Back to Normal?
July 2015

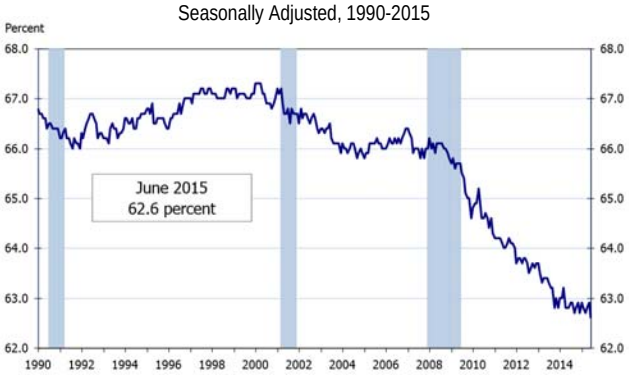
For years the focus of our quarterly economic discussion has been on the inability of the economy to achieve "breakout" momentum. The primary "boogey-man" was the unemployment rate, compounded by weak compensation. Economists and strategists repeatedly blamed the sluggish recovery on the nation's weak employment. Since 2009, the Federal Reserve has pointed to weakness in the country's labor market to justify the extraordinarily accommodative policy it has followed. Yet, the economy has grown 2.35% per annum since the recession of 2009, the unemployment rate went from near 10% in 2009 to 5.3% at the end of June, and the S&P 500 equity index returned 128% (13.5% p.a.) hitting many records on the way. During this time the inflation rate remained well-behaved at approximately 1.7% per year. Although this performance may compare unfavorably to prior post-recession periods, it has sufficed to put the economy on more stable footing.

Economists and strategists have focused on many elements of labor markets to justify weakness in consumption and economic growth. The unemployment rate and labor force participation rate have been widely discussed along with significant sub-components like part time workers, long-term unemployment, and the inability of job losers to find a job. By June 2015 the labor market picture looked much better. The graphs below show the improvement that each of these indicators has had over the last five years. In fact, most labor indicators have recovered to levels that existed prior to the 2008-2009 recession, suggesting the economy's foundation has more depth than commonly acknowledged.

Civilian Unemployment Rate
Seasonally Adjusted, 1990-2015

Note: Shaded areas represent recessions as determined by the National Bureau of Economic Research (NBER). Data online at http://data.bls.gov/timeseries/LNS14000000.

Civilian Labor Force Participation Rate
Seasonally Adjusted, 1990-2015



Note: Shaded areas represent recessions as determined by the National Bureau of Economic Research (NBER). Data online at http://data.bls.gov/timeseries/LNS11300000.

Part-time Workers as a Percent of Total Employed
Seasonally Adjusted, 1990-2015

Note: Shaded areas represent recessions as determined by the National Bureau of Economic Research (NBER). Beginning in 1994, data reflect the introduction of a major redesign of the Current Population Survey. Data online at http://data.bls.gov/timeseries/LNS12692153.

Long-term Unemployed as a Percent of Total Employed
Seasonally Adjusted, 1990-2015

Note: Shaded areas represent recessions as determined by the National Bureau of Economic Research (NBER). Data online at http://data.bls.gov/timeseries/LNS13025703.

Job Losers
Seasonally Adjusted, 1990-2015

Source: Bureau of Labor Statistics, Current Population Survey, July 2, 2015

In our first quarter 2013 Quarterly Letter, we discussed the falling labor force participation rate in relation to the nation's demographic dynamics. Our conclusion was that the participation rate would continue to decline as the "baby boomers" retired. Younger demographic cohorts were not large enough to offset the retiring cohorts. More significantly, from the perspective of today's labor markets, the lightest cohorts were the 35 to 45 year olds traversing their most productive years. Demographic analysis proves useful when reviewing labor markets, and while not comprehensive, it helps to understand weakness in many indicators. Unfortunately, it also suggests the economy's growth rate may not recover to pre-recession levels, regardless of government backed stimulus measures.

Over the last five years we have had many quarters of robust growth followed by decidedly disappointing ones. In 2010 a promising start to the year was truncated by the beginnings of the European debt crisis. In 2011 a dysfunctional U.S. government and ratings downgrade clipped the economy's momentum at the end of the summer, and in both 2014 and 2015 harsh winters interrupted the prior year's momentum. Now external events are again threatening both the U.S. and global economies. It seems, though, given how the last 5 years evolved, that we are actually traversing "normal," and the economy will withstand these and other likely external events over the next few years.

Economists believe the Fed will raise rates at its September meeting, but the handicapping shifted recently with events in Greece and the Shanghai Composite volatility. Federal Reserve Chairwoman Yellen indicated in testimony to Congress that she expects rates could rise in 2015, and the moves would be "gradual." An interesting feature of market psychology is that we expect the Fed (and other central banks) to follow an initial move with many others. A change in direction is interpreted to either provide stimulus or restraint. But what if the Fed just wants to have interest rates across the yield curve be "neutral," neither stimulative nor restrictive? Surely, the status of the U.S. economy, as unsatisfactory as it might be, does not require zero rate policy. Similarly, the economy is not so weak it cannot withstand a normal, unsubsidized yield curve. We believe the economy is strong enough to start the rate normalization process, and the move will be beneficial for the economy's long term health. Hopefully, the Fed recognizes extraordinary measures are no longer required for what appears like a normally functioning economy.

At GIA Partners, credit is in our DNA. We are a bottom-up credit manager who has managed credit portfolios in virtually every part of the world's fixed income markets as well as through some of the most severe credit events in history. Additionally, our investment team has the distinction of being among the first to recognize and actively invest in global high yield and emerging markets debt.

We have a thorough understanding of fixed income investments and their role in a globally diversified portfolio, which has rewarded our clients throughout market cycles.

Gloria Carlson
Director, Sales and Marketing
212 893-7835
gcarlson@giallc.com

Arnold West
Director, Institutional Sales
212 893-7815
awest@giallc.com