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Market Commentary
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Introduction

Looking back, 2014 was a year characterized by economic strength in the U.S., weakness internationally, and surprisingly low interest rates. The U.S. economy ended the year with the strongest momentum in over a decade based on the highest U.S. GDP growth rate since 2003, 2.7 million new jobs created, and a middle class benefitting from lower energy prices and rising wages. Low interest rates kept debt costs low for consumers and businesses while the Federal Reserve remained patient in raising interest rates. In contrast to the improving domestic economy, growth slowed internationally and positioned many of those countries to now face the challenges the U.S. has just overcome.

Domestic Equities

Despite volatility in the market, the S&P 500 was up 4.9% in the 4th quarter and finished the year up 13.7%. Positive economic data throughout the quarter coupled with the strengthening consumer outweighed the volatility overseas and falling energy prices. Personal income was up 4.2% year-over-year in November and consumer confidence reached its highest level seen since pre-2008. There is some fear that the significant fall in oil prices are signs of a slowdown in the global economy, but we feel this only strengthens the U.S. consumer and will continue to boost our growing manufacturing renaissance. The 33% decline in gasoline prices, combined with lower heating bills are expected to save the average U.S. household $1,800 annually. These savings in energy prices have also benefited U.S. corporations and we are seeing a continued expansion in the manufacturing industry. For example, a sock manufacturing plant that used to be in China opened in North Carolina because the reduction in shipping costs, tariffs, and energy made the U.S. a much more desirable location. We believe this bull market run is like a baseball game, in its seventh inning, it’s not over yet, so we continue to overweight U.S. equities.

International Equities

Europe has struggled with stagnant growth, fears of deflation and added volatility due to the possibility of Greece leaving the European Union. This has put the Euro into question which was down -4.22% in the 4th quarter. Although international equities seem to be facing many headwinds, the European Central Bank is planning a quantitative easing program similar to the U.S. efforts, which could lead to a strong run in their equity prices. After a strong start to 2014, falling oil prices and a strengthening dollar proved to be detrimental to Emerging Markets. Although these factors may persist in the short run, we continue to own the asset class, albeit at an underweight position to historical allocations, due to the attractive long-term growth rates, better demographics and cheap stock prices.

Fixed Income

Inflation has remained below expectations and U.S. Treasuries have once again seen demand as a safe investment when fear hits global markets. We do believe rates will eventually rise, in the meantime they are providing stimulus in the U.S. Low mortgage rates are supporting the housing market, businesses are able to borrow cheaply to fund new investments, and the government has been able to lower its interest costs for a decade to come. Many had expected interest rates to rise in 2014 as the Federal Reserve ended its program of quantitative easing but they actually went down due to even lower yields around the world, especially in Europe. For example the 10-year treasury yield ended the year at 2.17%, while similar 10 year debt issued in Germany yields only 0.54% and riskier debt in Spain and Italy both yield below 2%. In this environment, getting a 2% or more yield on a safe investment in the U.S. looks like a good deal.

Alts

The massive selloff in oil, which was down 41.56% during the 4th quarter, sparked a decline in master limited partnerships (MLPs). MLPs are energy companies that primarily process, transport and refine both crude oil and natural gas with revenues tied to the volume, not the price of the actual commodities. Demand for energy in the U.S. continues to increase due to our population growth and manufacturing renaissance and there is a possibility that the U.S. will become an energy exporter in the near future. Therefore the recent selloff is a market overreaction and we still believe that MLPs are attractive investments that have a track record of consistent dividend growth and will be boosted by an ever-increasing demand globally for energy.

Real Estate

Compared to last year's double digit gains, the Case-Shiller Home Price Index was up 4.5% from last year, which has helped affordability and is much closer to the normal rate of housing price gains we saw before the housing bubble. New housing starts have maintained a 1 million annualized pace, matching the average of the last 10 years, but below the peaks of more than 2 million seen in the mid-2000s. The difficulties facing first time homebuyers (student loan debt, stagnant wages, and higher credit standards) make it unlikely that the housing market will recover to pre-2008 levels but slower price appreciation, low rates, and wage gains should support gradual improvement. With housing making up nearly 10% of the U.S. GDP, any improvement would serve to drive growth even further.

Conclusion

The U.S. has diverged from the rest of the world in 2014 with accelerating growth and solid stock performance because of the emboldened strength of the U.S. consumer. We expect this trend to continue over the next year despite the headwinds from weaker global growth, a stronger dollar, and Fed policy decisions. We are more bullish on the U.S. than we have been at any point during this nearly 7 year long bull market. While the rally may be longer than average, bull markets don't die of old age alone and we don't see the potential for a recession on the horizon. Markets should be able to weather global concerns and rate hikes as they have in the past, though likely with more volatility than we've seen in recent years. An unfortunate consequence of the sharp divergence between the U.S. and the rest of the globe is that a diversified portfolio struggles when the S&P 500 outperforms all other asset classes. The goal of diversification is not to outperform the S&P 500 in any given year but to provide consistent returns with lower risk over a long time frame by investing both internationally and in diverse uncorrelated assets.