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Market Commentary
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Introduction

Call it a tale of two markets or a failure to communicate. U.S. economic data roared back following a weak first quarter. The labor market improved to levels not seen in 15 years. Leading economic indicators are in solid expansion territory and manufacturing data has been strong. Consumer spending posted its biggest gain in six years as the gas windfall was finally spent. But U.S. equity markets seem as though they haven't gotten the message. Stocks have continued trading sideways with a pattern of steep declines and equally steep recoveries. The bond markets have been paying a bit more attention. Stronger growth, growing liquidity fears, and the likelihood of a Fed rate rise have pushed interest rates higher (and bond prices lower) in the U.S. and globally. At the beginning of the year, we predicted a moderate rally in the U.S., outperformance from Europe, and volatility in interest rates. These themes are still intact, though we are less bullish on Europe until a resolution on Greece.

Equities

The S&P 500 finished the quarter essentially flat (+0.28%) and is up 1.23% for the year. Following moderately positive returns in April and May, volatility spiked in the middle of June and equities gave back most of their gains. The second quarter was a reminder that not all stocks are created equal. Small cap growth stocks continued their impressive rally, up 1.98% in the quarter and 8.74% so far in 2015. Despite market concerns over the timing of a rate hike, our research shows that stocks (especially small cap stocks) do well in the months leading up to the first hike, albeit with more volatility. Following the first hike, stocks experienced some rockiness but are almost always positive through the first half of the cycle. The labor market has shown improvement with jobless claims averaging near 15 year lows, job openings at all-time highs, and the unemployment rate down to 5.3%. Combined with the savings from lower energy prices, the boost to the consumer should give this rally some legs.

International Equities

Outside of Greece, the European economy has shown some improvement and may have more upside than the U.S. while Emerging Markets are facing challenges. The euro saw its first rise against the U.S. dollar since the first quarter of last year and manufacturing data is in positive territory in Germany, Italy, Spain, and Ireland. Despite the late June pullback driven by fears of a Greek default, international developed stocks (MSCI EAFE Index) ended the quarter up 0.62% and are still up 5.52% in 2015. The rally experienced by International stocks since March of 2009 is only half that of what we saw in U.S. stocks following the financial crisis, so there may be room for growth ahead. Similar to the situation in the U.S., international small caps rallied more than the broad market, up 3.49% in the quarter. The MSCI Emerging Market Index ended the quarter up 0.69% and is up 2.95% year to date but is facing some headwinds from the Chinese stock market, which makes up 25% of the index. Following a strong 37% rally during the first two and a half months of the quarter, Chinese stocks crashed, losing 25% from the peak. Daily price swings of 5% in both directions combined with high levels of margin debt may indicate that we are witnessing the end of a bubble.

Fixed Income

Volatility returned to the fixed income market as a Fed rate hike later this year became a very likely possibility. The 10yr Treasury yield rose for the first time since the 4th quarter of 2013, from 1.93% to 2.36%. This rise in interest rates caused the Barclays Aggregate Bond Index to fall -1.68% and the Barclays Intermediate Corporate Bond Index to fall -2.88%. Due to the improving economic data, the Federal Reserve gave guidance for the market to expect one to two rate hikes before year-end. The Fed's "Dot Plot" rate projection, which is the published forecasts of Fed officials, showed a median rate rise of 0.625%. We continue to believe rates will continue to rise, though not as rapidly as they did during the "Taper Tantrum" of 2013. U.S. Treasury bonds should still be attractive to foreign investors due to the equity volatility driven by the Greek default and lower relative yields across the globe. With this in mind, we continue to have a shorter duration positioning in our portfolios with an emphasis on corporate bonds, such as High Yield and Floating Rate Bonds, due to their low sensitivity to interest rates.

Alternatives

Alternative investments had a mixed quarter, but proved to be beneficial during the equity sell-off in June caused by concerns over Greece. Our low volatility alternative strategies, Market Neutral and Long/Short Equity, acted as risk management tools by diversifying our equity and fixed income allocations. In June JPMorgan Hedged Equity (JHEQX) and PIMCO Fundamental Advantage Total Return (PIMCO) lost -1.50% and -1.24% respectively while the S&P was down -1.94%. Master Limited Partnerships (MLPs) struggled for the 3rd straight quarter with the Alerian MLP Index down -6.09 %. MLPs continue to trade around the volatility of the price of oil, despite their business models that are tied to the demand for oil, which is up year-over-year in the U.S. compared to the price of oil, which is down nearly 50% from the highs of 2014. Stabilization in the price of oil driven by stronger than expected demand from the U.S. and Europe along with reduced supply should benefit MLPs going forward.

Real Estate

"There will be growth in the spring." This was the reverberating theme for housing in the second quarter as the bounceback from the harsh winter brought the housing market closer to pre-2008 levels of activity. The past spring has been the best spring for home sales and building permits in the entirety of the post financial crisis period. Pending home sales in the U.S. hit their highest level in nine years and new-home sales are up 20% from a year ago, hitting their highest level in seven years. The key first time home buyer category (ages 25-34) is working in an environment that boasts a 5.3% unemployment rate, coupled with gradual upticks in wages and lower energy prices allowing for increased savings for a down payment. We think these factors are creating tailwinds that will support the growing momentum in the housing market.

Conclusion

For years many investors questioned how stock prices rallied without strong supporting economic data, but today the U.S. is the strongest it has been in 7 years and stocks are relatively flat. Whether it is fears of a Fed Rate hike or a "Grexit" this market has not been able to get on track in 2015. Due to the ongoing speculation of these events, we do not expect volatility to go away anytime soon, but look for stocks to remain resilient on strong economic data. Despite our outlook for equities and the potential Fed rate hike later in the year, we continue to believe in diversification through fixed income and alternatives. The uncorrelated return characteristics of these asset classes should reduce volatility, while protecting our portfolio from potential market corrections.