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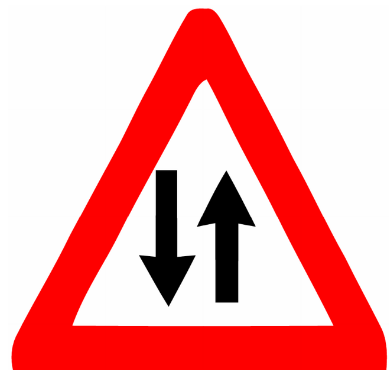
Fourth-Quarter 2014 Market Review ~ A Tale of Two Markets



January 2015 - It was a tale of two markets for stocks in the final quarter of 2014, with global economic and geopolitical turmoil dragging prices lower at the outset and a Santa Claus rally propelling them higher near the end. Known as the worst month of the year for the stock market, the beginning of October was true to form as the world's troubles came home to roost: the Ebola scare, ISIS in Syria and Iraq, deflationary pressures in Europe and Japan, and a slowing economy in China put stocks on a rollercoaster. Volatility returned when the then best day of the year was followed by the worst. Although the Russell 2000 Index of small cap stocks suffered a loss of more than 10%, the market decline was not considered an official "correction" because the drop in the Standard & Poor's 500-Stock index did not exceed the 10% benchmark (it sank 9.8% on an intra-day basis).

With investors following a "buy-on-the-dip philosophy," stocks snapped back from the swoon to finish October in positive territory, with the Dow Jones Industrial Average and S&P 500 closing at record highs. Better-than-expected corporate earnings and economic data alleviated concerns about the end of Federal Reserve quantitative easing.

Dow Jones "theorists" were in seventh heaven on November 5th when the Dow Jones Industrial, Transportation, and Utility Averages all closed at record levels, portending a bullish outlook for stocks. A mid-month calm overtook the market as investors began to believe that the U.S. economy would be able to weather a global slowdown and the end of the Fed's bond-buying program. The Dow Jones and S&P 500 bellwethers again finished the month at their highest levels.

The Dow Jones and S&P 500 rose for seven consecutive weeks through the first week of December, which was followed by the worst week in a few years, as a free-fall in oil prices put a damper on stocks. The quarter culminated with a "Santa Claus rally" when the Dow Jones jumped above 18,000 for the first time after it was reported that gross domestic product (GDP) climbed 5% in the third quarter, the best quarterly increase since the third quarter of 2003.

Meanwhile, consumers received an end-of-year gift in the form of lower gas prices. With weak demand and increased supply, oil prices tumbled by nearly 50% to levels not seen in more than five years. As a result, commodity stocks surrendered 10.1% and 12.6% for the fourth quarter and 2014, respectively.

It was also a tale of two markets during the final quarter and all of 2014 for domestic and international investments. Diversified portfolios did not fare well as foreign stock indices were lower across the board. The S&P 500 (total return) advanced 13.7% in 2014, while international developed market stocks shrank 4.5%. The S&P 500 lodged 53 record closes in 2014, while the Dow Jones posted 36 all-time highs. Even the tech-heavy Nasdaq came within 5% of its best closing level of 5,048.62 set back in March 2000.

Consistent with renewed market volatility, in October the yield on the 10-year Treasury Note slipped below 2% for the first time since May 2013, plummeting from 3.03% at the beginning of 2014. Concurrently, the average rate for 30-year fixed-rate mortgages fell below 4%, the first time since June 2013, and mostly remained under 4% for the balance of the year.

As expected, the Federal Reserve ended its bond-buying program in October. The Fed also kept its short-term interest rate policy near zero during the fourth quarter and said it intends to be "patient" when deciding on a rate increase, adding that the patient approach is "consistent with" its former "considerable time" language for when it may pull the trigger on higher rates. The central bank initiated its near-zero interest rate policy during the 2008 financial crises and then followed up with further economic stimulus in the form of a $3 trillion three-part bond-buying program.

With job growth exceeding more than 200,000 per month during 2014 and the unemployment rate falling to 5.8% from 6.7% at the outset of the year, it is expected that the Fed will begin to slowly increase interest rates in 2015. However, if inflation remains below the Fed's 2% target, wage growth remains stagnant, and/or foreign central banks continue monetary easing due to weak overseas economies, the Fed may delay raising rates.

The unexpected decline in treasury yields led to across-the-board gains for bonds in 2014. Rebounding from a miniscule advance of 0.3% in 2013, Municipals were at the head of the pack, surging 9.1%. A stronger dollar put a damper on international bond returns, as the Global Aggregate index inched up 0.6% versus the U.S. Aggregate bounce of nearly 6.0%.

At quarter-end, the yield on the 10-year Treasury note was 2.17%, down 33 and 86 basis points for the quarter and year-to-date, respectively (the yield as of January 14th was 1.85%).

Below are rates of return for selected market indices for the fourth quarter of 2014, full-year 2014, and the three, five, and 10-year compound annual returns as of December 31, 2014.

	4Q:2014	2014	3-Year	5-Year	10-Year
Equity (Stock) Indices					
Domestic					
Russell 1000 - Large Cap	4.88%	13.24%	20.62%	15.61%	7.96%
Russell Midcap	6.05%	14.75%	21.98%	17.43%	9.43%
Russell 2000 - Small Cap	9.73%	4.89%	19.21%	15.55%	7.77%
Real Estate (FTSE EPRA/NAREIT Global)	7.04%	14.73%	15.06%	10.93%	6.86%
Commodity (Dow Jones Global Equity 100)	-10.07%	-12.60%	-3.89%	NA	NA
International					
MSCI EAFE Developed Large Cap	-3.53%	-4.48%	11.56%	5.81%	4.91%
MSCI EAFE Developed Small Cap	-2.23%	-4.63%	14.20%	8.98%	6.40%
MSCI Emerging Markets	-4.44%	-1.82%	4.41%	2.11%	8.78%
Global - MSCI All Country IMI	0.70%	4.36%	14.90%	10.03%	6.91%

	4Q:2014	2014	3-Year	5-Year	10-Year
Fixed-Income (Bond) Indices					
Barclays Capital					
Global Aggregate	-1.03%	0.59%	1.47%	3.15%	3.85%
U.S. Aggregate	1.80%	5.97%	3.32%	4.85%	4.91%
U.S. Treasury TIPs	-0.03%	3.64%	2.80%	5.58%	5.10%
U.S. Corporate High Yield	-1.00%	2.45%	7.11%	8.23%	7.34%
Municipal	1.37%	9.05%	5.32%	5.77%	5.04%
International Emerging Markets	-1.73%	4.76%	7.73%	8.58%	8.41%

Source: russell.com, reit.com, djindexes.com, msci.com, barcap.com

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