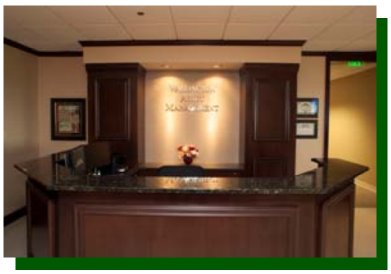
Wallington ASSET MANAGEMENT
INDEPENDENT INVESTMENT COUNSEL

QUARTERLY REVIEW

2014: SECOND QUARTER **102ND EDITION**



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COMMENTARY

ECONOMIC RECOVERY REACHES FIFTH ANNIVERSARY IN JUNE

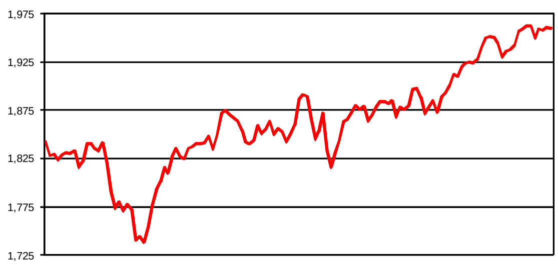
The U.S. has experienced 11 recessions since the end of WWII, with the recent recession, commonly referred to as the Great Recession, being the most severe. It started in December 2007 and ended in June 2009 as determined by the National Bureau of Economic Research (NBER), an independent group of economists that has officially called the beginning and end of business cycles since the 1920s. June 2014 thus marked the fifth anniversary of the end of the Great Recession.

The current economic recovery has been a long, slow slog with growth averaging 2.1% annually over the past 19 quarters. The first quarters of 2011 and 2014 even experienced negative growth, although the latter was due in part to a harsh winter. Economic growth in normal recoveries averages 4-5% annually. Gross Domestic Product (GDP), the final value of all goods and services produced, did not reach the 2007 peak until the third quarter of 2011. Since there are 15 million more working-age people in the U.S. today than in the pre-financial crisis era, it was not until the second quarter of 2013 that GDP per capita surpassed the earlier peak. Technically speaking, it was at this point in time that the economy transitioned from recovery to an expansionary phase. *(Continued on Page 11)*

