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Client Newsletter – Quarter Ending June 30, 2014

The second quarter of 2014 saw a return to market increases after a rough first quarter of the year. In fact, the government revised the first quarter GDP to a minus 2.9% from the positive 1% previously reported. The start of Obamacare and severe winter weather were the reasons most cited for the negative growth. Additionally, the Russian acquisition of Crimea and revolutions in the Middle East were events unsettling to the markets.

Slow economic growth resumed in the second quarter and the markets responded. Still growth remains sluggish and unemployment, though declining, has been slow to recover after the Great Recession. Perhaps the greatest reason for the continued ascendency of the markets has been the flood of liquidity from Global Central Banks. With continued cheap money and the manufacturing of money by the Central Banks, investors had few options except equities. Investors chased yield which benefited Utilities, Telecoms, and REITS, but they also needed places to park money which favors bonds. For now, equities seemed the best place to invest. The result was that stocks, especially those with yield, performed well. For the quarter equities were up 5.2%. Fixed Income benefited too as many investors sought protection from headline events and drove yields down while bidding fixed income up. Signs of froth are everywhere, but with continued cheap money fueling asset classes, the music just played on.

When does the music stop? No one knows of course, but it is a subject on investors' minds. It has been on investors' minds since the market bottomed on March 6, 2009 when it began its remarkable 224% ascent. Throughout the period since then pundits have criticized the market rise. Some investors sold the market short or simply stayed in cash on the sidelines. If you bet against the markets during this time, you lost. Investors "needed to be in it to win it."

With a 7.1% year to date increase, the markets have already had a better year than expected. Can it continue? The market has demonstrated its resilience so far and it seems unlikely that the Fed will change its announced policies so, as of this writing it appears that the markets will continue their upward march for the balance of the year. Headline news can and will cause volatility. The election cycle is worrisome, but by December 31 we should be higher than at present.

In October the Fed will finally stop Quantitative Easing with its last bond purchases. This program, which has been greatly criticized, has in my view kept the downturn from being much worse. How the markets will react to the removal of this safety net is not certain, but it should be a nonevent given that the Fed plans are well known. The next Fed uncertainly that has to be resolved is when will interest rates be raised. Signs now point to an increase in 2015, with the date uncertain. Of course a soft economy may delay the increase further. The Fed will not want to do anything to abort the recovery that has started, so I think the rise will be slow, only gaining momentum if the market absorbs the increases.

We are seeing opportunities for growth almost everywhere we look. When elections are over we should see firmness in the markets. So, we look to be fully invested for the balance of the year with a diversified portfolio. We expect to be rewarded.

- William D. Rutherford

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