



January 21, 2014

TAPER FINALLY BEGINS

Dear Investor:

The Fed has recently announced the beginning of the long awaited “taper”, the gradual reduction of Federal Reserve purchases of US Government securities. This is really good news in my opinion. The current plan is to wind this down to its end in 2014. As I’ve discussed in past letters, asset values have been distorted by this program. It alters the true supply and demand in the markets, and leads to artificially high prices. The market’s reaction to this announcement in December was positive. It looks like Wall St. and the Fed are finally in agreement on the need to get this going.

Most signs in the economy indicate that things are steadily improving and may be picking up somewhat. Many believe Q4 GDP will be 3% or even higher. ISM Manufacturing and ISM Services indexes both ended the year on very strong notes. Employment data was better, with averages of around 200,000 nonfarm jobs a month being created over the year. We still have a long way to go as U6 data and the participation rate both leave much to be desired. Retail sales had a reasonably good year, while auto sales had the best year since 2007 with total sales of 15.6 million vehicles. These are big components of consumer spending. Core inflation for 2013 was 1.7%, a little below the Fed target of 2%. Construction and housing are also doing very well. Housing starts are running around the 1 million unit range, up almost 30% from last year. Sales of both new and existing homes are essentially at 6 year high points.

We are expecting a continuation of these positive trends in 2014. There is some chance of an acceleration in growth as several headwinds have been reduced. Corporate and personal balance sheets are better, and there’s a lot of cash around. Durable goods data shows that business investment has been rising. Mutual fund data shows that money has been finding its way into the stock market. Credit is better as a lot of de-levering and rebuilding has been done. Home refinancing has dropped way off and most economists believe the banks will be loosening credit more to replace that business with new mortgage lending. The government situation is better with the recent budget deal and spending package, and last, the Fed has signaled another year of 0% interest rates. All of this increases the possibility that the growth of GDP could accelerate in 2014.

I look forward to working with you on your portfolio in the coming year.

Best Regards,

David Keim

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