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Client Newsletter

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History shows that investors lose far more money as a result of their own actions than markets lose for them.

As markets reach new all-time highs, investors who "stayed the course" have benefited from the long running bull market.

Since 2009, when the broad market S&P index hit its low of 667, we have seen a substantial increase in value, with the Dow rising from 6,470 to 15,035, the S&P from 667 to 1,606, and the NASDAQ from 1,265 to 3,422. The market has been up 17 consecutive quarters from the low. This was a rally that no one trusted and few liked, but proved its resilience. Those who pulled to the side lines missed this huge rally.

During this climb, the market has overcome fears of the "fiscal cliff", the budget stalemate, sequestration, the debt ceiling debate, European debt problems and a host of lesser fears to reach the highest levels ever. Investors had many reasons to worry, but those who kept their eyes on the horizon profited. As I have commented before, the market climbs a wall of worry, and this time was no exception.

In the beginning stages of the rally, companies engaged in creative destruction. They shed workers and cut expenses. This, of course, was another negative for the economy, but good for companies, profits and investors.

Investors sought refuge in the U.S., because its economy was stronger than most other countries. Countries with less flexible work rules suffered malaise, mounting debt and sinking economies. Investors found the U.S., with its rule of law and rising profits, preferable to countries with uncertain laws and lack of productivity. In spite of the ugly mess in Washington, companies prospered.

Low interest rates and various Federal Reserve programs aided the economy with little help from elected officials. Low rates helped businesses and individuals refinance their debt. Low interest rates kept the dollar weak and aided exports. Since the U.S. was considered a safe haven, investors preferred the U.S. to other countries with less robust recoveries.

The economic recovery and higher tax rates led to higher tax receipts for the government, which allowed the U.S. to operate with a budget surplus instead of the dire predictions of deficit spending. It was not pretty, but it has worked.

The economy is still weak, but subdued growth has given consumers and investors some confidence. Unemployment remains stubbornly high, with millions of jobs both destroyed and created in the process.

We are now in the process of transferring from a liquidity and Fed driven recovery to a fundamentals driven recovery. Going forward, it will not be the Federal Reserve, but profit growth that drives the economy and the recovery. The outlook is subdued, and many problems remain. Rising entitlement spending will surely present problems in the future. Politicians do not want to tell people what needs to be done to right the economy; it is not good for their own job security, as voters do not want to hear bad news. So we will no doubt plod on, muddling through somehow.

The outlook for profits is also subdued. Profit growth is expected to run about 2-3% year on year, but since profit growth usually does about 3% better than expected, we can expect 5-6% in earnings growth this quarter, and perhaps more in the rest of the year. If we were to grow at that rate or slightly above, we should see more growth in market value. Add a little more investor confidence, and one could see expanded multiples. With this growth and increased multiples, one can see a stronger market for the rest of the year. Of course, there are always the unexpected and unknowns, but the trajectory is for a strengthening economy. It is time again for patience, resilience and long term investing. Diversification is still important, as we have consistently stated and continue to construct our portfolios accordingly.

We will continue to work diligently to deserve your confidence.

Thank you for the opportunity to manage your portfolio.

William D. Rutherford

Rutherford Investment Management