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At a Glance...

2014: A Mid Quarter Update

A quick summary of economies & markets for you.

Announcement

As you opened our interim newsletter, you may have noticed our new name, new design and new website. We are excited to announce our affiliation with HighTower Advisors, a national advisor-owned financial services company. HighTower has its headquarters in Chicago, and we have the distinct honor to be the first HighTower office in the Pacific Northwest. We are pleased to be partnering with a strong national company that shares our client focus.

In the coming months, we look forward to showing you the strength HighTower will add to our existing services and also how our commitment to the growth, management and preservation of your family's wealth and well-being will remain unchanged. If you have any questions about this transition, we encourage you to call your advisor.

Mid Quarter Update

July was a difficult month for the United States stock market with all three of the major averages losing ground. Investors were faced with significant geopolitical concerns and these uncertainties caused investors to sell equities first and wait for resolution on the sidelines. Additional downward market pressure likely was the result of investors opening their July statements and finding negative numbers for the first time in several months. July monthly statements were a reminder that stock prices don't always move in a positive direction. The pullback continued in early August before turning around on hopes the geopolitical issues will subside. In addition, the market has pinned its hopes on much better than anticipated earnings reports. According to Zacks Investment Research 453 companies in the S&P 500 have reported second quarter results with earnings up 8.7% on average from the year earlier quarter's and revenue advanced 4.6%. More impressive, two thirds of the companies beat profit expectations and more than 60% topped revenue estimates.

Better than expected second quarter profit and revenue reports generally are a precursor for further momentum in the United States economy. In other words, these two trends go hand in hand. An acceleration in growth is just what the financial markets

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want and what Janet Yellen, is hoping for. The one caveat is instability around the world can quickly curtail future growth prospects. Clients must also keep in mind the current bull market cycle is five years old and the average bull market lasts for about that amount of time. We are likely in the late innings of this market rally, but it could be extended if the world headlines improve and earnings continue to accelerate to the upside because of strong economic growth. Many of the leading economic indicators we track are also showing favorable signals.

While financial market tail winds are nice, clients should be prepared for a set of potential market head winds, especially as we move into 2015. One possible headwind is rising interest rates. Currently, interest rates in the United States remain surprisingly low with the ten year treasury note comfortably at 2.375%, even with the Fed tapering it's bond buying program. Clearly other countries continue to demand U.S. debt and investors outside the U.S. are looking for yield. Interest rates in Japan and Europe are at or near zero making the U.S. debt more attractive on a relative basis. In addition, most on Wall Street were predicting a 3.5% or 4% yield on the ten year U.S. treasury note by mid-year or at a minimum by year end. A spike in global interest rates would likely put upward pressure on U.S interest rates.

Why are we focused on interest rates? The stock market typically struggles with higher interest rates. Interest rates rise for two reasons: increased economic growth or higher inflation. While the Fed is determined to engineer an economy that provides full employment, with a reasonable business investment, a rapid rise in inflation could force the Fed to increase interest rates much more quickly than the market expects, curtailing economic growth in the process. No one is talking about higher rates yet. However, the 15 year rally in the bond market is likely over, and the market is only 1-2 years away from a more normalized interest rate environment.

Stock prices can continue to advance during a period of rising interest rates as long as inflation remains contained and rates rise due to stronger economic growth. Stock prices react favorably to increases in earnings and an improving economy. However, if something gets in the way of this picture ie higher interest rates, stocks can also decline. In other words, a goldilocks' economy is best for stocks and bonds, not too hot and not too cold, but getting it right is very difficult if not impossible. Hence we are predicting an increase in market volatility in the months ahead.

Clients should take note that financial markets never go up forever without some form of correction, or ultimately a bear market. Most major United States indexes find themselves at record levels as noted above. The United States financial markets have not experienced a meaningful correction in more than two years and the odds favor a correction in the not too distant future, given U.S. markets historically experience a ten percent correction once a year, and a bear market appears on average once every five years. Recall this rally began in March of 2009, and is currently one of the longest running rallies on record, albeit from very oversold conditions.

Our goal is to prepare you our clients for the road ahead, so when the inevitable happens, we are able to explain it, keep you focused on your long-term goals, and help you understand the importance of maintaining your investment strategy in both good and bad markets. Enjoy the current ride, but be prepared to fasten your seat belt, as navigating the next market cycle will likely be more challenging. In our next article, we will discuss reallocating portfolios during turbulent times. If you have questions about how we prepare portfolios, please don't hesitate to call us at (425) 455-6623 or ask your advisor.