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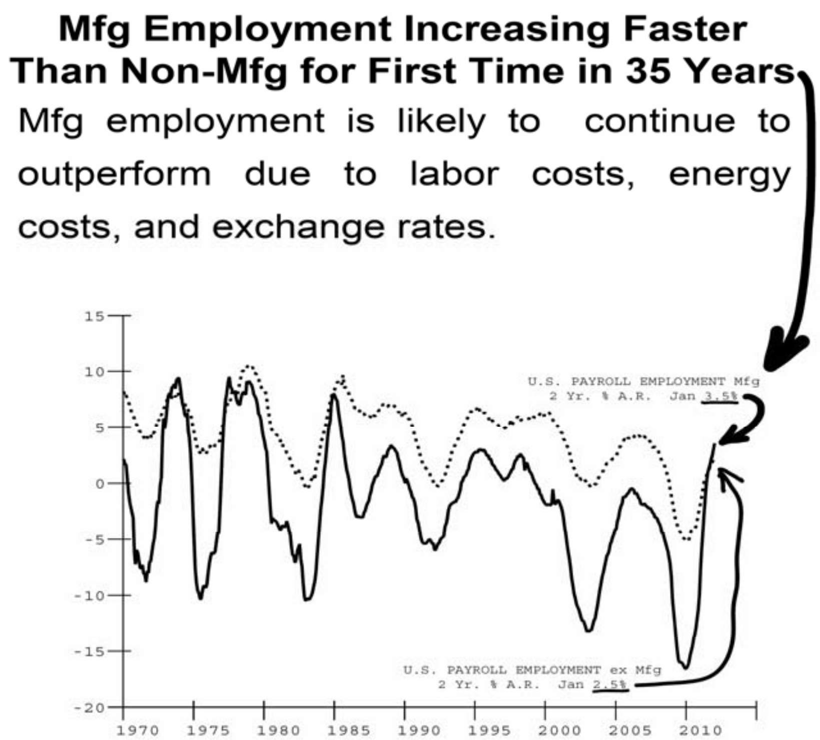
The Unheralded Revival of US Manufacturing

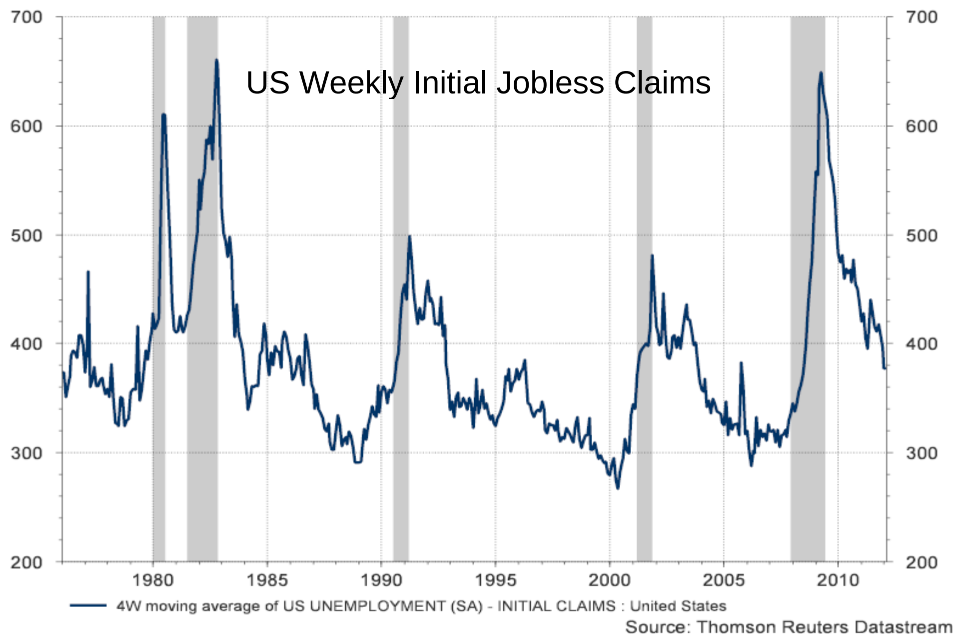
- We are long-term stock bulls and Treasury bond bears because of valuations. We believe that stock valuations are cheap and Treasury valuations are expensive because the global economic outlook is uncertain. Greece exemplifies this uncertainty, but we believe good news in the US -- a manufacturing giant -- trumps bad news in a small economy such as Greece. US manufacturing is delivering exciting news. The following excerpt from a report by ISI Group, one of our research providers, reinforces a point that we have been making: US manufacturing is experiencing a revival that is gaining momentum. Furthermore, ISI observes that last week marked the 19th week of stronger US economic data. We think this far outweighs Greece's problems in its long-term impact on our stock portfolio. The US economy is recovering despite the problems in Europe.



- Policy Purgatory continues in Europe as Greek politicians and voters weigh economic hardship imposed by the Troika (the European Commission, the International Monetary Fund, and the European Central Bank [ECB]) against default and a euro exit. Neither are pleasant choices. Economic logic says Greece will suffer more from a euro exit, a total banking collapse and the need to rebuild its economy from scratch. Despite these hardships, we think it is increasingly likely that a Greek default and exit from the euro will be how this tragedy ultimately ends, forcing/allowing Greece to confront its own destiny. Right now, Greeks are blaming the Troika, whose solution — more austerity in the midst of economic collapse — does not seem viable to them. We view the problem as an absence of trust. Greece's creditors do not (probably correctly) trust Greece with a longer more 'pro-growth' workout. That absence of trust largely prevents any hope of a workable solution, in our view. We should be prepared for default.

- In the context of our optimism on US and emerging market stocks, we believe a Greek default that causes a market correction could offer a potential buying opportunity for the following reasons. The rest of Europe's firmness in their negotiations with Greece suggests they believe their banks are already prepared for default. We also believe a Greek default and the subsequent economic pain will make Portugal, Italy and Spain more willing to embrace labor reform and deregulation, like Ireland. Finally, we believe the expansion of the ECB's balance sheet (printing money) and its purchases of Spanish and Italian bonds make contagion from a Greek or even a Portuguese default less likely.

THE WEEKLY CHART: EMPLOYMENT RECOVERY GAINING MOMENTUM



For a while last summer, progress in the employment market seemed to get stuck; it has recently shown clear improvement. The weekly report of the number of people registering for initial unemployment claims is one of the best and most timely indicators of present conditions, in our view. As one would expect, initial unemployment claims generally spike during recessions and then fall. The chart above eliminates the week-to-week volatility by using a four-week moving average and shows that, during economic expansions, the four-week moving average usually ranges between 300,000 and 400,000. The clear break below 400,000 in recent weeks reflects that the expansion is becoming more robust.