CAPITAL MARKETS SCOREBOARD

January 1, 2014 – June 30, 2014

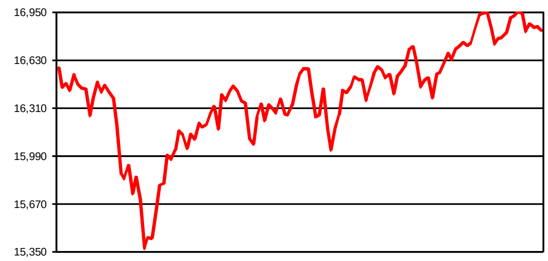
S&P 500



January 1, 2014 - June 30, 2014

2nd Qtr 5.23% YTD 7.14%

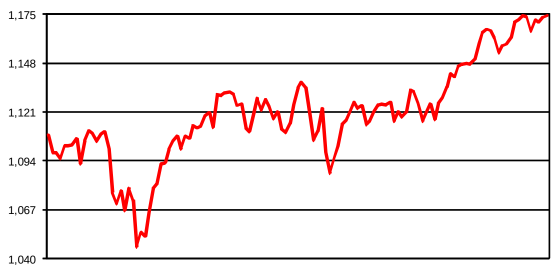
DJIA



January 1, 2014 - June 30, 2014

2nd Qtr 2.24% YTD 1.51%

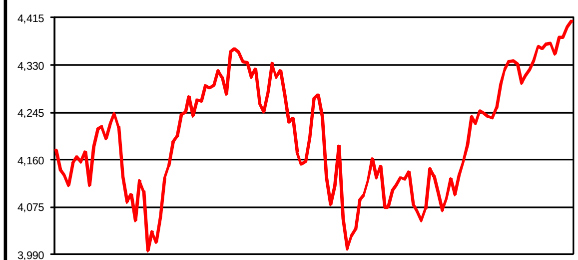
Russell 3000



January 1, 2014 - June 30, 2014

2nd Qtr 4.37% YTD 5.94%

NASDAQ

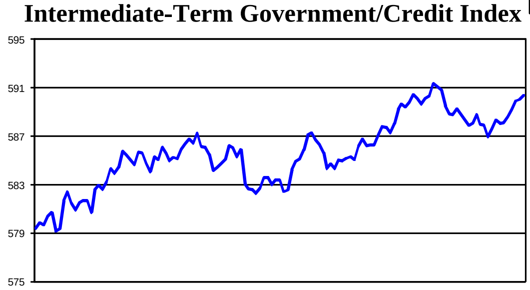


January 1, 2014 - June 30, 2014

2nd Qtr 4.98% YTD 5.55%

Bank of America - Merrill Lynch

Intermediate-Term Government/Credit Index

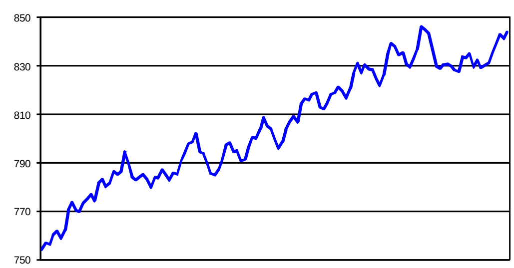


January 1, 2014 - June 30, 2014

2nd Qtr 1.19% YTD 1.90%

Bank of America - Merrill Lynch

Long-Term Government/Credit Index



January 1, 2014 - June 30, 2014

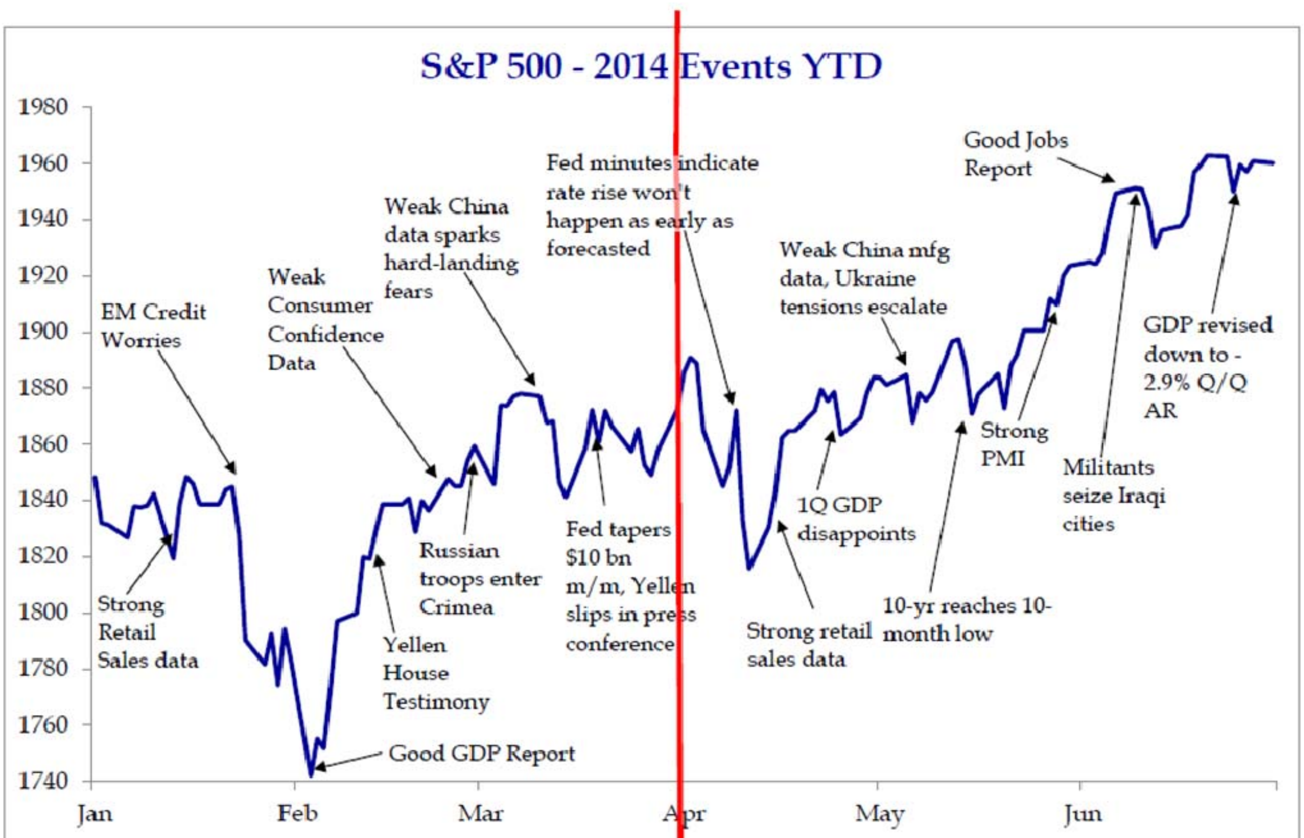
2nd Qtr 4.98% YTD 11.89%

EQUITIES

EQUITY SECOND QUARTER PERFORMANCE

In the second quarter of 2014, the Standard & Poor's 500 index (S&P 500) increased 5.23% on a total return basis, i.e., with dividends. The Utilities sector provided the second-highest return in the quarter, followed closely by the Information Technology sector. The decidedly-cyclical Energy sector's return far outpaced any other sector, including the combined returns of the bottom four sectors. In a bit of oversimplification, deadly combat in northern Iraq put a bid under oil prices in the quarter, contributing to Energy's outperformance. The other major U.S. equity indices, namely the Nasdaq Composite, the Russell 3000 and the Dow Jones Industrial Average, rose by 4.98%, 4.37% and 2.24% respectively. The stock market rose in the face of market participants dealing with a number of countervailing macro events in the quarter.

S&P 500 by GICS Sector	Total Return (%)
	2Q14
Energy	11.45
Utilities	6.79
Information Tech	6.05
Materials	5.06
Healthcare	4.06
Consumer Staples	3.94
Industrials	3.31
Consumer Discretion	3.13
Telecom	2.50
Financials	1.84
S&P 500 Index	5.23



Source: Strategas Research Partners

EARNINGS OUTLOOK

As the second quarter came to a close, the revenue growth estimate for the S&P 500 equaled 2.7%, according to FactSet Research Systems. Healthcare held the top spot at 8.3%, while Energy occupied the bottom spot at -3.5%. Turning to earnings growth, the consensus estimate for the S&P 500 was 4.9% year-over-year, led by the Telecom and Consumer Discretion sectors. The Financials sector is expected to be the laggard for the second quarter in a row, with expectations for a year-over-year earnings decline of 3.2%. Although nine of the ten economic sectors that make up the S&P 500 should generate higher earnings this quarter versus the second quarter of 2013, the aggregate estimate declined 1.7% from the beginning of the quarter. Since estimates generally decline as time passes, it is more interesting to note how this quarter compares to previous quarters. The intra-quarter drop was less than the average decline in the past four quarters (-3.9%), twenty quarters (-2.9%) and forty quarters (-4.6%).

