

From the desk of:

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## Financial Market Commentary: 1st Quarter 2015

### *International Equity in Developed Countries & Mid Caps Lead the Way*

Global equity markets are generally off to a solid start in 2015, with U.S. and international stocks turning in gains. Fixed income markets are also in positive territory for the quarter, and the U.S. dollar remains very strong relative to most currencies. All in all, it's been a fairly quiet period for the markets, with little in the way of upsetting news to damage the landscape.

Oil prices, which dropped precipitously in 2014 to about \$60 per barrel for Brent crude<sup>1</sup>, have continued to slide. Perhaps the bigger story in economic circles was the strengthening U.S. dollar. Both the Euro and the Japanese Yen lost 12 percent relative to the dollar last year, while the British Pound lost nearly 6 percent. That trend has largely continued this year.<sup>2</sup>

### *The Dollar and Your Investments*

The impact of the dollar's rise has implications for U.S. investors - and not just those planning a trip overseas. U.S. investors in a globally diversified portfolio are subject to what amounts to two different returns on their international holdings: a local currency return on the assets and a U.S. dollar return on the local currency. Consider a U.S. investor holding stock in a British firm. The investor must, in effect, convert his dollars to pounds today, purchase the stock and then, when he sells it, convert the pounds he has earned back to dollars. Thus, his total return reflects the return the stock made over the time he held it, but also, the change in the value of the dollar relative to the pound over that time.

If the dollar has strengthened relative to the pound, the pounds he earned will be worth fewer dollars when he cashes in. In other words, as the dollar rises, returns on foreign investments for a U.S. investor will be harmed. If only investors were better at predicting currency movements than they are at predicting stock movements, we could seek to profit from this!

### *The Dollar and Interest Rates*

The state of the strong dollar is at least one factor that argues in favor of slower interest rate increases by the Federal Reserve, as a strong dollar implies less concern over low interest rates driving inflationary price increases. Be that as it may, the Fed has certainly signaled that a rate hike in short-term interest rates is inevitable. The Federal Open Market Committee sets the Fed Funds rate, which is the interest rate that reflects how much banks pay to borrow from each other overnight.

Such is the state of our scrutiny of Fed comments that markets began to reflect uneasiness at the mere suggestion that the Fed intended to drop a line from its quarterly interest rate guidance indicating that it would be "patient" about future rate increases<sup>3</sup>. When the FOMC comments did come out, that word did not appear, and the Fed said that it might raise the rates as early as June. But Fed Chairwoman Janet Yellen noted at a press conference that "Just because we removed the word patient from the statement doesn't mean we're going to be impatient."<sup>4</sup> What markets make of this sparkling clarity remains to be seen.

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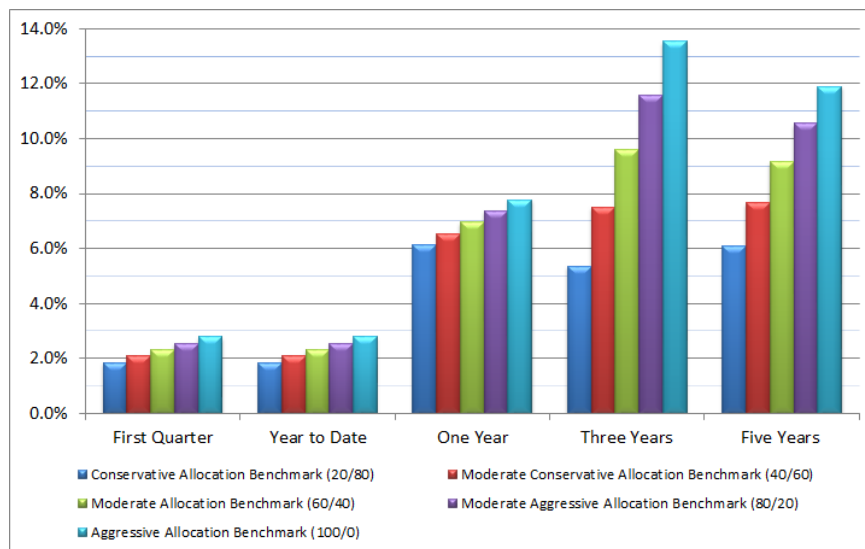
## Diversification Wins

