RUTHERFORD INVESTMENT MANAGEMENT
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**Client Newsletter – Quarter Ending March 31, 2014**

## Market capitulates after strong 2013

In 2013, the market had one of its best years ever. The broad market, as represented by the S&P 500 index, was up 29.6%. Typically, after a strong year, the market will continue on its course. After a nearly unbroken upward climb since March 6, 2009, one of the longest bull markets in history, the market was due for a pause, maybe even a correction (defined as a 10% drop). This year the market continued to reach all-time highs and then took a breather. The market appears tired, but its current pause so far appears in character and no cause to panic.

A severe winter disrupted manufacturing, retail sales, and, of course, employment. The Gross Domestic Product faltered. Following the winter, a crisis erupted in Ukraine, a not terribly significant economy, but geographically significant. It turns out that Vladimir Putin, the Russian President, has been feeling disrespected for years. In spite of his numerous statements to that effect over a period of years, the West, and particularly the U.S., seemed surprised when Putin moved to annex Crimea, a part of Ukraine. Crimea is of strategic importance to Russia and has been for centuries, because it provides Russia's only warm water port. Indeed Russia, by treaty, has a large naval base in Sebastopol.

Never mind that Russia, also by a 1997 treaty, had guaranteed Ukraine's borders. Rightly or wrongly, Putin sees Crimea (and Ukraine?) as part of Russia (Crimea was given to Ukraine by then Soviet President Khrushchev). A lot of Russian speaking people living in Crimea think that Crimea should be Russian too.

Putin also believes that the West is encircling Russia militarily. So he annexed Crimea. Putin says that the whole annexation happened suddenly and without premeditation. However, the process seemed well thought out and managed. Looking back, it appears that Putin had this in mind years ago. The West was too busy looking elsewhere for problems to pay attention. Then too, Obama had his famous pivot to the East, meaning an emphasis on the Far East. The West was caught flat footed. With no possibility of military intervention, the West was left to threaten "serious consequences". Much like the "bright red line" in Syria, the threats faded in consequence. U.S. allies blustered too, but interlocking economies prevented more serious action. Russia threatened that anything the U.S. did, Russia would match and raise. Checkmate.

Interlocking business ties are supposed to discourage wars and encourage comity among nations. However, not everyone is playing by the same rules. The Economist magazine, on its March 28, 2014 cover, had a picture of a bare chested Putin driving a Russian tank, with a caption "The New World Order". Putin has little regard for the ways of the West. He has his own rules and the folks in D.C. better pay attention.

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The markets reacted negatively to this realization and have been very volatile since. It is not clear how this all ends. Putin cloaked his takeover of Crimea as necessary to protect Russian speakers. Since there are many Eastern European countries with large Russian speaking populations, how far does he intend to go? With his new Russian speaking doctrine in hand Putin could justify a lot of land grabs and appears to be setting one up in Eastern Ukraine.

Putin's approval rating in Russia is at seventy percent. Of course a lot of leaders in history have had high approval ratings after aggressive action, only to see them fall in ensuing years. Putin has isolated Russia diplomatically in the international community. He must now do his own pivot to the East. With aging citizens, Russia's only population group that is growing is Muslims, who have their own problems with the mother country. Russia's economy is dependent on oil and gas. Russia used to need oil at about $85 per barrel to cover its expenses; now it needs oil at $107 per barrel. Currently oil is about $104 per barrel. It is easy to see that if we wanted to really hit Russia economically, we should increase our oil and gas production and exports. Even the threat of increased production would affect the price of oil, but the current administration's policies do not favor increased production.

In spite of all this, the U.S. economy is still expanding, albeit slowly. Retail sales are increasing, beating estimates. Consumer confidence is up according to the University of Michigan survey. We could do a lot more, but current government policies do not favor business expansion. The market is only 4% off its all-time high. The S&P is down 1.8% year to date. It may go down further. We are now entering the worst part of the year for the markets. "Sell in May and go away" is an old mantra. Maybe this year May came early. Furthermore, mid-year elections do not favor the markets. Too much uncertainty. We are in such a year. Perhaps after the November elections we will have more clarity. But remember, timing the markets is not a winning strategy. It has appeal to traders with a short term outlook, but sophisticated investors know that it is not a successful strategy. The attached chart shows the dangers of being out of the markets and missing its best days.

If you have questions, please call.