Revenue Growth: 2.7%

Name	Q2 '14 Growth Blended (%)	Q2 '14 Growth 31 Mar '14E
S&P 500	2.7	3.5
Health Care	8.3	7.8
Information Technology	5.3	6.0
Consumer Discretionary	4.9	5.1
Telecommunication Services	3.5	2.6
Consumer Staples	2.9	3.1
Materials	2.1	4.4
Industrials	2.0	2.2
Utilities	1.4	0.83
Financials	0.71	2.1
Energy	-3.5	-0.49

Earnings Growth: 4.9%

Name	Q2 '14 Growth Blended (%)	Q2 '14 Growth 31 Mar '14E
S&P 500	4.9	6.8
Telecommunication Services	21.9	26.7
Consumer Discretionary	9.3	13.5
Energy	8.6	9.9
Information Technology	7.4	7.4
Materials	7.4	17.7
Health Care	5.9	3.6
Industrials	5.4	4.8
Consumer Staples	2.7	5.2
Utilities	0.49	3.4
Financials	-3.2	1.6

Source: FactSet's Second Quarter Earnings Preview Presentation

EQUITIES MARKET BALANCE SHEET

As the equities market climbed in the second quarter, many strategists expressed concern about a number of factors which could impact future performance. There is worry that stretched corporate profit margins will be unsustainable, as the aggregate of companies in nine out of ten S&P 500 sectors exceeded their long-term averages. Tension in the Middle East has also increased in recent months as the Islamic State of Iraq and the Levant (ISIL) threatened regional stability. This could cause a spike in oil prices. Continued tapering of the Federal Reserve's Quantitative Easing (QE) program has led to concern over the timing and magnitude of tightened monetary policy. Many strategists also noted, though, that the economy appears to be gaining ground. The Job Openings and Labor Turnover Survey (JOLTS) displayed an increased number of job openings which indicates continued momentum in employment. In addition to better consumer health from employment and higher wages, consumer credit increased $26.8 billion in April. This supports a recent upward trend of increased loans and leases as a percentage of commercial bank credit which could feed consumer spending. These factors have contributed to an increase in both consumer and business confidence, continuing a post-recession upward trend. While some investors cite concern about elevated price-to-earnings (P/E) ratios as reason to avoid equities, the earnings yield, which is the inverse of the P/E ratio, remains over 5%. Thus, compared to interest rates such as the 10-year U.S. Treasury yield, the stock market may not be overvalued. While the aforementioned profit margins have caused price-to-sales measures to seem elevated, other valuation ratios remain at reasonable levels.

Current & Historical Net Margins by Sector

	Current (4Q Avg)	LT Avg	Percent Deviation
Discretionary	6.9	3.7	87.2%
Technology	15.9	9.1	75.9%
Telecom	9.4	6.4	46.8%
S&P 500	9.2	6.7	37.7%
Industrials	9.1	6.6	37.5%
Financials	13.6	10.6	28.5%
Energy	7.6	7.0	9.1%
Materials	5.7	5.3	7.8%
Staples	6.4	6.0	6.9%
Utilities	7.4	6.9	6.1%
Health Care	7.5	8.7	-14.2%

Source: Strategas Research Partners

EQUITIES

MERGER & ACQUISITION ACTIVITY

Trillions of dollars in offshore cash contributed to a resurgence in merger & acquisition (M&A) activity in the first six months of 2014. Over $1.7 trillion in global deal volume represents a 75% year-over-year increase as well as the highest volume since 2007. The Healthcare sector led the wave, with in excess of $300 billion in announced M&A. Many of the deals have been motivated by corporate tax inversion, whereby a company reincorporates in a separate country in order to avoid income taxes associated with repatriating revenue from international operations. Cross-border M&A represented 39% of all deals, a 132% increase for the year. Medtronic Inc.'s potential acquisition of Covidien Plc for $42.9 billion exemplifies the issue, as Medtronic attempts to reincorporate in Ireland. Medtronic, which is currently headquartered in Minneapolis, generated 54% of its fiscal year 2014 revenue in the U.S. while only generating 26% of its revenue in Europe. Pfizer Inc. attempted to utilize the strategy as well with the pursuit of a takeover of London-based AstraZeneca Plc. The takeover appears unlikely to succeed, since the overture was rejected even after multiple price escalations. The nearly $120 billion offer represented the largest proposed acquisition thus far in 2014. Congress has taken note of the potential loss of tax revenue from corporate inversion. Several strategies have been proposed to avoid inversion, ranging from broad reform to temporary "tax holidays," which would allow companies to repatriate revenue at a reduced rate for a short time.

The Healthcare sector led the wave, with in excess of $300 billion in announced M&A.

