Executive Economic Outlook And Summary

Fall/Winter 2014/2015

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Stay the course. That's Multop Financial's official statement for the next six months. Since our last Economic Outlook (published in May 2014) it has been our position that stocks would ultimately end higher in 2014 but investors should not expect the same returns as 2013. So far, our forecast is accurate.

While the majority of economic indicators still remains positive, we have seen the rate of economic growth begin to lose steam. This does not mean the economy is contracting; it means the economy is still growing, just at a slower rate than before. For stocks this type of situation can cause brief periods of increased volatility as market valuations adjust to the lower growth rates. The current bull market has been reconfirmed according to the Dow Theory, but we are cautioning clients that we may experience some "choppy waters" over the next six to 12 months since the broad market has not made any significant headway since July.

Many ask, "Why are US stocks at near all-time highs despite turmoil in the Middle East & Ukraine, sluggish growth in Europe and China and expectations that the Federal Reserve will begin raising US short-term interest rates in 2015?" The simple answer is this: US corporate earnings are up and bond yields are down. If you think corporate earnings are headed lower because the current record profits are set to recede, or because the world is falling apart at the seams, you can make the case that the market is "overvalued." But, if you think profits are headed higher over the next 10 years, then the overvalued argument is hard to support - unless you believe inflation and interest rates are going to move sharply higher.

In fairly loud fashion, the Federal Reserve has signaled it will begin to raise interest rates some time in 2015. The exact time of the raise is yet to be determined but as of the publication of this article it appears to be around June or July of 2015. While there's little room for debate about Federal rate increases, what can be debated is how this will impact overall interest rates in our economy. The Federal Reserve only controls interest rates of the shortest loans made, literally overnight in some cases, and this rate subsequently influences the rest of the interest rate market. Since US Government Bonds are still considered to be safer than say Germany or France's bonds it is likely the demand for US Treasury Bonds will remain fairly constant. This means that when the Federal Reserve does begin to increase interest rates, it will have little effect on mid-term & long-term bond interest rates. This isn't bad news for stocks. The general consensus for the last couple years has been that when the Federal Reserve begins to raise interest rates it will hurt the stock market, but it is appearing <u>not</u> to be the case.

Here are a few economic figures we believe are worth noticing:

- **The S&P/Case-Shiller Index** reported in June that home prices continue to rise.
- **The Conference Board Consumer Confidence Index ®** has been increasing over the past few months.
- **The Institute for Supply Management's PMI ® Index** reported at 59.6% which is 6.5% greater than figures in March reflecting growth for the 61st consecutive month at a faster rate. According to ISM, the majority of respondent's comments reflect continued optimism.
- **The National Federation of Independent Business** shows small business expansion in employment per firm continues for the 11th positive month in a row.
- **The Commerce Department** reported consumer spending has continued increasing over the past 12 months with a current increase of 0.2% for the month of July.

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- **The Bureau of Labor Statistics** reports that the unemployment rate is 5.9% in September and has changed little over the month.

- **U.S. Real Gross Domestic Product**, increased at an annual rate of 4.2% in the second quarter of 2014 after decreasing 2.1% in the first quarter. This increase in real GDP in the second quarter was primarily due to positive contributions from personal consumption expenditures, private inventory investments, exports, and nonresidential fixed investments, among others.

- **CBOE Volatility Index (VIX)**. Despite a few peaks since in the month of March, the VIX has remained relatively low. In March it sat at 17.82 then declined and spiked again in April and recently in August sitting at 17.03. Since that time, it has decreased in the month of September to 14.93 and is expected to continue to remain low overall with occasional spikes every few months.

- **Playing in the oil patch**. In recent news, oil prices have eased. The U.S. shale boom has transformed the oil industry since 2011 with a significant increase in domestic production. Over the last 20 years, oil production in the U.S. has exceeded imports and is expected to continue, surpassing Saudi Arabia by 2020.

Let's remember that 2014 is an election year. Even though it will only be mid-term elections, this cycle has the potential to significantly affect the financial markets and our economy mostly because we could see a change in the balance of power in Washington DC, thus impacting US fiscal policy. Based on current polls, the House of Representatives will remain Republican, but the senate is a toss-up. Statistically Republicans have a slightly higher chance of gaining control in the Senate than Democrats but that could easily change.

What does this mean for your portfolio? While the risk of a market correction appears "elevated" nobody knows whether the market's next 10% move will be up or down. It is Multop Financial's opinion that investors should avoid trying to time every "zig and zag" in the market and should focus more on the primary trend using the availability of attractive investments. In our opinion this means you should continue holding a mostly equity portfolio which is heavily weighted in domestic, large-cap stocks. Depending on one's risk tolerance, emerging markets and small cap investments appear attractive. Should we experience periods of increased volatility, holding a portion of your portfolio in non-stock market funds could help provide stability during these times. If you are currently a client and have met with us recently you know that your portfolio has done well in 2014. We have positioned your investments to reflect what we believe will happen looking forward. If you are not yet utilizing our advisory services, we would encourage you to contact our team and see what changes can be made to help you be in the best position possible in today's economy.

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