Market Update

December 31, 2014

Market moving events during the fourth calendar quarter of 2014 were driven by domestic issues, in contrast with the third quarter which was affected by geopolitical events.

October produced a mid-month point at which the S&P 500 was 9.9% below its September high, the definitional threshold of a market correction, typically 10-20%. This was caused by fears concerning the outbreak of Ebola and the lack of readiness apparent within both the Center for Disease Control and the hospitals receiving patients. The equity market bounced back when it became evident that the Ebola virus could be contained.

November brought an election outcome that was consistent with historic trends during the sixth year of a presidential term. However, the magnitude of the shift from Democratic to Republican office holders was of epic proportions. This shift was manifested at all levels of government from Federal through State and even to local elections. The equity markets rose after the election, however this was much more a result of the upward revision to third quarter GDP growth, at 5.1%, the highest quarterly growth in more than ten years, than it was to this political shift.

December saw a decline in energy prices turn into a precipitous drop that was down more than 40% from mid-year levels. Initially, economists and market analysts applauded the decline as the equivalent of a tax break for motorists and anticipated a boost to Holiday spending as a result. That optimistic view turned to concern as the decline in energy prices accelerated late in December and equity markets pulled back from their highs earlier in the month.

In summary, equity markets were more volatile in the fourth quarter than in any other calendar quarter this year. After all the gyrations up and down, the various segments of the U.S. equity market all turned in similar, generally good results. The Dow Jones Average was up 4.7%, the S&P500 was up 4.3%, the NASDAQ was up 5.4%, a Vanguard Mid-Cap index fund was up 5.4% and a Vanguard Small Cap index fund was up 5.5%.

Fixed Income markets were unaffected by the ending of the Federal Reserve's Quantitative Easing (bond buying) program in October. Investment yields on 10 year US Treasury Notes actually declined during the fourth quarter and full year returns were the best for this bond in at least several years.

Strong economic growth, low interest rates, and declining inflation all combined to display the strength of the U.S. economy in the fourth quarter. Currency markets reacted by revaluing the dollar upwards against virtually all other currencies.

Meanwhile, international equity markets continued to struggle. The Morgan Stanley Capital Index of Developed Markets declined by 4.2% during the quarter while an index of emerging markets declined by 2.8%. The worldwide drop in oil prices had a great impact on the economies of oil producing nations. Russia and Venezuela were among those most affected because of their heavy reliance on oil exporting revenues. Equity markets in India rose with the election of the new Prime Minister, Narendra Modi, a pro-growth leader. In contrast, the re-election in Brazil of President Dilma Rousseff, a Socialist, signaled continued disappointing prospects for economic growth. Predictably, equity markets declined after her narrow victory.

2014 marks the sixth consecutive year of positive returns for the S&P 500. Some market commentators are expressing concern that this pattern reminds them of the late 90s Tech Boom. However, our view is that valuations are far more reasonable today than they were in the 90s, and with low interest rates, there is room for further appreciation in 2015.

Raymond A. Beplat, CFA
Chief Investment Officer