Q2

Apr - Jun 2014

QUARTERLY ECONOMIC NEWS

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GDP (lagging indicator)

Q1, 2014 (Third Estimate)
Decreased at annual rate of 2.9%. Sharpest contraction since end of recession.

EXISTING HOME SALES

Thru May 2014
Up 4.9% from previous month. Highest monthly rise since August 2011.

UNEMPLOYMENT RATE

Thru June 2014
6.1% down from 7.5% in June 2013.

CONSUMER PRICE INDEX

May 2014
Up 0.4% for May 2014. 2.1% total increase over the last 12 months (not seasonally adjusted).

Economic News

The second quarter of 2014 showed positive movement for the economy. Unofficial GDP projections for Q2 are upbeat despite a sharp decline in Q1 (official "advance estimate" will be released on July 30). Markets continue to be bullish as we enter the second half of the year with the S&P climbing 4.70% in Q2 for a total increase of 6.05% YTD. The NASDAQ gained 4.99% and the Dow Jones Industrial Average was up 2.24%. Data released by the Department of Labor on July 3 indicated that unemployment fell to 6.1% in the month of June. While the rate of people looking for work was down, the debate over unemployment insurance continued between Democrats and Republicans. Conservatives claim that a failure to renew the benefits was the driving force behind unemployment falling to its lowest level in six years while liberals feel that job growth has prevailed in spite of limited benefits. With economic growth seemingly up and unemployment levels continuing to drop, many have been looking to the Federal Reserve (Fed) for a sign that interest rates may soon rise. In true Fed fashion, Janet Yellen is yielding little in regard to plans for raising rates. Her recent comments have outlined a reluctance to govern financial markets with monetary policy and instead encourage a regulatory or supervisory approach. Furthermore, while the Fed curtails bond buying from $85 billion per month to $35 billion per month starting in July, the reinvestment of proceeds from maturing securities continues to maintain the size of its holdings, mitigating the reduction by some $16 billion per month. Ending reinvestment could tip the Fed's hand as to when rates will begin to rise, as well as feed some analysts' fears that the act of bond buying—and not the size of the Fed's portfolio—is providing a boost to the economy. It will be important to monitor key economic indicators and any changes in Fed policy over the latter half of the year.

Index	2nd Qtr	1 Year	5 Year	10 Year
S&P 500 (Composite Price Index)	4.70%	22.04%	16.35%	5.56%
Russell 2000	2.05%	23.64%	20.21%	8.70%
MSCI EAFE (Price)	2.95%	20.33%	8.57%	4.03%
Barclays Aggregate Price Index	-0.18%	0.41%	1.00%	0.53%

The S&P 500 is a commonly used measure of common stock total return performance, the Russell 2000 is a commonly used measure of small capitalization stocks, the MSCI EAFE is a commonly used measure of common stock total return performance of international markets, and the Barclay's Aggregate Bond Index is a commonly used measure of the bond market. All referenced indices are unmanaged and not available for direct investment. Past performance is not a guarantee of future results.

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“Successful investing is anticipating the anticipations of others.”

John Maynard Keynes

GDP Plunge

The Bureau of Economic Analysis’ (BEA) assessment of GDP for Q1 2014 went from bad to worse over the course of Q2. While the BEA’s first two estimates indicated output had declined slightly in Q1, the third estimate released on June 25 reported that output dropped at an annual rate of 2.9%, the economy’s worst performance in five years. The decline is much steeper than most forecasters had predicted—this drop sharply contrasts the 3.4% annual growth rate the U.S. experienced in the latter half of 2013. Both the BEA and the White House attribute the decline to decreased inventory investment, as well as weak exports paired with increased imports. Some economists suggest that these volatile ingredients of GDP may have been impacted by severe winter weather that affected much of the nation during the first quarter. The weather also likely played a role in the first decline in four years in consumer spending on food services and accommodations, as many consumers preferred to stay indoors rather than face the harsh winter conditions.

Although GDP estimates reflect an overall decrease in output, increases were reported in certain independently calculated benchmarks that historically match GDP, suggesting the Q1 estimate was a historical anomaly. Despite the dismal first quarter growth rate, most economists are positive about the outlook ahead. Much of the data reported during the second quarter suggests activity is rebounding: existing homes sales are up, manufacturing is up, and the labor market continues to improve.

Capturing the Momentum

There has been much talk recently about “momentum investing” which is a strategy to capitalize on the continuance of existing trends in the market. Momentum investing involves buying stocks or other securities with consistently high historical returns over the previous three to twelve months, and selling those that have had poor returns over the same period. The general tenet is “Winners tend to keep winning and losers tend to keep losing.” After a period of volatility early in the second quarter, these strategies seem to have cooled off.

Activity in sectors such as technology, internet stocks, and biotechnology surged in recent months as investors flocked to high-flying “momentum stocks,” but the tides turned quickly. Concerns over violence in Ukraine, as well as ongoing anxieties about the economic recovery brought some market leaders (Netflix, Facebook, Amazon, TripAdvisor, etc.) back down to earth, dragging the broader market down with them. A number of momentum stocks fell nearly 20% from their highs for the year, but most recovered some or all of their losses as the second quarter wrapped up. At its low point in Q2, the S&P 500 fell nearly 3.5% from its high for the year, the NASDAQ fell over 8% and the Russell 2000 fell nearly 10%.

As the market leaders tumbled, other areas of the market gained. Defensive sectors of the market that had recently been viewed as market laggards, such as utilities and consumer staples, held steady or moved higher.

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