ECONOMIC & MARKET REVIEW

First Quarter 2014

The equity market covered a lot of ground during the first quarter but returns were little changed. The S&P 500 recorded a total return of 1.8% and the NASDAQ was up 0.8% for the first quarter of 2014. That's interesting considering the important events that took place during the quarter. More on that later. Bonds had an interesting three months, with the two year Treasury note up 0.08% in yield, but the ten year note down 0.29%. Developed international equity markets were also flat as the EAFE was up 0.7% and Emerging Markets recorded a -0.4% return for the quarter.

Janet Yellen took over leadership of the Federal Reserve in January. Her news conference post the release of the Federal Open Market Committee minutes in March drew much interest. The Federal Reserve has consistently used the term "for a considerable time", in referring to how long they would remain accommodative. Yellen further explained that "considerable time" meant six months from the point at which the Fed ends their last purchase of the now fading quantitative easing program. The Fed usually likes to be somewhat opaque when it comes to future policy moves. Now they are on record as to when they will begin tightening (raising) rates. If the bond buying program ends in December, then raising short term rates would start in June 2015, in line with what the market has expected. However, if the bond buying were to end in October, then rates would be raised in April, earlier than the market expected. The specificity of Yellen's comments caught the markets by surprise, and we saw considerable volatility afterwards. The most important point of this discussion is that interest rates are going higher. While the timing is somewhat vague, it is coming.

Additionally, Russia's quick annexation of Crimea added another hot spot for potential military action and political instability. So, international political angst is back on the front burner.

U.S. economic news was weaker than expected during the quarter. However, the horrible winter weather obviously impacted individuals and businesses. I had never heard the term "polar vortex" used prior to this winter. I hope I never hear it again. There were days in the first quarter when Chicago was colder than the South Pole…people in the windy city started referring to their Chicago as Chiberia. So, we will have to wait until April and May to get a good read on U.S. economic momentum. My expectation has been that we are in a long slow recovery and that growth is going to be like Goldilocks' porridge — not too hot, not too cold. But then again, there were bears in the house.

Remember the equity market last year? The S&P 500 was up 32.4%. The fact that equity returns in the first quarter 2014 are subdued is not a surprise. It may even be a blessing, as the market is digesting a great year and from my view behaving well. No one seems to like the market, everyone is worried. So, the bull market is climbing a wall of worry; precisely what you need to keep the markets moving higher. Additionally, the forward P/E of the S&P 500 at quarter-end was 15.4, a reasonable valuation level given today's rate environment. Still, I have positive but modest expectations for equity market returns this year and believe the U.S. economy is poised to do better over the last three quarters of 2014.

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Disclosures

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