Mid-Year Outlook--*New Castle Investment Advisors, LLC*

New Castle Investment Advisors, LLC expects full-year US GDP growth to be 2.8%--the highest in the developed world. The dismal First Quarter GDP growth rate of -.7% was similar to the economic slowdown of Q-1 2014 but like then is not indicative of a new recession. This year's fall-off was due to seasonality factors, particularly the weather, as well as the protracted West Coast ports labor dispute. However, recently reported improving economic indicators, including job numbers, construction spending, ISM manufacturing data, job claims, retail sales, and average hourly earnings are now all trending higher than most economists had projected at the end of Q-1.

An interest rate hike this year by the Federal Reserve is to be expected. Short-term rates have recently been telegraphing a flattening of the so-called yield curve, meaning the Fed directly impacts short-term rates while longer-term ones typically adjust to prevailing economic trends. In addition, we see inflation picking up this year, in part due to improving wage growth.

As the economy strengthens, this will cause the fixed income market (generally) to underperform; while valuations for the equity market now appear stretched, it is not as yet over-valued when taking into account prevailing bond yields. The current US bull market is one of the longest on record but still has room to run. The current elongated stock market bull duration is largely due to lagging job and wage growth, resulting from the nature of the 2008-2009 Great Recession. That recession was largely credit-induced and its full impact led to an historically slow economic recovery. But labor shortages are now appearing in several economically-sensitive economic segments, i.e., the housing construction market and improving consumer demand.

But do not expect a clear upward path for the economy or equities, or for that matter a downward one for bonds. Do expect heightened levels of volatility and at times uncertainty. This is typical of an aging bull market. Trend lines will continue to zigzag, but the prevailing direction continues upward. Given this backdrop, certain themes should drive the portfolio construction process. These include the following considerations:

--*The developed economies, such as Europe and Japan, will continue evidencing improving economies. In large part, this is due to relative currency depreciation driven by central bank quantitative easing policies. Thus, increased portfolio weighting on a relative basis toward developed world equities continues to makes sense.*

--*Given prevailing economic trend lines, certain industries and equity sectors should exhibit outperformance. Expect financial services to do well--due to interest margin expansion as well as increased loan demand. The health care sector also should continue to outperform. This is due to aging demographics, health care demand and merger activity. Relatively low interest rates in an improving economy with companies exhibiting heightened stock prices and balance sheet strength leads to decreasing stock share counts--this trend is particularly true in the pharmacological industries. Sectors such as materials, utilities and telecom will likely underperform due to a shifting interest rate environment, resulting in continued industry sector rotation toward cyclical growth equities.*

-Commodities will remain under pressure, thus providing less relative performance stimulus to those developing economies reliant on commodity exports for growth. That said, there exist pockets of opportunities within certain developing economies, particularly for consumer stocks in those countries with stable economies. China's growth is slowing and its equity market is somewhat extended but can continue to do well if market reforms continues there and it accelerates its transition to a more consumer-based economy. Oil is a wild card in large part because the prevailing over-supply condition is market- induced by Saudi Arabia due to geo-political considerations as well as US fracking activity. However, headed into next year, an improving world economy will likely result in stable- to-increasing oil prices. With inflation subdued and the "life support" quantitative easing policies of the US Federal Reserve having been lifted, there is little impetus at this time for owning gold. Having said that, gold prices could move upward if Greece exits the Euro or there is a world flare-up, but the trade in hard commodities at this time remains less than compelling.

--The fixed income market should experience yield compression, whereby shorter term rates increase while longer-term duration bonds increase less fully or actually contract. Such fixed income areas as floating rate debt, municipals, and so-called unconstrained fixed income funds deserve attention in the current environment, but one also needs to be mindful to the use of derivatives in some alternative investments, which for most client portfolios should not be used.

Increasing interest rates do not mean the equity market will sell-off. In the near-term, the adjustment upward in rates will likely cause some market disruption, but increasing rates underscore an improving economy as well as healthier corporate margins, revenues and earnings--the key components to equity performance.

Bottom-Line: stay the course. Expect increased market volatility and likely some sell-off during the course of the summer but also expect the equity market to finish the year higher from here. We see the US domestic equity market--as measured by the S&P 500--finishing the year between 7-11% (it is now basically flat as of this writing) and the developed world equity markets higher in absolute terms but that performance will be muted by currency depreciation. We favor large and mid cap cyclical equities as opposed to more defensive names, like consumer durables.

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