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Money Managers You Can Trust

July 2015 Thoughts and Insights

Welcome to the summer of Volatility!

The first half of 2015 ended with a cascade of challenges for our portfolios including a worsening of Greece's fiscal crisis, new concerns about Puerto Rico's ability to repay its municipal bonds, and a surge in volatility for Chinese equities. These developments came as financial markets weighed the longer-term implications of an interest-rate "liftoff" by the Federal Reserve.

As a result, returns for the major asset classes in first half of 2015 have been down. Treasuries fell in price as rates rose, a sign that the U.S. economy would resume growth. This increased expectations that the Fed would increase borrowing costs as soon as September. The broader bond market (as represented by the Barclays U.S. Aggregate Bond Index) also finished in negative territory.

Meanwhile, the S&P 500 Index posted only a small gain for the first half of the year. The large-cap equity benchmark reached an all-time high on May 21, but gave up its gains as the Greece crisis worsened and Fed concerns moved front and center.

Here are our thoughts for the second half of the year:

- Expect more volatility. Stock market volatility has increased since April, coincident with increasing expectations for a Fed rate hike, Greece, and China.

- The US economy is slow, but moving forward. We do not see any signs of a recession, but headwinds stalling growth include: cautious corporate managers who are slow with capital spending; households still deleveraging after the 2008–09 financial crisis, keeping their spending in check; budget constraints keeping federal, state and local spending contained; and a strong U.S. dollar holding back growth in exports.

- The interest-rate normalization by Federal Reserve will be the dominant theme affecting asset prices in the U.S. markets. Continued U.S. jobs growth, although modest, should reduce the unemployment rate toward 5.2% by the fourth quarter. The Fed has signaled this as a signpost to begin raising rates by year end, as long as consequences from the Greek situation are contained.

- The Greek situation will likely continue fueling volatility and bears close observation, but it is unlikely to materially undermine the fundamental health of the U.S. economy. The United States likely will benefit from concerns about the long-term viability of the Eurozone project, with investors preferring US assets for quality and stability.

- Equities are likely to remain flat over the second half of the year. We don't believe that stocks are extremely overpriced, especially compared to cash and bonds.

- The Fed's plans to raise interest rates could cause short-term market disruptions but stock market reactions should be relatively tempered. While this is a significant event, we do not believe it is the game changer many may assume. To begin, rates will increase from zero to simply low. In addition, structural factors such as an aging population which increases the demand for income and bonds are likely to keep rates low over the long term.

With all of these factors in mind, we sold out of all our emerging market equities and debt; we took positions in consumer cyclical stocks to be ready for the consumer to spend again; we took a position in the largest German companies; we remain committed to our focus on income producing investments to earn through dividends and interest when prices are down; and we have remained in shorter term bonds looking for better yields once the Fed does lift off. In addition, we have higher cash balances that will also serve as ballast during turbulent times.

Equally important in times of increased volatility, despite investor's temptations to abandon the markets, we believe the better strategy for long-term investors is to stay the course. Evidence shows that time in the market produces better results than trying to time the market.

Lastly, holding diversified investments in precious metals, stocks and fixed income doesn't guarantee profits or prevent loss (nothing does), but it does allow you to spread your risk across a broader set of instruments that may respond differently to a given set of market conditions. Since there are no "screaming buys" right now, mixing it up is likely one of the best strategies.

As always, we remain dedicated to the prudent stewardship of your investments. We invite you to call, write, or stop by anytime with any questions you may have.

Michelle