
# Market Perspective

Special Edition - October 2014

You may have watched the short video clip in our last newsletter exploring various reasons for the marked increase in market volatility over the last few weeks.   It is because of increased market volatility that I have been pursing defensive measures over the last several weeks to protect clients' investment capital.

I was recently on a conference call with Brad McMillan, CFA®, CAIA, MAI, AIF®, and chief investment officer at Commonwealth Financial Network.  His compelling analysis included the following points:  The economic fundamentals in this country are strong and getting stronger.  The economic recovery is continuing as well.  Business growth and consumer growth are both above trend, and are sustainable.  Unemployment rates are also going in the right direction, although wage growth is still sluggish.

Around the globe, the US continues to be the top performing market.  In European unemployment rates are going in the other direction, and Chinese real estate values are declining for the first time, much like our experience here in the US in 2007 and 2008, but India and Japan show very good growth rates.  See "A Bumpy Ride, But Not Time to Worry"" below for additional market perspective by Brad McMillan.

## A Bumpy Ride, But Not Time to Worry

Comments by Brad McMillan, CFA®, CAIA, MAI, AIF®, chief investment officer, at Commonwealth Financial Network

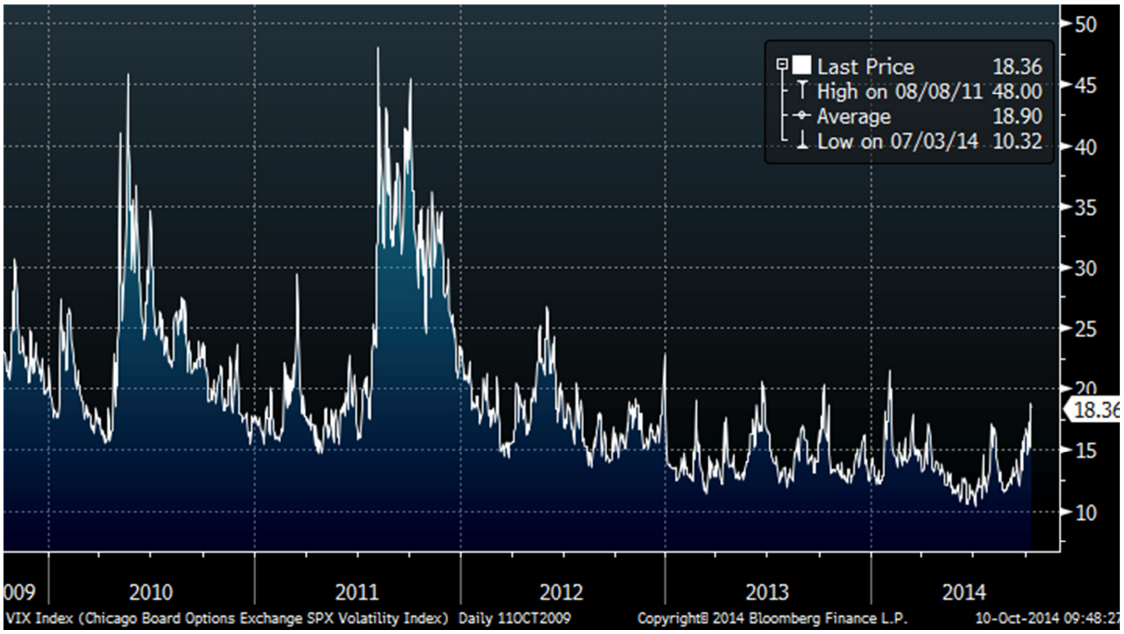
"Over the past few days, the market has taken investors on a roller-coaster ride, and I suspect many of us are feeling a bit queasy. No one likes to be jerked down and up and back down again. What's going on?

**Putting things in perspective**

As I write this, the S&P 500 is up more than 4.5 percent year-to-date, and the Nasdaq is doing slightly better than that. At the beginning of 2014, I predicted that the market would end the year around 1,850. Even after the drops, our current position isn't bad at all.

On a year-to-year basis, we're doing even better; the S&P 500 is up more than 14 percent from last October, much higher than average annual returns. And the pullback itself is just under 4.5 percent-actually quite small and something we've seen a couple of times this year already.

What's more, over the past five years-a very good time for the markets from a return perspective-volatility has almost always been higher than it is now, as you can see in the following chart.




True, volatility is edging up. But it hasn't hit the highs of 2014, remaining closer to the lows of 2009 through 2012.

From a historical perspective, then, the bumps we're experiencing are very normal. From a return perspective, we're still in a very good place. Even looking at the drawdown from the peak, there's really nothing to be concerned about yet.

**No gains without some risk**

So, why the worry? Returning to the chart, you can see that the market has been incredibly calm over the past couple of years, and especially this year. Investors have come to expect that tranquility, which is a mistake. Financial markets are usually much more volatile than they have been, and that risk is at the heart of why we can make money there. You don't get one without the other.

The question, of course, is whether the market will continue to drop. No one can say for sure. But here's what we do know: Although prices move around, they ultimately depend on fundamentals, which are improving. Improvements in the economy should support the stock market, acting to limit any damage.

We're in an interesting place right now. The economic recovery in the U.S. should drive markets up, but current values are already at very high levels-priced for perfection, really. In my opinion, this is what's behind the rising volatility: the conflict between stocks being repriced to more reasonable levels, even as those reasonable levels rise with the improving economy. We should be seeing volatility here, as the market tries to sort out the reality of the situation.

**Expect more volatility**
We may quite possibly experience a further drop, even a significant one. Because of the improving fundamentals, though, we have something of a cushion below that will limit the damage, and possibly even set up a bounce-back.

Volatility is certain. Fortunately, we're better positioned to weather it than we have been for years."

My staff and I deeply appreciate the continuing opportunity to work with you. Please let me know if you have any questions or requests. Thank you.

Sincerely,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