Economic Update

Broadleaf Partners, LLC

Bed Pans and Bunk Beds
June 22, 2010

This past weekend, my wife and I packed the car and drove our family to Miami University in Oxford, Ohio for our twenty year, college reunion. The campus remains as beautiful as it ever was, but the people and memories are always what make a place feel more like a home. In this sense, it was nice to share a stroll around campus with my wife, a few of her sorority sisters, several of my fraternity brothers, and our three children.

In particular, I looked forward to giving my kids, ages 14, 11, and 6, a glimpse of what college life is like, the centerpiece of which would be a stay in my freshman year dorm. While the new Farmer School of Business was an absolutely stunning Four Seasons experience, a Knights Inn could have given the dorm rooms a run for their money. They were far smaller than I had remembered, perhaps because the beds had been "unbunked" and the furnishings were exactly the same, just another twenty four years older. The air conditioning unit was a nice upgrade from the window fan I had used as a freshman, but in the end, lost a hard fought battle with a sweltering June. In truth, the dorms hadn't changed, I had.

Our conversations with friends naturally focused on our families, careers, and recent events; my wife's college roommate joked that the only good thing to come from the BP oil spill was that it made her husband's job as a lobbyist for Toyota a tad bit easier. In a similar vein, the sting of continued bad news from Europe may be soothed by a market which has bounced off its 1040 lows and is currently trading towards the upper end of recent resistance.

At this stage of the economic recovery, unemployment trends should be improving, but they are not; the notion of a jobless recovery appears to be gaining steam. In spite of corporate cash balances resting at record levels and spending intentions remaining high, few executives appear willing to pull the trigger on additional people, plant and equipment. In the face of an unstable regulatory environment, the markets may be clueing into the notion that it is better to watch what these executives actually do with their money rather than what they are saying.

On the positive front, the household employment survey is considerably stronger than the private payroll survey, which like the weekly unemployment data, remains weak. According to ISI's Ed Hyman, when there has been a divergence in the two surveys in the past, the household survey has tended to be the more accurate. In addition, various discussions with real estate professionals, surveys taken by institutional research firms, and company conference calls suggest that apartment rents are continuing to improve and that incentives are declining. This could suggest that employment may be better than generally advertised or it could simply

mean that in the rent versus own battle, the decision is currently in the former's camp. My bullish side would simply add that if the rental environment continues to improve, eventually rents will go high enough to make the incentives of cheap real estate and low mortgage rates stand out and begin to shift the pendulum back in ownership's favor.

For most of the past two years, I have believed that some government involvement in the economy was necessary to keep it from falling into a second great depression. Now that we've recovered, the vilification of the private sector by the government is getting a bit old. I've heard too many tales recently of public sector employees retiring at fifty after as few as twenty years of service at 85% of pay. Such benefits haven't existed for the average, everyday private sector workers for years. I, for one, know of few private sector employees under fifty who will receive a pension. At some point, the government must take care not to bite the hand that feeds.

Going forward, we may indeed be operating in an extended period of slower growth, the so called "new normal." In such an environment, nominal gains in the stock market may be lower and dividends and active management may therefore play a more dominant role in generating outperformance for investors.

In recent months, we've been favoring stability over cyclicality, except where cyclical improvements have gone unrewarded, and innovators over those companies that participate in more mature markets. Though not as intentional, we've also favored domestic companies rather than those with international sales exposure. To be clear, we're not in the double dip camp, we simply believe that the bulk of the market's cyclical gains are now in the rear view mirror.

At the end of our Miami weekend, I asked each of my children what they thought about college life. Unencumbered by the trappings of a "used to" or "entitlement" lifestyle, my six year old son won the best of show award by telling me that the coolest thing was the long walk you got to take to go to the bathroom. He proudly insisted on leading the way on more than one occasion. At 4am and over forty, I would have preferred a bedpan.

When I was in college, I once loved the very room I could now no longer appreciate, simply because it was my own. Viewed from the perspective of youthful enthusiasm, a new normal needn't be any different.

Kindest Regards,

Doug

Doug MacKay
Chief Investment Officer
dmackay@broadleafpartners.com
Office: 330-650-0921

Bill

Bill Hoover
President
bhoover@broadleafpartners.com
Office: 330-650-0921