Source: Thompson Reuters

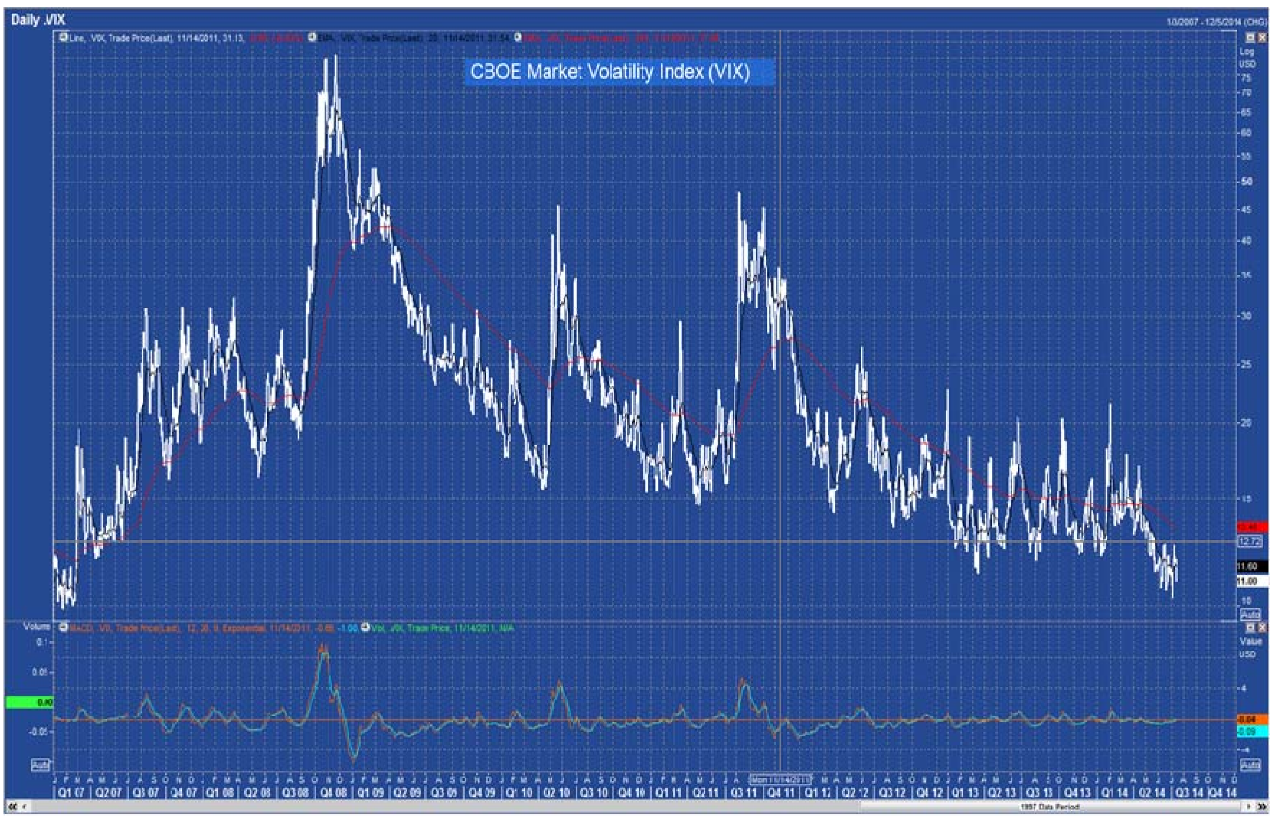
H1 - First half of the year
H2 - Second half of the year

EQUITIES

LOW VOLATILITY (FOR NOW)

So far, 2014 is on pace to be a vintage year for investors, as it would be the first time in more than 20 years that all major asset classes have rallied in unison. Through the first half of 2014, the S&P 500, the MSCI World Index and the MSCI Emerging Markets Index all provided positive returns for equity investors. The fact that these major equity indices provided positive returns in the same period is not uncommon. It is highly unusual, however, for these positive returns to occur in unison with all major fixed income indices, the Dow Jones Commodity Index and gold. One key driver of these positive returns has been the drop in the 10-year U.S. Treasury bond yield from 3.04% at the beginning of 2014 to 2.53% at the end of June. Falling bond yields around the globe have driven many investors into other asset classes in search of higher yields.

