



## **Economic and Portfolio Outlook 2nd Quarter 2015**

*(Released April 2015)*

We stated in our first quarter outlook for 2015 that there were market signals giving us reason to pause even though the job nonfarm payroll jobs report for December was strong, and the Dow Jones Industrial Average (DJIA) and the S&P 500 Index were both within reach of new all-time highs. Looking in the rear view mirror, we saw the following economic data points:

- U.S. equities markets were essentially flat for the first quarter of 2015 with Dow Jones Industrial Average (DJIA) and the S&P 500 Index returning 0.32 and 0.96 respectively.
- A downward revision in fourth quarter 2014 U.S. GDP.
- The Fed signaled a potential interest rate increase in 2015.
- A subpar jobs report for March
- Continued strength in the U.S. dollar.
- Increased bond-buying on the part of the European Central Bank.
- Concerns over slowing growth in China.

Looking forward, we continue to see slow growth for the U.S. economy. Retail sales are down, home construction and sales came in weaker than expected, and orders for durable goods have fallen in three of the last four months. The Atlanta Fed recently cut its growth projection for the U.S. economy to zero for the first three months of the year, and many analysts are expecting earnings for the S&P 500 to fall this year for the first time since 2009. S&P 500 earnings have declined only five years out of the last 25, and each one coincided with a recession. This data provides a macroeconomic view that is less than optimistic.

Negative interest rates indicate desperation on the part of policy makers when traditional policy options have proved to be ineffective. We believe this desperate move in the euro zone region has contributed to the continued climb in the DJIA and the S&P 500 indexes as well as to continue low yields on U.S. treasury bonds. U.S. treasuries, while volatile during the first quarter, finished with gains marking the fifth consecutive quarter of positive returns. The yield on the 10-year Treasury note decreased by 49 basis points to 1.68% in January, which was its lowest level since May 2013. A big reversal in February resulted when Treasuries experienced their sharpest sell-off since 2013, as the yield on the 10-year not moved back to the 2.0% mark. Going into March, we once again saw Treasuries rally, ending the quarter with a gain.

Although the Federal Reserve removed the word “patient” from their prepared remarks in their March statement, seemingly to prepare markets for a rate hike in 2015, they replaced it with a more data dependent approach which appears to focus again on the Fed’s inflation target of 2.0% and economic growth. They simultaneously lowered their expectation on both of these metrics, which seemed counterintuitive. Based on the updated projections and the rhetoric in the Fed’s prepared remarks, we believe a rate increase will be pushed out until late 2015 or into early 2016.

In our view, it will be difficult for the Fed to justify a rate hike with macro data continuing to come in weaker than expected, especially with GDP tracking around zero percent and inflation well below the Fed’s 2.0% target rate. Ultimately, the Fed will do whatever it deems necessary whether or not it raises rates. In the meantime, we anticipate a continued flattening of the yield curve that began over the past year, only with more intensity with the short end moving up and the long end of the curve continuing to trend downward.

Record low yields across the Eurozone have been amplified by the ECB’s massive bond-buying program of 60 billion euro-a-month which they started last month. Most recently, Spain joined the club of those countries with negative interest rates as their 6-month bills sold at a negative rate in early April. Record low yields in the region may continue as the ECB continues their bond-buying, growth remains low to negative and inflation remains benign. The question now is at what point will the U.S. markets begin to feel the impact of this global contraction in growth?

### **Foreign Markets**

Reports from the European Central Bank’s (ECB) last policy meeting show that top officials are determined to continue with the full 1.1 trillion euros, or \$1.2 trillion, of their planned stimulus. The minutes of the March 5<sup>th</sup> ECB meeting reported that all members were in agreement that there was no room for complacency and that the stimulus plan, which involves buying €60 billion in government and corporate bonds each month, had to be fully implemented and supported. The stimulus began on March 9<sup>th</sup> and slated to last at least 18 months. The purpose of the program is to nudge inflation back toward the ECB’s official target of close to 2%.

Japan, which has suffered a long period of deflation and falling prices, launched its unprecedented stimulus plan in April 2013 with a goal of getting inflation to 2% in two years. While there was early success pushing inflation above 1% in the first year of the stimulus plan, inflation in Japan at the two year anniversary is now about zero.

The Russian economy shrank by a reported 2% during the first three months of this year, which is its first contraction since 2009 due to Western sanctions imposed after Russia annexed

Ukraine's Crimea region just over a year ago. Prime Minister Dmitry Medvedev estimated that Russia's GDP had dropped by as much as 1.5% this year as a result of the imposed sanctions and estimates this number could increase several times this year.

The Bank of England (BOE) continues to maintain its historic low interest rate of 0.5% with the Monetary Policy Committee (MPC) hesitant to raise rates as inflation has fallen well below the Bank's 2% target. However, recent minutes of the MPC showed that all members believe that it is likely the Bank rate will be higher in three years.

The People's Bank of China (PBOC) has joined policy makers around the world with its own monetary easing as they confront the risk of excessively low inflation. China reported GDP for 2014 of 1.4%, the slowest since 2009. Since 2010, the Chinese economy has effectively decelerated by 30%. In response, the People's Bank of China (PBOC) reduced its reserve requirement ratio by 1%, the second reduction this year, making more credit available. However, Finance Minister Lou Jiwei was quoted as saying that the Chinese government has sufficient policy tools and that China is able to achieve its growth target of about 7%.

**CAPITAL MARKETS SNAPSHOT**

<b>EQUITY</b>	<b>As of 3/31/2015</b>	<b>1Q2015</b>	<b>12-Month Return</b>
DJIA	17,776.12	0.33%	10.57%
S&P 500	2,067.89	0.95%	12.73%
NASDAQ	4,900.88	3.79%	18.12%
MSCI EAFE	1,849.34	4.88%	-0.92%
<b>RATES</b>	<b>As of 3/31/2015</b>	<b>As of 12/31/2014</b>	<b>As of 3/31/2014</b>
Fed Funds Target Rate	0.25	0.25	0.25
3-Month Libor	0.27	0.25	0.23
6-Month CD	0.35	0.43	0.26
2-Year Treasury	0.56	0.66	0.42
10-Year Treasury	1.92	2.17	2.72
30-Year Mortgage	3.69	3.83	4.40
Prime Rate	3.25	3.25	3.25
<b>COMMODITIES</b>	<b>As of 3/31/2015</b>	<b>1Q2015</b>	<b>12-Month Return</b>
Gold	\$1,187.00	-1.58%	-8.11%
Crude Oil	\$47.60	-10.64%	-53.14%