We would be the last to say that a quarter's worth of data is worth a dime, but we would also probably be remiss not to point out that international developed markets are up more than double their U.S. large stock counterparts year-to-date (this return includes currency translation)<sup>5</sup>. Why does this matter? It doesn't, unless you are an investor whose inclination at the close of calendar year 2014 was to realign your portfolio based on the previous year's performance. Last year saw U.S. large cap stocks trounce other equity asset classes. Had you taken it as a signal to shift assets toward U.S. large holdings, you would have missed out on the better performance now occurring elsewhere. The same could be said of the split within the U.S. market between large and small firms. The winds were more favorable for large companies last year, but this year, smaller firms are off to a better start.

## In Focus

If you ever find yourself contemplating a market chasing move - such as jumping on an asset class that has recently performed well - remind yourself that the information content related to recent returns is already baked into current prices. Knowing ahead of time that the S&P 500 would do well in 2014 would have been great. Knowing now puts you in the same boat as everyone else. Long-run capital market returns reflect the short-term impulses of their constituent individual markets. We believe your long-run odds of success are bettered when you do not get sidetracked by these respective ups and downs.

## Benchmark Performance



<sup>1</sup> Plumer, Brad. "Why oil prices keep falling—and throwing the world into turmoil." *www.vox.com*, Dec. 18, 2014.

<sup>2</sup> According to Yahoo Finance

<sup>3</sup> Hilsenrath, Jon. "Fed to Markets: No More Promises." *The Wall Street Journal*. March 17, 2015.

<sup>4</sup> Appelbaum, Binyamin. "Fed Signals It May Increase Rates by Midyear." *The New York Times*. March 18, 2015.

<sup>5</sup> According to Morningstar and based on the S&P 500 and MSCI EAFE GR indexes as of March 31, 2015

Certain sections of this commentary may contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets.

The performance quoted represents past performance and does not guarantee future results. Investing involves risk including loss of principle. No investment strategy such as asset allocation or diversification can guarantee a profit or protect against loss in periods of declining values. Index returns are for illustrative purposes only and do not represent actual account performance. Indexes are unmanaged and one cannot invest directly in an index. Index performance returns do not reflect any management fees, transaction costs or expenses. The Internal Rate of Return (IRR) is used to calculate the true, money-weighted rate of return. Like the Modified Dietz calculation, the portfolio or asset is valued at the starting and ending points of the period. Cash flows are based on their timing. The IRR is related to the time-value of money or present value formula. It calculates the discount rate which will take the starting value and all cash flows to result in the ending market value. Performance returns for time periods longer than 365 days have been annualized.

Conservative Allocation Benchmark (20/80) is comprised of 10% S&P 500, 2% S&P MidCap 400, 1% S&P 600, 6% MSCI Developed EAFE (TRN), 1% MSCI Emerging Markets (TRG), 80% Barclays U.S. Aggregate Bond.

Moderate Conservative Allocation Benchmark (40/60) is comprised of 20% S&P 500, 4% S&P MidCap 400, 2% S&P 600, 12% MSCI Developed EAFE (TRN), 2% MSCI Emerging Markets (TRG), 60% Barclays U.S. Aggregate Bond.

Moderate Allocation Benchmark (60/40) is comprised of 30% S&P 500, 6% S&P MidCap 400, 3% S&P 600, 18% MSCI Developed EAFE (TRN), 3% MSCI Emerging Markets (TRG), 40% Barclays U.S. Aggregate Bond.

Moderate Aggressive Allocation Benchmark (80/20) is comprised of 40% S&P 500, 8% S&P MidCap 400, 4% S&P 600, 24% MSCI Developed EAFE (TRN), 4% MSCI Emerging Markets (TRG), 20% Barclays U.S. Aggregate Bond.

Aggressive Allocation Benchmark (100/0) is comprised of 50% S&P 500, 10% S&P MidCap 400, 5% S&P 600, 30% MSCI Developed EAFE (TRN), 5% MSCI Emerging Markets (TRG).