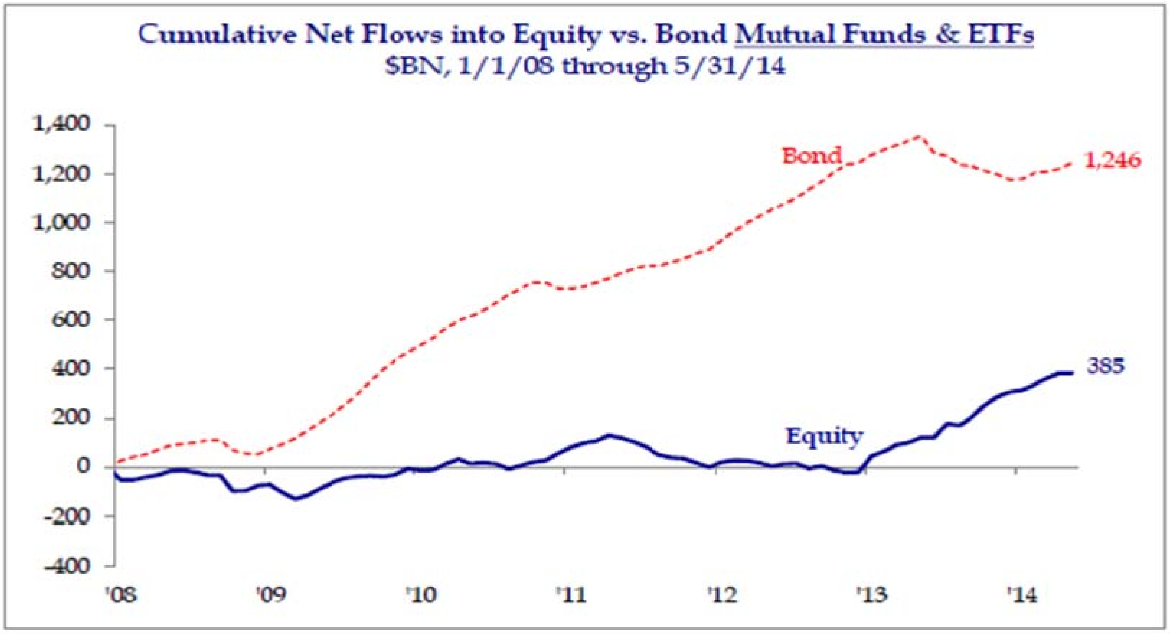
As prices have risen, volatility in the markets has declined precipitously, in many cases to record lows. An unusual calmness has settled over the stock market in 2014, and to a lesser extent, the last three years. As of the end of June 2014, the S&P 500 had not closed on a daily basis more than 1% above or below the previous daily close for 51 straight trading days, the longest period of daily volatility this low since 1995. In June alone, there were 13 trading days when the market moved less than 0.25%. Longer term, the S&P 500 has not had a major correction (a decline of 10% or more) in almost three years. The last time such a decline occurred was the summer of 2011 when the U.S. Treasury debt was downgraded.



Source: Thomson Reuters Eikon

The most widely-followed measure of market volatility is the Chicago Board Options Exchange (CBOE) Volatility Index (VIX), which is implied from option prices. The VIX is commonly referred to as the fear index. This is a forward-looking volatility measure, but it is highly correlated with historical volatility. The VIX has averaged 13.8% in 2014, the lowest first-half average in volatility since 2007. The long-term VIX average is 20.04. On many days this year, the VIX has been in the 10-12 range including a seven-year low of 10.42 in June. Such low volatility is concerning in that it can lead to investors taking on too much risk, usually via debt and leverage, in an effort to capture overestimated returns.

EQUITIES



Source: Strategas Research Partners

FUND FLOWS: AN INSIGHT INTO INVESTOR SENTIMENT

From the beginning of 2008 until the second quarter of 2009, the flow of funds into equity mutual funds and exchange-traded funds (ETFs) declined. Cumulative equity fund flows were near zero at the end of 2012, before they began a precipitous increase in 2013. By May 31, 2014, cumulative net flows into equity funds reached $385 billion, with nearly all of the increase coming since the beginning of 2013.

On the other hand, cumulative fixed income fund flows steadily increased since the beginning of 2008 until 2013, at which point they declined before increasing again this year. By May 31, 2014, they had increased by a cumulative $1,246 billion from January 1, 2008, dwarfing the equity fund flows over the same time period.

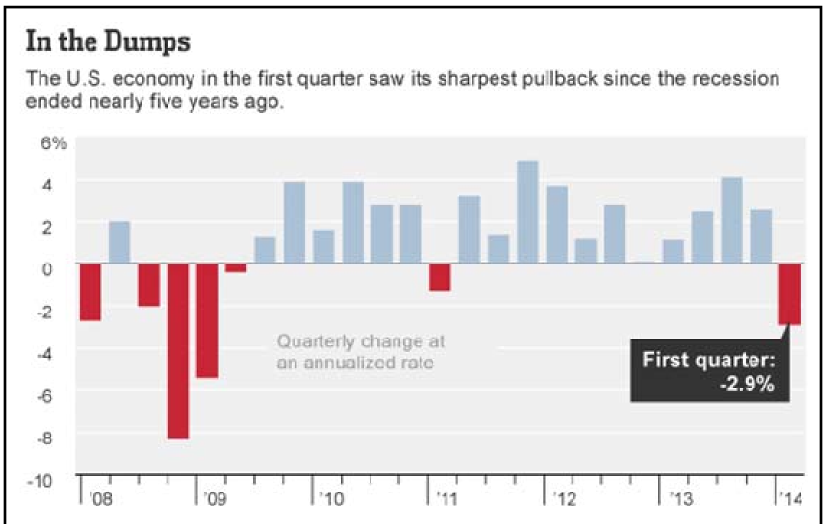
Given the significant flows into equity funds since the beginning of 2013 combined with the recent bull market returns, one might think that investor sentiment would be in bullish territory. This conclusion is not necessarily supported by the American Association of Individual Investors' (AAII) Weekly Sentiment Survey. As of June 25, 2014, the date of the latest official survey, the bullish sentiment reading was 37%. According to AAII historical data, this was slightly below the average bullish sentiment level since the poll's inception in 1987. On the other hand, SentimenTrader.com's "Smart Money/Dumb Money Confidence Survey" indicates the stock market may be ripe for a correction. The mixed signals given by fund flows and sentiment indicators provide evidence as to why the vast majority of market timing strategies have not been successful.

