
## April 2014 Commentary

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### The Fed Is Tapering. Should You?

In its December, 2013 meeting of the FOMC, the Federal Reserve began to implement the reduction of its asset purchases program known as "Quantitative Easing". It is expected that the amount of purchases will be reduced in every meeting until October, when the program will officially end. What does this mean to you?

The optimistic view is that asset purchases by the Federal Reserve are no longer needed. This is significant because, as we mentioned in our fourth quarter commentary, tapering is overall a good thing as it suggests the economy can now stand on its own two feet. Put simply, with tapering, we are now closer to "normalized" growth — valuations driven by earnings growth. This means investing in "high quality" companies with strong balance sheets, strong cash flows and managers that consistently reinvest well.

However, this action by the Fed also adds a level of risk and uncertainty to the markets. What we do not know are the ultimate effects of tapering. Some analysts believe that Quantitative Easing has not only artificially reduced market interest rates, but also artificially supported equity prices. Normalization would then mean both a significant increase in interest rates and lower stock prices. Therefore, as tapering moves forward, expect a bumpy ride and volatility along the way.

## Domestic Equities

U.S. economic data remained mixed as the unusually colder winter skewed many market indicators, particularly consumer driven data. With the exception of the Dow returning negative .2%, all of the respective domestic indexes returned positively during the first quarter 2014. Ironically, utilities that lagged throughout 2013 significantly outpaced the other sectors, followed by healthcare. Early in the quarter, many stocks sold off sharply due to tepid Chinese manufacturing data and its potential impact on other emerging economies. Subsequent volatility in early March was a result of geopolitical tension in the Crimean region of Ukraine; however the market remains hopeful that further Russian sanctions by the United States and Europe will help curb further conflict.

## U.S. Bond Market

The 10 year treasury began the year at 3.00% and ended the quarter at 2.73%. This decline in yield is attributable to risk aversion resulting from the Ukraine crisis as well as short term risk in the emerging markets courtesy of China's manufacturing data. It's important to note that this rally occurred despite the Fed reducing its monthly treasury purchases by $5 billion at each of its last three policy meetings. As a firm, we believe there will soon be pressure on the 10 year and it will be increasingly important to lower duration in bond portfolios. There are opportunities in corporate debt because of the credit spread here, as well as in the municipal markets. However, with the inevitability of a normalized yield curve, paramount to any bond portfolio is to be able to reduce duration and find quality offerings. The new Fed Chairman, Janet Yellen, has made it clear that the Federal Reserve will keep rates low until unemployment and inflation goals are met, but we do not want to be overly exposed on the yield curve when this switch occurs.

## International Markets

Just as in the domestic markets, there appears to be a shift to quality rather than high growth opportunities. That said, near term, we prefer developed international over the emerging markets. Over the next several years we are excited about confidence returning to the European markets. Europe led the way this quarter returning 2.21% while the All Country World ex-U.S. returned .61%. During the first quarter emerging market currencies and hard assets had a significant sell-off, which put pressure on the commodity oriented economies. Our strongest international conviction remains in Europe, which posted its third consecutive quarterly advance. It is possible that the European Central Bank will inject more liquidity into the markets, and this will only help to increase the appreciation of many of the sectors within the region. However, some of this growth remains in question depending on the outcome in the Crimean region and Russia's response to imposed sanctions.

## Summary

The potential volatility as a result of the Federal Reserve reducing its asset purchasing program reiterates the importance of rebalancing your portfolio, taking gains, and revisiting your long-term investment strategy. It is true that investing is an act of optimism —investors are naturally positive people. But as investors, we must stay disciplined with our allocation strategy, weighing the impact of both short-term and long-term success. This translates to the notion that today's winner may perhaps be tomorrow's laggard. What we have found to yield the best probability of success is to stay diversified across asset classes, rebalance so as to capture gains, and to allocate based on your risk tolerance, investment goals and time horizon.

As always, we appreciate your continued confidence in our firm.

| U.S. Bond Market | | |
|---|---|---|
| **Index** | **First Quarter 2014** | **Year-to-Date** |
| Barclays Capital U.S. Aggregate Bond Index | 1.84% | 1.84% |
| Credit Suisse High Yield Index | 3.07% | 3.07% |
| Barclays Capital Municipal Bond Index | 3.32% | 3.32% |
| Barclays Capital Global Aggregate Ex-U.S. Dollar Government Bond Index | 2.79% | 2.79% |
| J.P. Morgan Emerging Markets Index Plus | 3.73% | 3.73% |

| U.S. Stocks | | |
|---|---|---|
| **Index** | **First Quarter 2014** | **Year-to-Date** |
| DJIA | -.15% | -.15% |
| S&P 500 | 1.81% | 1.81% |
| Nasdaq Composite | .54% | .54% |
| S&P MidCap 400 | 3.04% | 3.04% |
| Russell 2000 | 1.12% | 1.12% |

| International Averages | | |
|---|---|---|
| **MSCI Index** | **First Quarter 2014** | **Year-to-Date** |
| EAFE (Europe, Australasia, Far East) | .77% | .77% |
| All Country World ex-U.S. | .61% | .61% |
| Europe | 2.21% | 2.21% |
| Japan | -5.47% | -5.47% |
| All Country Asia Ex-Japan | -.68% | -.68% |
| EM (Emerging Markets) | -.37% | -.37% |