Market Update

June 30, 2014

The most important, market moving event of the second calendar quarter was Federal Reserve Chairman Janet Yellen's June post-Federal Open Market Committee press conference. She indicated that the Committee was not concerned with inflation picking up nor was she anticipating any near term need to raise interest rate levels. Capital markets responded favorably and the results for various market indices during the quarter indicate that assuming more risk provided more returns to investors.

The 10 year U.S. Treasury yield ended the quarter just above the 2.5% level, and bond returns for the first half of 2014 were comparable to equity returns. The S&P 500 and the NASDAQ index were both up almost 5% during the quarter while the Dow Jones Industrials lagged with a gain of 2.3%. Developed International Markets, as represented by the Exchange Traded Index Fund (EFA), were up 4.1% while Emerging International Markets, as represented by the Exchange Traded Index Fund (EEM), were up 6.5%.

A number of market commentators have indicated that the policies of the Federal Reserve have fostered an increase in asset values, particularly equities, without having any meaningful impact on wages and employment levels. Consequently, asset prices are showing a tendency to "drift" higher. I agree with this assessment.

Geopolitical uncertainty, rising oil prices, and large negative revisions to first quarter GDP figures, all had little to no impact on equity prices. Corporations continue to sustain very good profit margins, and merger and acquisition activity has increased nicely. Even companies engaging in mergers that will allow "tax inversions" to change the country of domicile for tax purposes have failed to provoke anything other than political griping.

While markets are performing well, the overall economy is lagging. In short, with the economy stalled for the first half of the year, a robust second half will still only produce roughly 2% GDP growth for the full year, another lackluster result. Corporate profits will be up 5-8%, interest rates will remain low and as a result, measures of overall market volatility will be at or near record low levels.

Many market observers refer to the current attitude of investors as complacent. I agree with that assessment and I believe that complacency will continue as markets continue to drift higher.

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