FIXED INCOME SECOND QUARTER PERFORMANCE

According to Bank of America Merrill Lynch, their broad U.S. Corporate & Government Master Index returned 2.07% in the second quarter of 2014. This increase far exceeded the -2.68% return generated in the second quarter of 2013. The index gained 0.81% in April and 1.27% in May before declining slightly by 0.003% in June. An index of just U.S. corporate bonds posted returns equal to 1.17%, 1.53% and 0.17% in April, May and June respectively, or 2.89% for the quarter. Thus, the government bond exposure in the broader index somewhat held down returns, which is also evidenced by Bank of America Merrill Lynch's U.S. Treasury Index producing a second quarter return of 1.56%. The high yield (a.k.a. "junk bond") index gained 2.57% for the quarter, and now lags the investment grade bond index by 0.30% on a year-to-date basis. Municipal bonds produced a return of 2.69% in the second quarter.

U.S. GROSS DOMESTIC PRODUCT

Reports released during the second quarter on Gross Domestic Product (GDP) for the first three months of the year showed growth of 0.1% followed by an initial revision to -1.0%. On June 25th, first quarter GDP was again revised down to a seasonally-adjusted annual rate of -2.9%, the worst quarterly decline in five years and the largest total downward revision since 1976. GDP growth has averaged 2.1% annually over the 19 quarters since June 2009, compared to a 4.1% annual average in other expansions since 1960. While weather, lower exports and weak business investment all played a role in the bleak quarter, consumer spending on healthcare accounted for roughly two-thirds of the negative revision. Consumer spending on healthcare accounts for just over one-sixth of GDP. Despite healthcare spending estimates for the first quarter that were nearly twice as high as healthcare spending in the fourth quarter of 2013 and nearly four times the year's average, healthcare spending declined 6.4%. The severe inaccuracy in estimates was largely due to the tumultuous rollout of the Affordable Care Act (ACA). It was originally thought that the ACA would immediately increase the number of Americans with health insurance, which would result in higher overall healthcare spending beginning in the first quarter of 2014. However, technical glitches in the enrollment system left both those who were previously uninsured and those who lost their previous coverage unable to enroll in a new plan. As a result, the net impact on GDP from consumer spending on healthcare was -0.16% versus the Department of Commerce's estimate of 1.0% and the 0.62% experienced in the fourth quarter of 2013.



Note: Adjusted for inflation Source: Commerce Department

While the latest report on GDP was dismal, other economic indicators support the contention that the negative results were largely due to transitional factors. Auto sales have picked up since the end of the first quarter, with annualized car and light truck sales in the month of May reaching their highest level since February 2007. Retail sales picked up in April and May, as did investment spending by businesses, which were both very low in the first quarter. Consequently, many economists believe that annualized GDP will run near 3% for the remainder of 2014 in spite of the poor start to the year.

ECONOMICS & FIXED INCOME

INTEREST RATES: DEFYING CONSENSUS

At the beginning of 2014, the consensus was that the 10-year Treasury bond yield, then at 3%, would rise gradually during the year as the economy recovered. Instead, the 10-year yield declined, hitting a low of 2.44% in May and ending the second quarter at 2.53%.

Annual returns near the 2.5% level may seem paltry to some investors, and they are when looking at yields historically. Relative to the sovereign bonds of other countries, however, they seem attractive. Japan has the lowest interest rates of any major country in the world with their 10-year debt yielding 0.56% annually. This is due to 20 years of no growth and deflation or little inflation. The "Japanification" of interest rates has carried over to European countries as they have also experienced historically low 10-year yields: Germany (1.24%), France (1.7%), Switzerland (0.65%), the Netherlands (1.48%) and Denmark (1.62%). Italy and Spain are able to borrow 10-year money at almost the same rates as the U.S. with yields at 2.85% and 2.66% respectively. Even Ireland, which almost defaulted on its debt, borrows at 2.35%, which is surprisingly lower than the rate in the U.S.
Lower European interest rates due to lower expected economic growth and inflation have made U.S. rates more attractive, thus raising prices and lowering yields. The dismal U.S. economic growth in the first quarter of 2014 (GDP -2.9%) also lowered interest rates. Another factor that has impacted interest rates worldwide is a decline in the net supply of sovereign bonds relative to demand. Net supply is the gross issuance of bonds minus redemptions and bonds that mature. Germany, for example, will not need to issue bonds this year. The U.S. has reduced its net issuance of debt from over $1 trillion in 2009 to around $400 billion this year.

Lower government bond yields have also impacted corporate bond yields and credit spreads, which are the difference between corporate bond yields and government bond yields for bonds of similar maturities. In the U.S., the credit spread of investment-grade bonds hit a seven-year low of 0.976% recently, meaning high-quality corporations can borrow at interest rates of less than 1% more than the U.S. Treasury. Low-quality, high yield (junk) bonds in the aggregate also reached their lowest yield in history in June at 4.8%, while their credit spread was also at its lowest point in history at less than 2.3%.

