GAMBLE JONES
INVESTMENT COUNSEL SINCE 1956

JAMES N. GAMBLE
(1922-2004)
FOUNDING PARTNER

THOMAS S. JONES
THOMAS W. BENT
ALISON J. GAMBLE
DENNIS D. SLATTERY
DAVID M. DAVIS
ASHLEY J. GUERRA
COLBY HACKERMAN
THOMAS F. JONES
SCOTT R. PHILLIPS
TAP N. LE
ROBERT L. SOUZA
PETER L. VIEHL
RYAN S. BUCKMASTER
TIMOTHY S. GARRITY

301 EAST COLORADO BOULEVARD
SUITE 802
PASADENA, CALIFORNIA 91101
TEL (626) 795-7583
FAX (626) 795-7689
WWW.GAMBLEJONES.COM

July 2015

U.S. capital markets drifted in a relatively narrow range during the second quarter, in part because there were no major developments for investors to digest. As such, this letter updates some of the major topics we have discussed in the past.

Greece continues to negotiate with its creditors. As of this writing, the outcome is unclear. Although Greek citizens voted against the austerity programs proposed by creditors, the global financial impact of a Greek default has been dramatically reduced by the European Central Bank's centralization of the region's banking system. Further, private banks as a whole have reduced their exposure to the country by nearly 80%. In addition to the short-term financial impact, longer term consequences include the precedent Greece would set should it leave the European Union. We do not own any Greek securities directly, and that will not change because they do not meet our investment criteria. However, we will take advantage of opportunities for long-term investors in U.S. stocks should the crisis create them.

The U.S. dollar remains strong relative to most currencies. It has fallen slightly from its March peak but is still up 20% from last summer. The strong dollar drives imports higher (they are cheaper on a relative basis) and reduces exports (which are more expensive on a relative basis). This combination increases the trade deficit and lowers GDP. In fact, the first-quarter reduction to GDP due to the increased trade deficit was the largest in thirty years. A strong dollar also reduces the international earnings of U.S. multinational corporations. The decrease occurs when foreign profits are translated into dollars for accounting purposes, even when the profits themselves are not. This translation effect lowered first-quarter earnings, and it will also reduce second-quarter earnings.

After falling from over $100 to less than $50, the benchmark U.S. oil price approximates $60 per barrel as of this writing. Economics 101 teaches that price is determined by supply and demand. On the supply side, energy producers have responded to lower prices by laying off tens of thousands of employees and laying down hundreds of drilling rigs. These cutbacks will eventually reduce the oil supply and create upward pricing pressure. On the demand side, energy consumption rises when prices fall and when the global economy grows. In theory, the equilibrium price is that which balances the marginal cost of production with a given level of demand. In addition to these natural economic forces, oil markets must also contend with geopolitics. As an example, the amount of oil supplied by Iran will rise if the country reaches a nuclear arms agreement. OPEC is another wild card, although its members are producing at high capacity utilization rates. We expect continued oil price volatility.

After keeping short-term interest rates near zero since December 2008, the Federal Reserve Board is preparing the market for the first increase in nine years. It is unclear whether the Fed will raise rates in 2015 or in 2016, largely because the decision depends on the strength of future economic data. Members of the Fed have also indicated that subsequent rate increases will be gradual. In contrast to stable short-term interest rates, long-term interest rates moved higher during the quarter. Ten year Treasury rates climbed from 1.9% on March 31st to 2.4% on June 30th. Part of the increase was due to a rise in European interest rates, but strength in the U.S. economy and growing expectations of higher short-term rates also contributed. The Fed will likely proceed slowly and cautiously.

The domestic economy is growing moderately again after stagnating in the first quarter. Forecasters expect U.S. GDP to grow 2.5% - 3% for the balance of the year. Perhaps more telling than the government's employment statistics, Wal-Mart, Target, and McDonald's have all raised wages, and General Electric is negotiating a raise with union members. These raises indicate that the labor market has grown tighter. Stronger labor markets eventually lead to increased consumer spending, which is an important economic driver.

We remain constructive on the outlook for the U.S. economy and expect it to continue growing moderately. However, we are not alone in our optimism, and this positive outlook is reflected in stock valuations. The S&P 500's forward price-to earnings ratio exceeds 17, which is above the long term average of 15. The low interest rate environment also contributes to higher equity valuations because it makes stocks more attractive relative to interest bearing alternatives. While the broad market appears fully valued, we continue to find attractively priced individual stocks and are ready to take advantage of any long-term investment opportunities that materialize.

Before closing, there are a few administrative items this quarter:

- We have updated our website at www.gamblejones.com. It has several new features that we hope you find helpful.
- We are proud to announce that Gamble Jones was selected as a member of the Financial Times 300, a collection of the country's leading investment advisors. Please see our website for more information about this honor.
- This will be the last quarter in which we automatically send portfolio statements and bills because the information they contain is also available on your brokerage statements. However, if you would like to continue receiving them, please let us know.

Sincerely,

Alison J. Gamble, President
Gamble Jones Investment Counsel