Market Insights

1st Quarter 2015 | Economy | Capital Markets

ADVANCE CAPITAL management

Economy

While several investment themes from 2014 continued into 2015, a few new ones surfaced with the potential to either help or complicate the landscape. An improving jobs picture, low interest rates and steady improvements in housing remain the foundation for solid economic growth going forward. Conversely, the Federal Reserve's decision to end their quantitative easing programs late last year and begin the process of raising interest rates, along with the dramatic rise in the U.S. dollar versus world currencies, has led to an uptick in market volatility and investor anxiety. Investors have scrambled to discern how these forces might impact both growth and valuations in the capital markets in the coming quarters.

The marked improvements in household finances and confidence are a direct result of the much improved employment picture. Over the past year, approximately 3 million new jobs have been created and the unemployment rate has continued to fall to a post-crisis low of around 5.6 percent today. The economy has been averaging more than 200,000 new jobs per month for the past year, marking the best streak in 20 years. While there is still debate about the health of the labor market given the low level of participation and soft wage growth, the numbers suggest a continued recovery. At the same time, oil prices are now $20 per barrel lower than they were in December and a full $40 lower than the average oil price in 2014. American consumers are treating the windfall judiciously, spending some and saving the rest, which suggests its effects will be steady and long-lasting.

Since the start of the year, there have been other significant developments that could potentially impact the outlook for the global economy in a material way. Since December, a parade of more than 20 central banks from around the world have eased monetary conditions by slashing interest rates toward zero or even below. In January, the European Central Bank (ECB) announced a 1.1 trillion euro quantitative easing program that was much larger and more open-ended than the markets expected. Together, these actions have produced a wave of global monetary policy accommodations largely unforeseen. This should support growth and inflation in these countries.

During the quarter, relatively positive economic data and solid investor sentiment helped push capital markets higher. Although the markets sold off in early January, they quickly bounced back toward all-time highs before fading near the end of the quarter. The S&P 500 Index produced a 0.95 percent return, while the S&P 400 Index produced a 5.31 percent return. In bonds, the yield on the 10-year U.S. Treasury bond fell from 2.17 percent at the beginning of the quarter to 1.92 at the end, producing above-average returns.

March 9th marked the six-year anniversary of the bull market in equities, which is now the fourth longest and fifth best performing one on record. Further, the S&P 500 Index has gone 41 months without a 10 percent drop, more than double the long-term average of a correction every 18 months. Not surprising, many investors are starting to worry about the current bull market's age and the potential for a modest or steep decline at some point in the near future. While there has been periodic turbulence at times and the market has declined over the past few years, the trend has remained positive. Many investors have been on the sidelines waiting for more "normal" market conditions. In a world that continues to struggle with deflation and deleveraging, the "new normal" may be anything but normal for the years to come. However, a bit more caution is warranted at this point in the market cycle.

Looking ahead, the strength in housing, employment and manufacturing is evidence to support the argument that the U.S. economy is on a positive and sustainable growth trend. Yet, there are several headwinds that could potentially trip up investors in the quarters ahead. First, the improving economy validates the Federal Reserve's intentions to move interest rates higher to more "normal" levels. While marginally higher interest rates are expected by investors, any miscalculation in the timing or magnitude could impact capital market valuations. Next, the diverging central bank policies around the world has led to a much stronger U.S. dollar which could negatively impact earnings for domestic multi-national corporations. Finally, after the six-year bull market, market valuations appear elevated for many sectors of the fixed-income and equity markets. The question remains whether investors will have the fortitude to rationalize these headwinds against current valuations. We continue to expect both modest growth and average to below-average returns for both stocks and bonds for the remainder of the year. Yet, we are cautious given the environment and the potential for increased volatility if expectations are not met.

As always, investing in the capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser.

Capital Markets

During the quarter, interest rates declined slightly and equity volatility ticked higher as investors tried to evaluate the next move by the Federal Reserve and the likely impact on the economy. For the quarter, growth stocks trounced value stocks across the market-cap spectrum and foreign markets tended to outperform domestic. Fixed income did well, with most sectors posting positive results.

Market Index Performance (%) As of March 31, 2015

	1st QTR	YTD	1 Year	Annualized 3 Year
S&P 500	0.95	0.95	12.72	16.08
Dow Jones Industrial Average	0.33	0.33	10.57	13.15
Nasdaq Composite	3.86	3.86	18.28	18.23
Barclays Aggregate Bond	1.61	1.61	5.72	3.10
Citigroup BIG Corporate Bond	2.23	2.23	6.75	5.22
MSCI World	2.47	2.47	6.68	12.92

Disclosure Note: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	5.57%	6.21%	Represents the number of unemployed persons as a percent of the labor force	Continues to decline at steady rate
Consumer Price Index	0.00%	4.20%	Represents changes in prices of all goods and services purchased for consumption	Remains low
U.S. Capacity Utilization	78.90%	80.60%	The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime	Near historical average
Gross Domestic Product+	3.70%	6.60%	Total value of all goods and services produced indicates strength or weakness of the economy	Rebounded and positive trending
10 Year Treasury Yield	1.92%	6.67%	Yield on the current 10 year treasury bond	Remains low and in trading range
Annual Housing Starts	897,000	1,453,000	New privately owned housing unit starts annualized rate	Steady improvement

*Average from 1966 to Present
+ Annualized
Source: Bloomberg

Disclosure Note: Portfolio holdings and percentages may fluctuate based on market conditions. Past performance is no guarantee of future performance. Investments are not FDIC insured and may lose money. Investors should be prepared to bear the risks associated with investing.