HOUSING: A DRAG ON ECONOMIC GROWTH

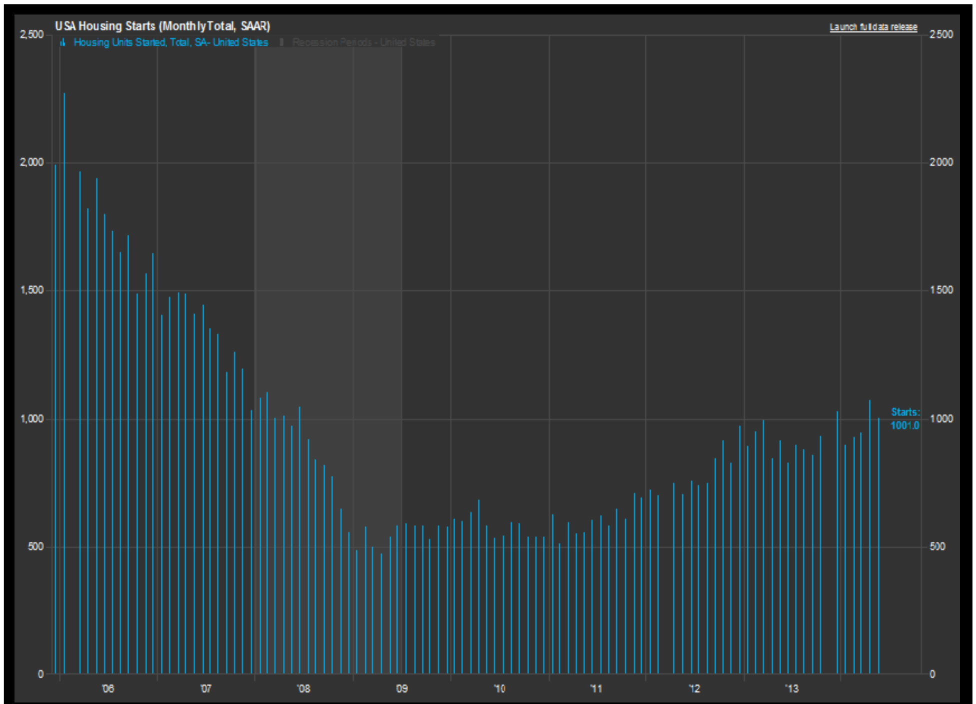
The American dream is not what it used to be according to a survey by the non-profit MacArthur Foundation. This survey showed that nearly two-thirds of Americans believe they are less likely to build equity and wealth by buying a home today than 20 or 30 years ago. A majority thought renting was just as appealing as ownership in terms of wealth creation. This is especially true of the 25-34 year old age group. The scars of the bursting of the housing bubble from 2006-2010 obviously still remain.
Over the last two decades, annual housing starts in the U.S., including single-family housing and apartments for rent, have averaged 1.367 million units. The high point was 2.2 million in 2006 and the low point was around 500k in 2008-2011. The level of housing starts has recovered since 2011 but has not reached its 20-year average. After November 2013, when housing starts hit 1 million, they slid backward again for six months until picking up in May 2014. Some of the pre-May softness was no doubt due to the harsh winter.
Another measure of housing, existing home sales, increased at a seasonally-adjusted annual rate of 4.89 million for May. This was the highest increase since last October. Likewise, new home sales increased 18.6%, reaching a six-year high. Pending home sales in May also hit an eight-year high. While improved from the depths of the crisis, housing has been a drag on U.S. economic growth. At the peak of the housing bubble in 2006, the contribution to economic growth of housing construction and renovation was more than 6%. Currently, it is about 3%, much of which involves rentals, as apartment rents have increased and vacancy rates decreased.
While home prices, sales and starts have improved since 2011, it will likely take a very long time to get back to pre-housing crisis levels. Home prices have risen 20% since 2011, and 30-year mortgage rates surpassed 4% at the end of June 2014, making housing less affordable. Mortgage lending has fallen to a 14-year low as rising rates have dampened demand not only for new mortgages, but also for the refinancing of existing mortgages. Qualifications to get a mortgage loan are also stricter today than in the pre-crisis era.

(*Continued on Page 10)*

ECONOMICS & FIXED INCOME

HOUSING: A DRAG ON ECONOMIC GROWTH *(Continued from page 9)*

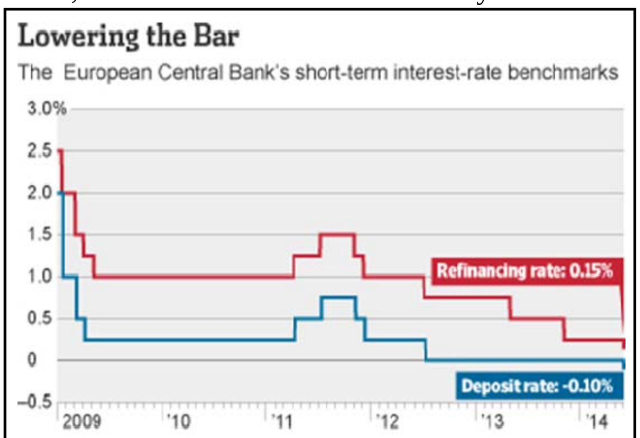
Household formations are approximately half of what they were before the housing crisis, suppressing housing demand, even though the population in the U.S. has increased. This has been especially evident in the 25-34 year old age group, which has been dealing with record amounts of student debt. Demand has also been impacted by a very low supply of homes, as thousands of single-family units have been converted to rentals, many by private equity investors.



Source: FactSet

DRAGHI'S HISTORIC DECISION

On June 5th, European Central Bank (ECB) President Mario Draghi announced a negative interest rate policy for deposits by European banks in an effort to curtail disinflation and provide a spark to an anemic economic recovery. The rate at which banks hold their money at the ECB was decreased from 0.0% to -0.10%, which means lenders will essentially be charged for holding their excess funds at the central facility. Historically, no major central bank has established such a policy. Denmark adopted negative interest rates for a brief period in 2012 in an effort to drive up the Danish krone, but reversed the decision shortly thereafter when the ECB announced their commitment to preserving the Euro. With May marking the 25th consecutive month in which lending to companies and households in the Euro Zone fell, the ECB hopes that the negative interest rate policy will encourage banks to lend instead of parking money at the central location. Currently, the ECB's target for Euro Zone inflation is just below 2%, but actual inflation in the month of May came in well below that level at roughly 0.5%.