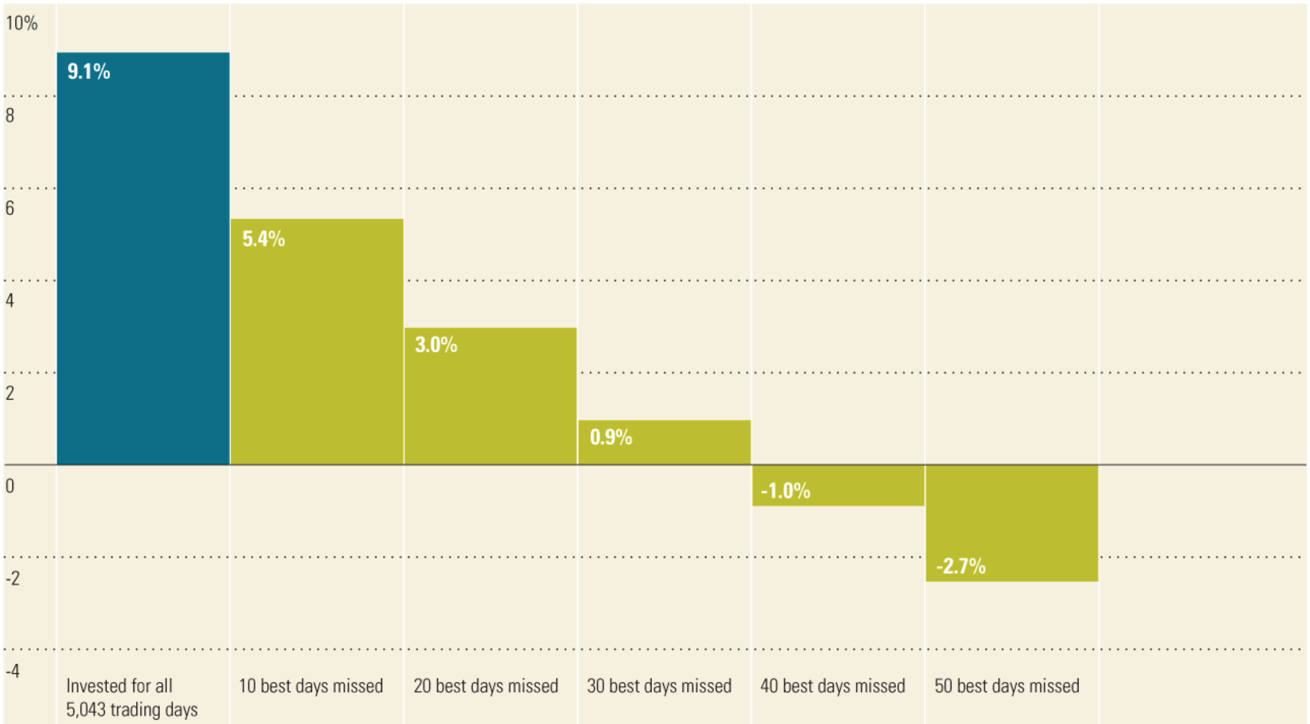
***William D. Rutherford***

**Rutherford Investment Management**

# Miss a Little, Miss a Lot

**Dangers of market timing**

Risk of attempting to time the stock market, 1991–2010




**Timing the market can be harmful to your wealth**

Investors who attempt to time the market run the risk of missing periods of exceptional returns. This practice may have a negative effect on a sound investment strategy.

Buying into the market when it is performing well and selling when it is on the decline could reduce, rather than increase, returns over the long run. Although successful market timing may improve portfolio performance, it is very difficult to time the market consistently.

**To have and to hold for better or for worse**

The image illustrates the risk of attempting to time the stock market over the past 20 years by showing the returns investors would have achieved if they were to miss some of the best days in the market. Investors who stayed in the market for all 5,043 trading days achieved a return of 9.1%. However, that same investment would have returned 5.4% had it missed only the 10 best days of stock returns. Further, missing the 50 best days would have produced a loss of 2.7%.

Unsuccessful market timing can lead to a significant opportunity loss. A buy-and-hold strategy may prove more successful in keeping portfolios well positioned regardless of what direction the market takes. Rather than reacting to short-term volatility and trying to time the market, consult a financial professional to develop a sound long-term investment plan.

**Past performance is no guarantee of future results.** This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss.

Source: Stocks are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general.