Eideard Group
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***Market Commentary*** ***Mid-Summer 2014***

## *Bad News is Good News and Good News is Bad News*

Despite what was seen as an unusual, almost unprecedented, increase in global geopolitical tension during the first half of the year, US stocks remained extraordinarily resilient. Whether it was the Russian-Ukrainian border conflict and the resulting Malaysian airliner shoot-down, ISIS and its increasing terrorist foothold in Iraq and Syria, or the recently renewed violence between Israel and Hamas, market volatility remained surprisingly low.

As well, most other markets; bond, commodity and currency also seemed virtually immune to any negative news on the US economic front. For the last two years, the financial world had been predicting that 2014 was going to be the breakout year: the year the US economy would finally break away from the gravitational pull of what has been a remarkably lengthy post-recession crawl. Five months into this year and that prognostication has proven false. Not only did the US economy not grow, but first quarter productivity receded at an annualized -2.1% rate. While the blame was immediately placed on an admittedly harsh winter, there is now increasing debate that perhaps structural changes in the US economy - including demographics, employment participation and technology - may become significant enough headwinds to prevent the US economy from ever again realizing what has been its historical 3%+ annual growth rate.

Aside from the pedagogic nature of this discussion, from the street view, stocks continued to extend their reach into new highs while bonds surprisingly continued to challenge equity returns despite the daily preoccupation that the Fed could raise rates anytime.

This so called “Goldilocks” scenario, swaddled in a surprisingly pervasive sense of investor complacency, has stirred bulls to begin to worry that the stock market has finally reached an inflection point and prescient bears to take folly in what they see as vindication, perverse as that may be, that a market correction is finally in the making. To the point, this notion seems of late to be, at least in part, materializing as year-to-date stock market returns have been almost cut in half.

As most of our clients knew heading into this year, we were very uncomfortable with - and particularly cautious over - persistent stock gains and valuation levels despite the fact that the Fed said no bubbles were forming. We remained hopeful that some form of relief would allow corporate earnings an opportunity to catch up to stock prices. It seems this may be the beginning of that “breather period”. With 2nd quarter earnings announcements just over 70% complete, some 68% of S&P companies report beating analyst’s estimates - hence the corporate earnings picture continues to look robust in an otherwise slow-growth environment.

On the bond side of things, the benchmark 10 year Treasury yield continues to be range-bound at 2.55%; well off its highs from the FED scare back in May 2013 when we saw its yield climb through 3.25% before subsiding. Municipals, which typically take their cue from the 10Y Treasury, remain especially attractive. In the meanwhile, Fed Chairwoman Yellen remains persistent in thought that, until the slack in, and the quality of employment metrics improves, wage inflation begins to surface and CPI exceeds their target, interest rate increases are not an option. That could be for a long, long time.

360 Route 101 Suite 13C Bedford, NH 03110 T 603-471-9909 F 603-471-9996 eideardgroup.com
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