be a pickup in M&A and corporations being more willing to spend on growth rather than on buybacks and dividends. According to ISI Group, over the past 53 days there have been over 76 M&A deals announced, and C&I loans are improving. See Table 4.

Table 4
C&I Loans Are Improving (As of March 14, 2014)

(% change q/q)	3Q13	4Q13	1Q14
Non-Real Estate			
C&I	**0.7%**	**2.3%**	**2.3%**
Cards	-1.0%	4.1%	-5.8%
Auto & Student	0.9%	1.2%	0.9%
Total Non Real Estate	**0.3%**	**2.5%**	**-0.1%**
Real Estate			
Resi Mtg	-3.0%	-0.6%	-0.9%
Home Equity	-1.8%	-2.7%	-1.9%
CRE	1.5%	1.8%	0.5%
Total Real Estate	**-1.6%**	**-0.4%**	**-0.7%**
Total Loans	**-0.7%**	**0.9%**	**-0.4%**

Source: ISI Group, Federal Reserve

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Given That Valuations are Normal and Risks Remain, Maintain Normal Asset Allocations

Despite our expectation for blue skies to come, it is important to recognize that there could still be short term disturbances and unexpected consequences. Over the past 5 years the annual average real rate of return of the S&P 500 has approximated 15%, twice the historical average, and valuations are back to normal levels on average. Given our prudent nature, we are committed to maintaining our asset allocations at levels consistent with each client's specific risk profiles. Some areas of concern for Bourgeon are the unintended consequences of Fed tapering, potential for deflation in Europe, continued weakness in China and emerging markets, and geopolitical uneasiness with Russia/Ukraine/Crimea.

Continue to Increase Exposure to GARP Companies and Reduce Defensive

With the monetary punch bowl being taken away as the Federal Reserve tapers quantitative easing, choosing the right companies in the right sectors will become increasingly important. Our favorite secular growth stories are US exposure over international, housing, natural gas, and manufacturing. But there are opportunities in other sectors as well. During the first quarter we continued to increase our exposure to GARP (Growth-At-a-Reasonable-Price) companies and take profit from Defensive companies or those companies where we believe the risk/reward was moving against us.

Our Strategy to Own Individual Laddered Bonds Mitigates the Risk of Price Decline

The Federal Reserve appears to be firmly committed to tapering quantitative easing, with some bias toward eventually raising rates earlier than expected. The 10 year Treasury has now settled in the 2.7-3.0% range, almost double the 1.6% low hit in May 2013. We continue to believe that the move in interest rates going forward is more likely to rise than to fall. Our bond strategy in this environment has remained consistent for some time. As we have discussed in prior letters, we own individual bonds rather than bond funds. Thus, one knows the yield-to-maturity on the bond at any given time. Bond funds, on the other hand, have the potential to trade below net asset value during times of quick redemptions, and the fund never fully 'matures.' We also buy bond ladders with a relatively short duration (under 5 years). Thus, every year approximately 20% of the portfolio matures providing an opportunity to repurchase bonds at the then higher rate, which results in reduced interest rate risk.

While we have only spoken generically about asset allocation in this letter, we believe that it is a very individual decision. We do our best work for you when we are up-to-date on changes that may be occurring in your lives. We enjoy speaking with you and sharing ideas on a regular basis, and if your situation changes in between our discussions, please reach out to us and let us know.

We look forward to speaking with you soon and thank you for entrusting us with the management of your money.

Sincerely,

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