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# Financial Market Commentary: 2nd Quarter 2015

## *International Developed Stocks Lead the Way*

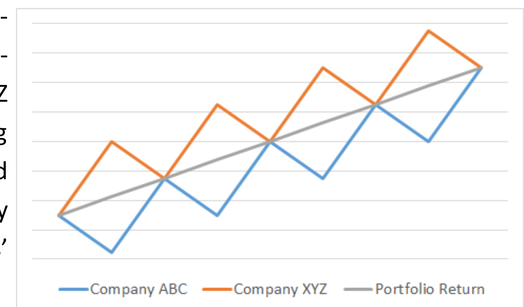
A question that I am often confronted with, especially over the past year, is whether or not to "stay the course" and remain diversified with investments in international markets. After all, entire countries remain on life support (Greece), and many others may be headed down a similar path (Spain, Italy, Portugal). Not to mention that if the value of U.S. dollar continues to rise, returns for on international investments for U.S. investors may be harmed (see Q1 Market Commentary). Moreover, groups such as ISIS continue to plague the world with instability and turmoil, especially areas in the middle east.

Why do we stay the course? Depending upon what market guru you listen to, international securities have similar long-term *expected* returns compared to their U.S. counterparts, and have also had similar *historical* returns. Unfortunately, as the past five years have taught us, those two markets do not move in perfect tandem as international markets have markedly trailed domestic markets. In investment terms, we would call this relationship "correlated" (as both markets have risen), but not perfectly correlated (as their returns have been different).

## *Playing the Averages*

"Mean reversion" is a theory that suggests prices and returns eventually move back towards their mean or average.[1] The theory suggests that investors should purchase securities whose recent performance have greatly underperformed relative to their historical averages and vise versa. Furthermore, by owning two securities that have had similar historical averages *but are not perfectly correlated*, investors can reduce their risk while still enjoying returns close to the two securities' historical returns.

Take for example two theoretical companies: ABC and XYZ. Each company has identical long-term returns as illustrated in the graph. However, each company experiences "good" periods at different intervals. During the first period, Company XYZ *outperformed* Company ABC, and subsequently *underperformed* in the following period. Ultimately, by owning both securities in equal portions, an investor could reduce their overall portfolio's risk as the combined portfolio experiences steady returns. While the combined portfolio achieves the same return as each securities' return, the portfolio achieves superior *risk-adjusted* returns.




## *Equities Continue to March Forward; Bonds Struggle*

International developed markets continued to lead the way for equity markets in the second quarter, building on an already impressive lead. Year-to-date, the MSCI EAFE Index (representing international stocks) has returned 5.52%. Meanwhile, the widely followed S&P 500 Index has returned 1.23% this year, while the Dow Jones Industrial Average is up a mere 0.03% for the year.[2]

Bonds, on the other hand, charted their worst return in recent years as the prospect of the Federal Open Market Committee's first rate hike in nine years hurt fixed income markets. Even though the Barclays Aggregate Bond Index lost 1.68% during the second quarter (it's worst quarter since the second quarter of 2013) it is only down 0.10% Year-to-date and is up 3.94% over the past twelve months.[2] As noted financial journalist Alan Roth suggests, "Stocks are riskier in a day than high-quality bonds are in a year."[3] In other words, even though the performance in fixed income markets have struggled lately, stocks have historically presented investors with much more downside risk over short periods than bonds have.

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## In Focus

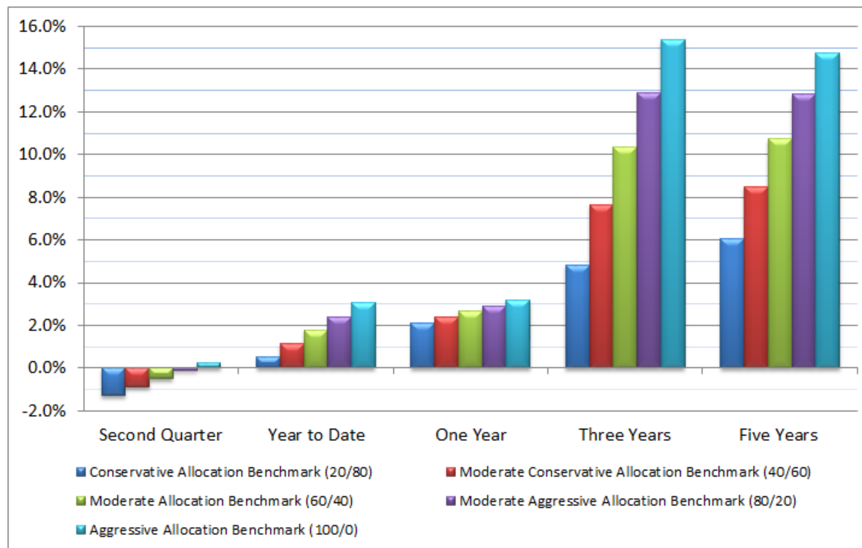
Markets can bewilder. In the wake of potentially bad news, international markets continue to shine while, as the U.S. economy appears to be improving, U.S. markets have only produced modest returns. Bonds, which have historically been an asset class that preserves capital, produced negative returns through the second quarter. Mean reversion may explain some of the market's unpredictability, as asset classes that have been out favor come back into favor. Ultimately, without risk associated with investing your capital, you can not expect to earn higher long-term returns than on "risk-free" assets classes such as cash. Let us help you identify a level of risk that you can tolerate through all market cycles to get the most out of your money over the long-term.

## Five Points Financial Services welcomes John Posey

I would also like to welcome and introduce John Posey as Five Points Financial Services newest financial advisor. John joins us with a wealth of experience as having served as a financial planner at a local accounting firm in Grand Island for the past 7 years, and has more than 10 years of experience in the financial services industry.

John holds both the CERTIFIED FINANCIAL PLANNER™ designation and the Accredited Investment Fiduciary Designation. He is also a member of the Financial Planning Association of Nebraska. John and his wife, Krystal, live in Doniphan and have three children. John is eager to help serve our existing clients and is currently accepting new clients.

## Benchmark Performance




[1] Mean Reversion Definition | Investopedia. (2003, November 24). Retrieved July 14, 2015, from http://www.investopedia.com/terms/m/meanreversion.asp
[2] *According to Morningstar and based on the S&P 500 TR, Dow Jones Industrial 30 TR and MSCI EAFE NR indexes as of June 30, 2015*
[3] Roth, A. (2015, March 25). Allan Roth: Sophisticated Fear And Greed. Retrieved July 14, 2015, from http://www.etf.com/sections/index-investor-corner/21614.html

*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).*