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Client Newsletter – Quarter Ending December 31, 2014

Markets Hit Highs In 2014

Calendar year 2014 turned out to be a positive year for the markets with all indices making a strong showing. The year had its dips, with strong drops in January of 3.5% and in both July and September of 1.4% each. As December went on, the market staged a strong rally, until it ran out of steam. In the last days of December 2014, the market began to falter. By then, the markets had been in strong upturn for the year, and since March 9, 2009 up 244%. The market began to look tired, as well it might after 70 months of this bull market.

When January 2015 started, it looked like the market might resume its upward trend, but by then headline events began to overcome this rise. A sudden drop in oil prices spooked the market, despite lower oil prices being advantageous for most of the U.S. economy, even while hurting the oil producers specifically.

The U.S. dollar got significantly stronger against the euro and other currencies. The strong dollar had the positive effect of drawing foreign investment to the U.S. from other countries, as the dollar and U.S. denominated securities were the safe haven. However, about 47% of U.S. profits come from sales overseas, so a strong dollar could impede those sales. A strong dollar has the effect of lowering the price of imported oil and gas. Oil prices and energy costs for U.S. consumers could go even lower. As oil-weakened gas at the pump and cost of heating became less expensive, the consumer was expected to spend more because of lower energy costs, and to some extent did. Sales at fast food restaurants generally increased, but retail sales disappointed in the Christmas season.

The euro remained under pressure as the Eurozone continued to have financing issues. Once again, exit from the euro by Greece became a topic, the so called Greexit. This prospect raised many profound issues. First the euro is like the roach motel. You can check in but you can't check out. There is no procedure for withdrawal. On the other hand, the situation in Greece is such that the only solution seems to be an exit, unless of course the northern European countries bail out Greece which seems extremely unlikely. But if Greece can leave the euro, what about Spain, Italy and Portugal? If countries can leave, what is the future of the euro, and for that matter the whole European political structure? So you see there is strong impetus to save the euro, but no clear path. The dollar now approaches parity with the euro, and we suspect we will reach that point in the not too distant future. Delay your European travel plans and get a discount.

Russia and the Ukraine still cause worries. The ruble has fallen drastically; money is fleeing Russia for western countries. Still Putin seems bent upon his polices which have been so devastating to Russia. The fear is that as things get worse for Russia, Putin will cause further conflict to draw attention away from his failed policies. Even Putin has implied that he has about two years to put the Russian economy back on the right path, but does not seem inclined to do anything to further that aim.

Switzerland surprised the world by allowing its currency to appreciate 30% in one day. This unprecedented increase sent a shock throughout the markets and upended many financial firms that were on the wrong side of that trade. It won't be just currency traders that suffer; Swiss firms that sell to other countries will suffer too. The further effects of this change are yet to be felt and can be far reaching.

Almost all of these negative factors which affected the U.S market came from outside the U.S. The U.S. itself still has a growing economy. Consumer confidence has increased. Inflation was down 0.4% in December. The labor market is mediocre, and payrolls and wages are growing slightly. Profits for companies are expected to grow about 8% this year; the first quarter will be a good indicator. Profit growth will be good for the economy. It is generally thought that the U.S. Federal Reserve will start raising interest rates in the U.S. mid-year; however, recent events and economic indicators suggest they might take longer to raise rates. There does not appear to be any urgency, with inflation tame and oil prices dropping. Central banks in other countries are lowering their rates and trying to pump up their economies. The chairman of the European Central Bank is believed to want to begin a program of buying government bonds and even assets, such as the U.S. had with Quantitative Easing. So far Chairman Draghi has not been successful in his desire, but with Europe in the doldrums, he may yet have his way. The Chinese and Japanese are also carrying out monetary easing.

Earlier in 2014, we withdrew from the energy sector and therefore escaped the plunge in energy prices. We also brought our money home to the U.S. several months ago and reported that to you. Investments in the U.S. were better than overseas. So we had two changes in our portfolios that protected us from downdrafts and reinvested in stronger holdings. At present, we think the U.S. is the strongest and safest place to invest. The rest of the investing world seems to agree with us. We think having our money invested in the U.S. gives us the benefit of the strongest economy in the world, even if subdued, and one of the strongest currencies.

Should you have any questions are comments, please do not hesitate to contact me.

William D. Rutherford

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