Azimuth Financial Planning – Market Commentary October 2014

Dear Client,

I recently attended the National Association of Personal Financial Advisors annual conference in Charlotte, NC. With the recent volatility in the markets, October 15th might has been the climax with a 500 point swing in the Dow, much of the economic discussion at the conference revolved around this topic. Questions such as are the severe swings in the market an indication of a bear market, usually defined as a 20% or more drop, or a simple correction, defined as 10% drop? Or was it a sign of the usual October mood swings that consistently occur almost every year? Or perhaps it was only a temporary blip in the long-term bull market?

Based on this uncertainty I thought the view of two investment professionals that made presentations at the NAPFA conference might lend some perspective to the recent market turmoil. Each one represents an opposing viewpoint of the market; one bullish, one quite bearish. Frankly you can find about the same number of people on each side of the argument on whether the market is over or under valued. If economic viewpoints and statistics are not your cup of tea please skip to the end of the article where I lay out some historical worst case scenarios for a few model portfolios; please consider this in the context of your specific situation and contact me if you have concerns.

The bull point of view is represented by Bob Doll of Nuveen Investment, some of the factors that Mr. Doll cited as backing his bullish stock market sentiment:

- U.S. employment is at all-time high – we have experienced the longest 200,000+ monthly job additions in 17 years.
- Housing starts recovering, but still far from normal and debt payments as a percent of disposable personal income is at an all time low.
- Corporate perspective -balance sheets in great shape, income statements free cash flow and the level of profitability are ramping up. S&P 500 earnings growth is accelerating. Frankly corporations have plenty of cash to invest or return to shareholders.
- The U.S. is producing more energy and importing less; the country is experiencing an energy renaissance which lowers consumer and business energy costs. Low energy costs lowers inflation and promotes manufacturing competitiveness, thereby increases jobs directly and indirectly. The energy revolution also improves national security.
- U.S. Manufacturing Renaissance - wage rate differentials between countries is disappearing. For example emerging markets have experienced wage rate increases (Brazil +8.3% annually for 15 years). U.S. manufacturing wage rates have been flat or decreasing, and abundant cheap natural gas, relatively speaking

compared to Europe help to increase the desire, willingness to do business in the U.S.

- As a result manufacturing employment is growing, fastest in 30 years.
- Potential Productivity Boosters – What is the next BIG thing?
    - U.S. energy will continue to positively impact the U.S economy.
    - Smart manufacturing and 3D printing.
    - "Cloud" (big data) computing.
    - Quantum computing.
    - Robotics.
    - Health care advances.
    - All areas where the U.S. excels.
- Washington D.C. will be benign for stock prices – the midterm elections will potentially provide a market boost. In midterm election years September-October have always been bad months for the U.S. stock market, post-election markets have increase 16% in all of the past 12 midterm elections. However, factors from possible election runoffs/recounts to problems overseas could cause the rally to be more muted than in the past.

Bob Doll's negative market factors are:

- Real wages stagnant – wages after inflation for many have been flat for decades, this can lead to reduced consumer spending potential unrest.
- Geopolitical hotspots – Ukraine, Mid-East are unpredictable and could be a market unknown.
- Deleveraging continues – countries and some industries continue to pay down debt which is a damper on growth, primarily an issue in the EU.

The bear market point of view is represented by David Wright, portfolio manager for Sierra Investment management, who believes the stock market is in for a long bear market period.

- Stock prices have been artificially inflated by U.S. Fed's massive Quantitative Easing program; basically QE has kept interest rates low. QE is coming to an end which will focus the market on fundamentals of U.S. economy, some of which are concerning.
- A months long deterioration in economic data from Europe and China has resulted in significant risk to U.S. companies' earnings.
- The ominous downtrends in commodity prices might indicate a deflationary trend. There are concerns that the EU will be in 'deflationary' period; the results are long periods of slow growth due to delayed consumer spending, slow corporate investment.

- The top 10% of U.S. population have recovered very well in incomes, purchasing power and net-worth; the other 90% have had no recovery.
- Most of the job recovery has been in part-time and low income jobs; the U.S. economy is creating a lot of 'McJobs'.
- Over 50% of Americans tell pollsters they feel the U.S. is still in a recession.
- Social welfare programs are expanding rapidly, food stamp enrollment is at an all time high.
- At the same time luxury auto manufacturers such as BMW, Mercedes, Maserati, Porshe, Rolls-Royce hit record sales in 2013.
- Disposable incomes for many are still near 34 year lows and with working hours under pressure people are spending less.

Again the points above are their views not mine, but I think they present an interesting juxtaposition that illustrate the dangers and difficulty that exist in trying to time the market. Each has a valid point that seems credible, so it is almost a coin toss as to whether one should take action in one way or another.

I fall somewhere in between, not a bull, nor a bear, think the fundamentals are okay, but believe that the current market is tired after a 5 year run, and markets never run straight up; we are due for at least a correction, and perhaps something more severe.

Therefore, I ask you to consider the following recent history:

An aggressive 80% stock-20% bond portfolio was down -42% between 3/08-2/09 the worst period of the most recent bear market. For the 2008 calendar year the portfolio was down -33%; however, for 2009 if one held onto the portfolio is was up 33%.

A balanced 60% stock-40% bond portfolio was down -32% between 3/08-2/09. For the 2008 calendar year the portfolio was down -25%; however, for 2009 if one held onto the portfolio is was up 26%.

A conservative 40% stock-60% bond portfolio was down -22% between 3/08-2/09. For the 2008 calendar year the portfolio was down -15%; however, for 2009 if one held onto the portfolio is was up 17%.

The reason I bring this up now, and during meetings all the time, is I find when markets are climbing people tend to have a higher risk tolerance; but when market turn that tolerance changes. Which helps to explain why most U.S. stock investors under-perform the S&P 500 by about 4%-6%; they buy high-sell low.

Part of my job is to help you avoid this tendency; therefore, if you have any concerns with the above numbers let's talk. There is nothing problematic in moving to a more conservative position now if it helps you sleep at night; there is a problem if you do it in a market like we experienced in February of 2009 which was the very bottom.

In the meantime, I am continuously surveying the investment market for alternative investments that serve to diversify the stock, and bond portions of the portfolio. However, it is difficult finding reasonable solutions that are not over priced and not a 'black-box' solution that is hard to understand. As I perform the due diligence and if I find suitable solutions I will bring them forward for your consideration if they fit with your circumstances, until then please call me to discuss any of you concerns.

Sincerely,

Bill Simpson, CFP®, MBA
Azimuth Financial Planning, LLC
(603) 373-8793
bsimpson@azimuthplanning.com
www.azimuthplanning.com