viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

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# Resilient Markets?

Last year, most U.S. equity markets posted double-digit gains. Of course, with the current bull market now in its 5th year, this was cause for a number of talking heads to predict a 10%+ correction for the first quarter of 2014. While the markets did see considerable volatility, the quarter finished with small gains for domestic stocks and small losses for international equity markets.

One asset class that did exceptionally well during the past quarter was U.S. real-estate. The NARIET Index, composed of publicly traded U.S. Real-estate Investment Trusts, ended up nearly 8% for quarter - a glowing example of why portfolio diversification and active asset allocation (i.e. trimming big winners and redeploying those proceeds to trailing class assets) can often contribute meaningful long-term portfolio returns.

U.S and international news stories gave the markets more than enough excuses to retreat, make investor nervous and prove the talking heads correct. If you listened to the news and did not look at your portfolio, you would assume markets went down this quarter.

In the U.S., we had our retails sales figures coming in lower than expected causing investors to worry that the economy was starting to slow.

After her first Federal Reserve meeting as Chairman, Janet Yellen gave her first news conference. As the major force behind the Feds increased transparency, it was expected that she would shed light on when they would start raising the Fed funds rate. Previously, Ben Bernanke had promised the Federal Reserve would hold rates below 0.25% until unemployment fell below 6.5%. With unemployment now at 6.7%, Janet Yellen changed the guidance of Bernanke to “Future rate rises will be assessed using a range of economic data, with no single target”. Markets love clarity - especially when it comes to interest rates. This guidance caused jitters, not just in the U.S markets, but also the emerging markets, who were hit hard because of the affect rising interest rates will have on the U.S. dollar.

Malaysia Airline Flight 370 disappearing without a trace did nothing to calm the U.S and international markets. Memories of 9/11 came back when it was reported that two individuals on the plane were traveling on stolen passports. Every day it seemed like there was another theory about the whereabouts of the plane and the sinister plots behind its disappearance.

If that was not enough, the possibility of war between the Ukraine and Russia over the fate of Crimea should have forced the market down. Even though war was averted, the annexation of Crimea will have a long term impact economically amid the worry that Russia becomes more aggressive in adding territory.

Given all of the worrisome news and the expectations that markets would pullback, we did see a number of negative days in the markets during the quarter. To the surprise of the talking heads, whenever the market did go down, money came back in, driving it right back up. It was a classic “buy on the dip market”. The reason for the equity markets resilience is that they are not overvalued. Nor are they undervalued. For example, the S&P500 is trading for 16 times earnings. Which is close to the average over the last 30 years. The all-time high was 31 in 2000 at the top of the internet bubble. The low was 9 in 2009 at the depths of the financial crisis. With the market being fairly valued investors are taking advantage of pull backs to put money that is on the sidelines to work.

This strategy is exactly what we did in our portfolios. On the equity side of our portfolios, we followed our strict disciplines and sold companies or asset classes that had become over-weighted. When the markets pulled back, we used some of the cash in our accounts to purchase companies or asset classes that were under-weighted in our portfolios. For the fixed income portion of our portfolios, we have continued to replace maturing bonds with short term maturities so that we will be able to take advantage of rising interest rates that we feel we will see over the next year.

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