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Market Commentary ***Winter 2014***

Reflecting on 2014 / Peering into 2015

As you'll remember, 2014 started off on a relatively sour note. For equity investors, the surprise and sheer delight of 2013's outsized gains quickly evaporated with the New Year. Many immediately questioned whether 30% plus returns were simply too generous. Perhaps stocks had borrowed too much from the future at a time when the economy was still very fragile. And so this sentiment played out as first quarter equity returns delivered less than 2%. Even more disappointing was GDP itself. First quarter productivity notched a dismal 2.1 contraction, the first negative growth rate in twelve quarters. It was not long before the "R" word resurfaced. Could it be that we were slipping back into a mild recession or was the poor performance really driven by those harsh winter conditions? In hindsight the latter was correct. By early April economic activity had picked up sharply and by quarter's end productivity had expanded by a robust 4.6%.

Over the next three months, economic conditions and investor sentiment continued to improve. By the end of the third quarter, GDP had notched another sizeable gain with greater contributions coming from consumer spending and capital investment. The six month growth rate was now one of the fastest in more than a decade. Likewise, all the major stock averages moved in lock step reaching incremental highs almost daily. Surprisingly, all of this good news occurred against a backdrop of unusually high and increasing geopolitical tension. Whether it was Russia and the Ukraine, ISIL's expansion into northern Iraq or the renewed conflict in Gaza, it was clear investors were not going to be distracted. So while investor complacency became an increasing concern late into the summer, the resilience of the market overshadowed these new risks.

By mid-September, the stock market appeared weary and arguably overbought with most of the averages having reached their peaks. Then, very abruptly, sobriety set in. The swift change in investor sentiment came on the heels of the International Monetary Fund's steep revision of near term global growth as was evidenced by Germany's steep decline in output, Russia's productivity collapse and currency devaluation, Japan's economic retrenchment; the result of an untimely consumption tax and China's continuing slowdown. Between September 19th and October 16th stocks tumbled by some 7% leaving year to date returns nearly flat and investors shaken by the notion that the first significant correction since the crisis might be at hand.

The unexpected contraction however was surprisingly short lived leading to a classic V shaped recovery. By November, the broad market had recaptured its lost ground and climbed even higher as the year wound down. In the end, 2014 became another solid year for equity investors albeit laced with more worry than had been witnessed over the last few years.

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Concurrently, US bond markets and other more interest sensitive assets classes including preferreds and REITs, also performed remarkably well in 2014. But the least expected, quietest and yet most surprising performance of all came from the unusual rally of long US government bonds which posted whopping 25%+ returns. Underscoring these solid returns was the stability of the benchmark 10 year Treasury and incessantly falling global rates.

Among a host of other big stories to emerge from 2014 was the precipitous collapse in oil prices over the second half of the year through this writing. Brent and WTI crude prices fell by over 53% leaving the energy sector all but mortally wounded. Surging new production from US shale beds coupled with Saudi resistance to production cuts and already soft global demand served to drive oil futures to lows not seen since 2008. Despite the stock market's swift reaction to the unexpected collapse, common sense suggests that, at least for the near term, only good can come of it for consumers here and abroad.

As we embark on the New Year, we note that the US economy appears to be one of the only beacons of growth in a sea of global weakness. And while US consumer confidence and investor sentiment remain relatively robust, the path to continued expansion is not without some risk. Accordingly, a new, very important question is poised for 2015: Will the US be able to escape the gravity of the larger global malaise or might it too succumb? If it escapes, one can presume the Fed will begin to raise rates sometime before the close of 2015. If a slowdown materializes, its silver lining would most likely be a delay in interest rate normalization. Admittedly, we'd take some pleasure in the latter knowing full well that if and when tightening begins, it will not come without some pain for both stocks and bonds as investors begin to adjust to the new reality. And so, with a sense of confidence but also some trepidation, duly noted by the market's recent volatility, we prepare to navigate a new set of credible headwinds some of which, because they are global, may simply be beyond our ability to control. In the meanwhile, all we can do is remain vigilant, cautious, disciplined and diversified - always with a focus on the longer term.