TRITON

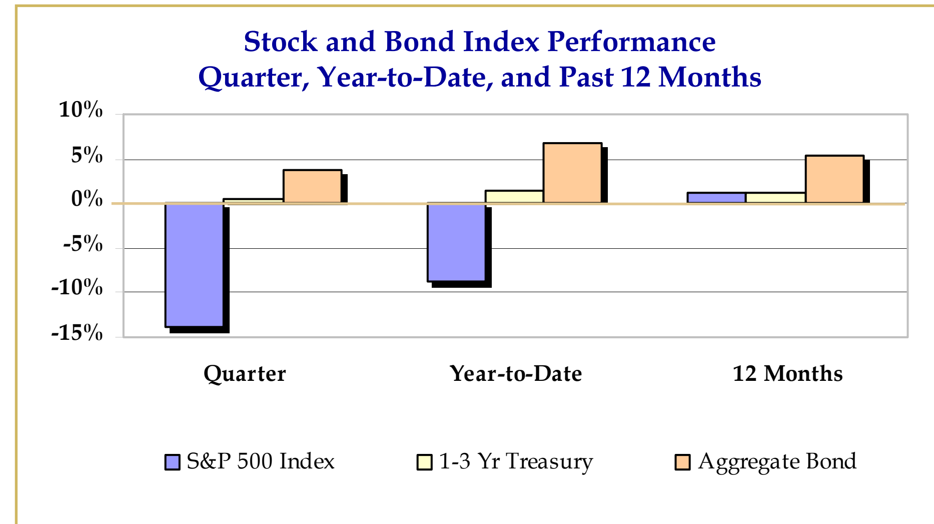
INVESTMENT ADVISORS, LLC

Procrastination is the bad habit of putting off until the day after tomorrow what should have been done the day before yesterday ~ Napoleon Hill

All Europe, All the Time

Global markets, uncertain of the extent to which Greece's debt will encumber European banks, gyrated with each announcement regarding crisis resolution. Rumors of comprehensive solutions were met with enthusiastic rallies, only to be undone when the details proved disappointing. The S&P 500 Total Return Index fluctuated more than 2% on a day-to-day basis nineteen times during the quarter. Unfortunately, twelve of the nineteen moves were to the downside. When the final bell mercifully signaled an end to the volatile quarter, the S&P 500 Index was 13.87% below its June level. Bonds, as measured by the Aggregate Bond Index, provided only a partial offset by returning 3.82% to investors.

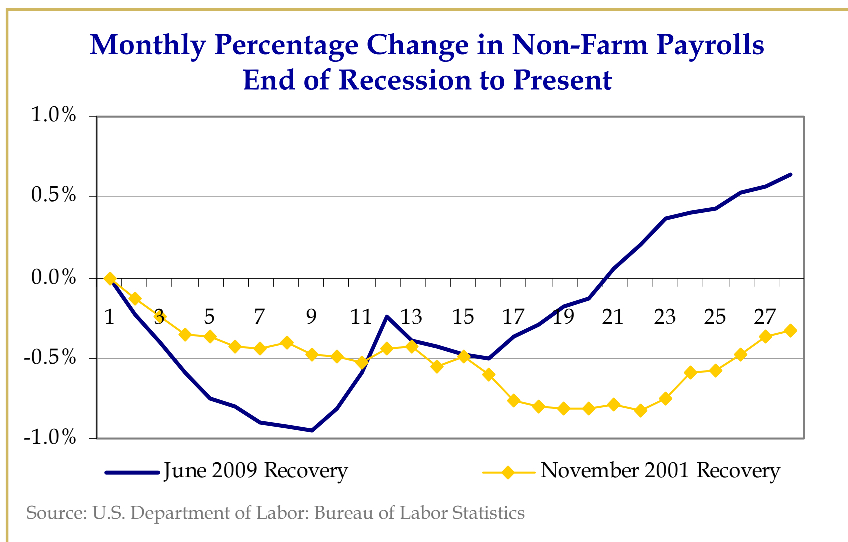
A wise, 90-year-old landlord once told me that he always responded immediately when asked to a fix a leak because "plumbing never gets any better." This simple lesson, when applied to the debt crisis, is not lost on IMF managing director Christine Lagarde, who noted that the path to recovery is "much narrower than before and getting narrower." All interested parties would like to see the debt crisis resolved before too much damage is done. Our economic review suggests that current U.S. difficulties relate more to recessionary overhangs than to European debt issues. We don't need contagion added to our list of maladies.



Unemployment Bad, Job Growth…OK?

Third-quarter financial indicators are in, and the results are pretty good. Industrial Production is up, New Orders are up, the Producer Price Index held steady from last quarter, and Non-farm Payrolls pushed higher. In fact, post-recession job growth is better today than it was during this point in the 2001 recovery. Non-farm Payrolls have inched 0.64% higher in the 27 months since the recession was declared over, versus a slight 0.33% loss coming out of the 2001 recession (see chart below).

