From right to left:

Rod Smyth
CHIEF INVESTMENT STRATEGIST

Bill Ryder, CFA, CMT
DIRECTOR OF QUANTITATIVE STRATEGY

Ken Liu
GLOBAL MACRO STRATEGIST

Lowering International Exposure in our Growth & Income Portfolios; US Housing a Bright Spot

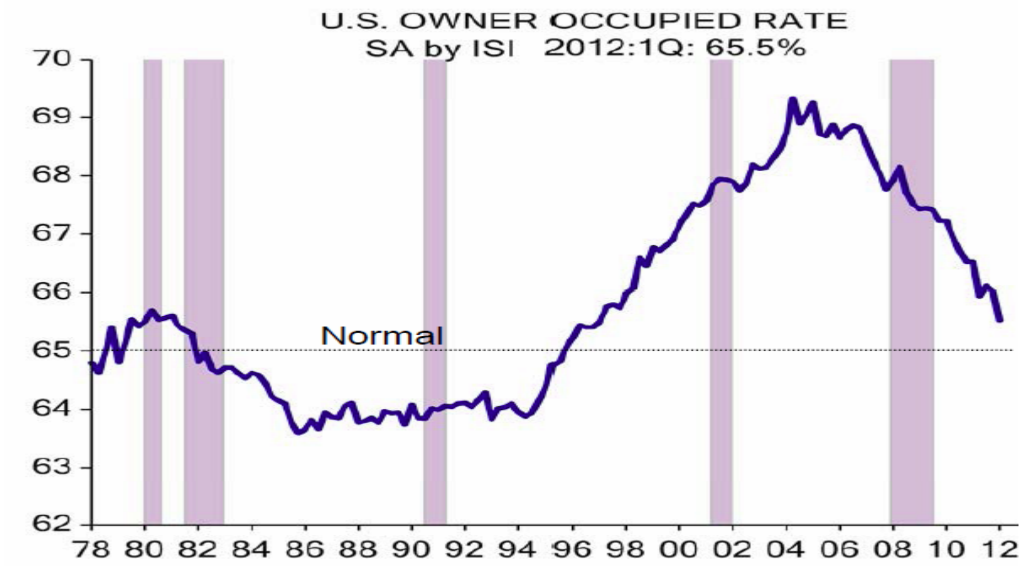
- Employment and global purchasing manager surveys, reported during the first week of the month, generally set the economic mood – last week's message was recession in Europe, stable but lower growth in China, and slower growth in the US. Last Wednesday, with the S&P 500 around 1400, we further reduced our underweight position in non-US markets. **We remain concerned about conditions outside the US and, with both the US economy and S&P 500 losing momentum, we thought it would be prudent to raise cash levels for our more conservative portfolios.**
- US employment increased by 115,000 in April, while the prior two months were revised higher, bringing the three-month average of job gains to 176,000. The unemployment rate ticked down to 8.1% as labor force participation dipped. Aggregate payrolls (hours worked multiplied by hourly earnings) increased 4% from a year ago, ahead of 2.7% headline inflation, which is likely to fall further as energy prices decline. The Federal Reserve has become more vocal about meeting its full employment mandate (while maintaining price and financial stability), but **unless there is more of a marked deterioration in employment and growth, it will be hard to make the case for more aggressive monetary stimulus.**
- US purchasing manager surveys continued the theme of modest economic growth and employment while showing expanding activity in the export sector. The ISM non-manufacturing survey (77% of the US economy is service-oriented) remained above the 50 level, which indicates business expansion, but declined 2.5 points in April to 53.5. The ISM manufacturing survey continued to exhibit strength, rising 1.4 points to 54.8 with new orders climbing 3.7 points to 58.2. The export components for both surveys rose five points. **We find it encouraging that, with the rest of the world slowing, US exports for both manufacturing and services remain in demand.**

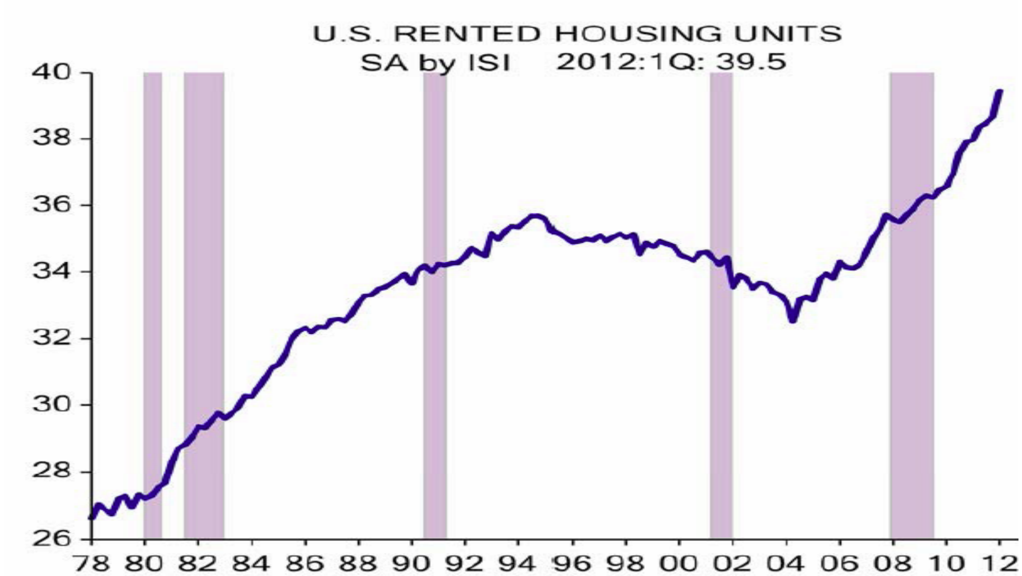
Hope for Housing

Falling homeownership rates are boosting rental and investment demand for housing (see Weekly Chart). **With investors seeing better rental yields and stabilizing prices, short sales (where owners find buyers and any debt is forgiven) are overtaking foreclosures, helping to clear excess inventories.** Price-to-rent ratios are approaching their mid-1990s bottoms and are an important source of support for the housing market, in our opinion (see *Weekly View* 3/5/12 for more details), along with new household formation and improved affordability. Homebuilding has provided a boost to economic growth for the first time since 2006, which should continue with net orders and backlogs rising. Unfortunately residential investment still remains below three percentage points of GDP (usually above four), the lowest in the post-WWII era.

Demographics help explain falling home ownership (and rising rents) as young people stay in school longer, delay employment, and need to be mobile for job flexibility. As the *Wall Street Journal* reports: "The younger workforce will have less money to cover daily expenses, pay off student loans (which are more massive than for previous generations), save for a home down payment or start a family. The gap also means less money paid into Social Security and Medicare to support retired baby boomers." Helping to offset this, household formation growth is rising again following a steep decline, and we believe that the combination of attractive prices, low mortgage rates, and rising rents are allowing the housing market to find a bottom in many parts of the country.

THE WEEKLY CHART: LESS HOME OWNERSHIP, MORE INVESTMENT PROPERTIES





The charts above, courtesy of ISI Group, show that US owner-occupied housing rates are almost back to pre-housing bubble levels, while the number of renters has surged. We agree with ISI's conclusion that occupancy rates back to normal levels is positive for the housing market, especially given the upward pressure on rents. This is making buying more attractive than renting, thus increasing the demand for housing.