Source: ECB Source: The Wall Street Journal

Banks within the Euro Zone still remain unhealthy, so the ECB has announced other measures to spur economic growth. Two such measures are implementing a decrease in the main interest rate from 0.25% to 0.15% and a decrease in the rate on the ECB's marginal lending facility from 0.75% to 0.40%. In essence, the goal of these policies is to spur lending by lowering the cost of funding for banks. This should make some previously unprofitable lending to households and businesses more lucrative. Nevertheless, banks in the recent past seem to have been unwilling to pass the benefits of lower funding costs on to borrowers, meaning further measures to foster change within the banking system may be necessary before a material increase in lending is seen.

COMMENTARY

ECONOMIC RECOVERY REACHES FIFTH ANNIVERSARY IN JUNE

(Continued from page 1)

What is the cause of subdued economic growth this time? Unlike the other 10 recessions since WWII, the Great Recession was caused by a financial crisis which, in turn, was caused by too much household debt (mostly mortgage debt) and an overleveraged financial system. Basically, the U.S. experienced a credit bubble which imploded and caused the Great Recession. Reinhart and Rogoff in their book, *This Time It's Different: Eight Centuries of Financial Folly*, show that recoveries from recessions caused by a financial crisis are weaker and take longer than recoveries from normal cyclical recessions. Debt has to be pared down and balance sheets strengthened before a return to normal growth can be expected. With this in mind, the pace of this recovery has been fairly predictable.

Since the Great Recession, deleveraging has occurred in households, mostly in the form of less mortgage debt. Deleveraging has also occurred in the U.S. Financial sector. Household debt has fallen from 73% of GDP in 2008 to 55% today, while U.S. Financial sector debt fell from 118% of GDP in 2008 to 82%. Conversely, the federal government has levered up, with debt rising from 72% of GDP in 2008 to 102% today. The government debt includes public debt as well as debt held by government agencies such as Social Security. Along with the debt of non-financial corporations and state and local governments, consumer credit has been fairly stable relative to GDP during this same time frame. As a result, the total U.S. debt-to-GDP ratio has fallen from 409% of GDP in 2008 to 392% today.

The five-year recovery has made American households, on average, wealthier than ever. The aggregate wealth of U.S. households, including stocks, bonds, cash, real estate and other assets, hit an all-time high of $81.8 trillion in the first quarter of 2014, up $26 trillion since the low point in 2009. Much of this has been due to the U.S. stock market which has risen appreciably since the lows of March 2009. Housing prices have also rebounded, even though they still remain about 20% below their peak. Averages can be misleading, as approximately half of American households do not own stocks and more than one-third do not own homes. For many, it does not feel like a recovery has occurred.

While household wealth has more than recovered, the news for jobs and income has not been as rosy. A key milestone was reached in May 2014 when U.S. payrolls surpassed the peak number employed in 2008. In other words, more jobs have been created in the recovery than had been lost during the recession. It took two years to wipe out 8.7 million American jobs, but more than four years to recover them all, making this the longest job recovery of any recession since WWII. Even though the unemployment rate has fallen from 10% in 2010 to 6.1% in June 2014, a look behind the jobs numbers shows that many of the jobs recovered are not necessarily the same ones lost. For example, over 3 million net jobs have been added in the healthcare, hospitality and food service areas, while over 3 million net jobs were lost in construction and manufacturing. On a net basis, though, employee income declined due to the differential in wages across these industries. Almost 1 million additional full-time jobs in finance and government were lost, and many of the new jobs created have been part-time. Also, the long-term jobless rate is stubbornly and historically high at over one-third of the unemployed. The jobs recovery changes by region, as energy states such as North Dakota and Texas have done well, while housing bubble states such as Nevada and Arizona have not recovered at the same pace.

With the jobs recovery lagging normal recoveries, it is not surprising that wages also remain subdued; they have increased at about the same rate as economic growth. One constraint on wage growth has been slow growth in labor productivity, which has increased at about 1% annually in recent years. Even the middle class is feeling the pinch. Median household income has fallen from a pre-recession peak of $56,080 to $51,017 in 2013. Although improved since the recession years, subdued wages and less job security do not bode well for the confidence of many consumers, which is another reason why many people do not feel like an economic recovery has occurred.

The hope is that the economic expansion will prove to be more resilient than the typical one since the economic recovery has been so weak. At 60 months, this economic recovery and expansion is already the sixth longest since WWII. If it lasts another 13 months, it will match 2001-2007, which included the housing boom.

COMMENTARY

The recovery and expansion has a long way to go, though, to match 1991-2001, a period in which technological advances positively impacted the economy. On the plus side, household budgets and balance sheets are in better shape, the financial system is stronger, Europe is coming out of its recession, fiscal and monetary policies are normalizing, inflation and inflationary expectations appear under control and interest rates remain at low levels. The economy needs more real income and wage growth for this expansion to be sustainable longer-term. An improved political climate in Washington would also help meet that objective.

"Although most Americans apparently loathe inflation, Yale economists have argued that a little inflation may be necessary to grease the wheels of the labor market and enable efficiency-enhancing changes in relative pay to occur without requiring nominal wage cuts by workers.

~ Janet Louise Yellen, 15th Chair of the Federal Reserve