Everyone knows that numbers can be tortured to say anything, and I readily concede that job losses from the beginning of the



most recent recession are far greater than any post-war downturn. However, when compared to the last cycle – not only to the end, but to the low point as well – job growth is running neck-and-neck with the "jobless recovery" of 2001.

Most people attribute the anemic employment recovery to the loss of construction and construction-related (financial) jobs, and this is partially true. Of the 6.6 million jobs lost since December 2007, about 740 thousand of those have been construction related. Those jobs are not expected to return any time soon. Housing peaked in 2006, and bubbles generally take from seven to ten years to unwind. That leaves us with two to five years of disappointing construction-related jobs growth. As disheartening as this is, it is not nearly as troubling as what's occurred in the manufacturing sector.

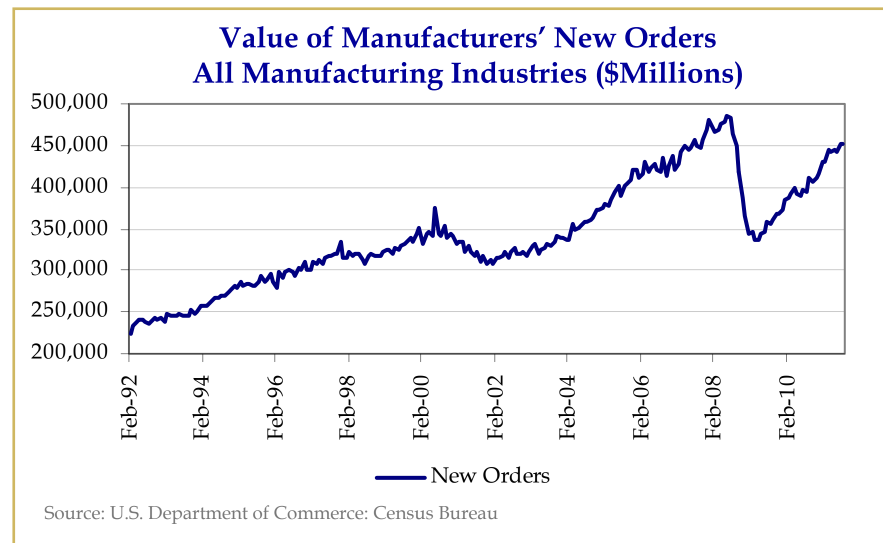
Doing More with Less

The value of Manufactures' New Orders is closing in on pre-recession levels (see chart below). This is encouraging given the Japanese supply chain and U.S. natural disaster disruptions of past quarters. However, it should not be assumed that this will lead to growth in manufacturing jobs.

Manufacturing has lost 2 million jobs since December 2007. Worse still is that manufacturing never recovered from the recession of 2001. The economy lost 1.2 million jobs over the past ten-year period. In the same time frame, manufacturing lost 5.2 million jobs. We still manufacture things in America; we just do it with far fewer people.

Meanwhile, wages for all workers fell from 49.1% of GDP in 2001, to 44.4% as of June 2011. After-tax corporate profits concurrently rose from 5.5% of GDP to 10.1% – a record high.

Stocks benefited from the 2008-2011 rise in profit margins, as they always do. It doesn't necessarily follow that stocks fall when margins contract, but history shows that price appreciation is more difficult. With margins at an all-time high, history suggests that a bit of caution is warranted.



Investing in an Uncertain and Volatile Environment

It is incumbent upon European leaders to fashion a comprehensive solution to their debt crisis. Greece's economic conditions are deteriorating with time, deepening the losses that bondholders must realize as part of the restructuring. The fall in bond prices is problematic because the natural holders of sovereign debt are banks, and banks are required to pledge a certain level of high quality assets against their loans. Failure to meet capital requirements necessitates the injection of more capital. Who, when, and how much are the questions European finance ministers are trying to work out. Failure to resolve these issues would be highly contractionary.

In light of the numerous obstacles laid before it, the American economy is performing reasonably well. We are seeing areas of recovery, despite the stagnant employment picture. It is difficult to ascertain how much of current market weakness is tied to Europe, and how much is tied to the domestic economy. Given the volatility surrounding announcements of a debt deal versus the persistent progress of our economy, our read is that the gut-wrenching volatility is coming from Europe.

In this environment of sluggish growth, corporate earnings have benefited greatly from expanding profit margins. The NIPA after-tax profit margin stands at 10.1% – that's 400 basis points higher than its 50-year average of 6.1%. At some point margins will shift direction and begin their reversion to the mean. History suggests that stock market gains become more difficult in a falling profit-margin environment. Our Outlook for Stocks remains positive, albeit tempered by a bit more caution than our valuation models suggest.

~ Stephen E. Carr

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Glossary of Terms Mentioned

Basis Point – One-hundredth of one percent, or .01%. One hundred basis points equals one percent.