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QUARTERLY ECONOMIC NEWS

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Economic News

2014 marked the third year in a row where the S&P 500 and NASDAQ experienced gains; however, these advances were more tenuous than in previous years. US GDP growth, continued quantitative easing and steady job growth helped fuel gains. On the other hand, domestic and international issues led to greater stock market volatility, including the first 10% correction in 3 years. Worries over the Ebola crisis, turmoil in Ukraine, ISIS, plummeting oil prices, and interest rate uncertainty led to market jitters at various points throughout the year.

Despite moments of investor anxiety, 2014 proved to be a solid year for the equity and fixed income markets. The S&P 500 finished the year up 11.39%, and the NASDAQ finished up 13.40%. In addition to the strong returns in equity markets, the bond market posted a healthier performance than most analysts had estimated. With the Federal Reserve vowing to keep interest rates low, the benchmark 10-year Treasury finished the year with a yield of 2.17%, a drop from 3.03% at the end of 2013 but still better than expected. The fixed income markets could garner more attention in 2015 as the Federal Reserve evaluates whether to start raising short-term interest rates.

Sector performance varied widely in 2014, the best being utilities and healthcare with returns of 26% and 25% respectively. The telecom and energy sectors posted the worst performance, returning losses of 1% and 10% respectively.

The following table highlights the average annual returns for various indices:

Index	4th Qtr	1 Year	5 Year	10 Year
S&P 500 (Composite Price Index)	4.39%	11.39%	13.05%	5.44%
Russell 2000	9.73%	4.90%	15.55%	7.77%
MSCI EAFE (Price)	-3.86%	-7.35%	2.34%	1.59%
Barclays Aggregate Price Index	0.78%	0.96%	0.64%	0.36%

Russia on the Radar

With the international spotlight on Russia's foreign policy as 2014 drew to a close, the status of the Kremlin's energy export economy bears monitoring as we move into the new year. Russian government officials are projecting a 0.8% decline in GDP for 2015, which would be the first decline in Russian GDP since October 2009. Tempered expectations relate to the depressed price of oil, prompted in part by a historically strong output from the US. Furthermore, OPEC's resistance to paring back production fueled a futures drop of nearly 50% on the year. With energy accounting for 25% of Russian GDP, according to the OECD chief economist Catherine Mann, depressed prices per barrel (hovering between $50 and $60 of late) have dampened the economic outlook.

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GDP (lagging indicator)

Q3, 2014 (Third Estimate)
Increased at annual rate of 5.0%
Boosted by increase in consumer and government spending.

EXISTING HOME SALES

Thru November 2014
Down 6.1% from October 2014, but up 2.1% from November 2013.

UNEMPLOYMENT RATE

Thru December 2014
Declined to 5.6% (seasonally adjusted).

CONSUMER PRICE INDEX

November 2014
Down 0.3% for November 2014 (seasonally adjusted). Sharp decline in gasoline index was the main cause.

"In investing, what is comfortable is rarely profitable."

Robert Arnott

The Bank of Russia has said GDP could contract by as much as 5% if oil remains around or below $60 per barrel. As a result of the bleak outlook on Russia's all-important energy sector, many investors are abandoning the ruble, compounding existing economic issues. On December 15, sagging currency values and foreign currency reserves reached a 5-year low, prompting the central bank to raise interest rates a staggering 6.5% overnight in an effort to combat the depreciation of the ruble. With inflation soaring to a 3-year high, and the ruble having lost nearly half its value against the dollar, the S&P rating service hinted that Russia risks losing its investment-grade rating. While the ruble rallied somewhat toward the end of the year, the central bank risks higher inflation and serious long-term economic effects with an extended period of 17% interest rates. Between Western sanctions, the crisis in Ukraine, and economic hurdles at the end of the year, Russia will no doubt be happy to put 2014 behind it.

Inflation - Too Much or Not Enough?

In an effort to curb the ballooning unemployment rate in the second half of 2008, the Federal Reserve began slashing the federal funds rate to lower the cost of borrowing, spur consumer spending, and consequently increase hiring. By the end of 2008, the federal funds rate stood at 0.16%—down from 3.94% in January 2008—and a game of cat and mouse ensued between the Federal Reserve and the world at large. Suggestions of a rate increase continue to be met with fear of increased unemployment, while suggestions that it may be lowered further, or even held at current levels, are met with cries of impending inflation. The federal funds rate stood at 0.09% early in the fourth quarter of 2014 despite an improving labor market (the unemployment rate dipped below 6.0% for the first time since the recession of 2008). While Fed Chair Janet Yellen has indicated that the federal funds rate will go up in the foreseeable future, caution still seemed to rule in December as the federal funds rate rose only as high as 0.13% before closing out the year at 0.06%.

If imitation is the highest form of flattery, the Federal Reserve should feel good about its global perception: the European Central Bank has been particularly interested in mimicking the US' interest-rate-cutting approach. There is concern about the globalization of this trend, and many fear that lowering interest rates too much ultimately dissuades would-be lenders from offering new loans. As we go forward in 2015, it will be worth keeping an eye on which nations implement this type of deflationary monetary policy.

The S&P 500 is a commonly used measure of common stock 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 Barclays Aggregate Price 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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