viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

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Who Would Have Guessed?

2013 was a great year for U.S. stock markets with most major equity indexes up double digits. Five years ago, who would have thought we would be where we are today?

Back in 2008, it seemed like everywhere you turned, another crisis was predicted to bring the U.S. economy to a grinding halt. By the end of the year, Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke had become television staples with regular updates on both the problems and their possible solutions.

As predicted, the U.S. economy began to unravel after experiencing a liquidity crisis brought on by massive subprime mortgage and structured investment failures.

The real-estate market collapsed along with many of the banks that had been lending money to individuals who had little or no ability to repay. Over the next three years, the Federal Deposit Insurance Corporation (FDIC) closed 465 failed banks.

The carnage left Lehman Brothers, previously, the fourth largest U.S. investment bank, out of business. With the assistance of the Federal government, the very same liquidity issues forced many financial institutions such as Washington Mutual, Bear Stearns, and Merrill Lynch into mergers with better capitalized competitors.

By the end of 2008, the Federal government had organized a much needed financial safety net in the form of direct ownership and capital infusions through their $700 billion Troubled Asset Relief Program (TARP). Nearly twenty major US financial and manufacturing companies participated in the program.

Tax incentives were put in place to help both corporations and individuals. The Federal Reserve provided further relief by taking actions to reduce borrowing costs to near zero.

Historically, the S&P 500 does not have many 5-year periods with negative returns. By the end of 2008, however, the index was down nearly 40% with a 5-year annualized rate of return at -2.2%.

To add insult to injury, the U.S. economy lost nearly 9 million jobs with the unemployment rate rising from 5% at the beginning of 2008 to 10% before the end of 2009. Things were looking pretty bleak five years ago.

Fast forward 5 years and you see a very different picture. Most of the companies that needed assistance from TARP have paid it back. The government has divested most of the securities it purchased from companies. Banks are getting stronger and are back to lending to qualified applicants. Home builders are well on their way to recovery and real-estate prices are moving back up. Unemployment is falling and the economy is growing.

In fact, the Federal Reserve currently believes the economy is showing sufficient sustainable growth to begin slowing down its bond buying program that has been keeping interest rates low.

As the economy has recovered, so have corporate earnings. So much so that the average company in the S&P 500 had record earnings this year. With rising earnings, comes higher stock prices - in many cases, record prices. Every major U.S. stock market index has set a new all-time high in 2013.

Corporate earnings are projected to continue to grow 8% next year and our portfolios are projected to grow earnings at 12- 15%. With the average U.S company also fairly valued, the stock market is likely to continue its advance in 2014. This is not to say it will go up anywhere as much as it did in 2013 or that there will not be bumps along the way. But, our feeling is the S&P 500 will end 2014 up between 8-10% barring any unforeseen event. Outside the U.S., the recovery for most economies is lagging; however, we feel confident many regions will do as well - if not better - than the U.S over the next few years.

Marshall & Sullivan thinks that interest rates will continue to rise as the economy recovers. With this in mind, we expect to continue to avoid bonds with longer maturities in our balanced accounts so we have bonds maturing to take advantage of the higher rates when they do appear.

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