Bubble, Bubble, Toil and Trouble
A Midsummer Night's Mid-Year Review

	Trends	Portfolio & Forecast Implications
Love's Labour's Lost: Federal Reserve Updates its Forecast	The Federal Reserve adjusted its forecast significantly for 2014 after a disappointing beginning to the year. As of March, the forecast for growth was in the 2.8 to 3.0 percent rate. It has now been revised to a range of 2.1 to 2.3 percent.	The key implication pertains to interest rates. With growth continuing to remain at or below America's long-term potential, the Federal Reserve is likely to remain accommodative. Even though its QE3 program is being wound down, investors probably don't have to worry about increases in short-term rates until very late in 2014 or next year.
Corporate profits tamed in early 2014	Profits from current production fell from $198.3 billion during the first quarter of 2014 after rising $47.1 billion during the prior quarter. Equity prices continued to expand nonetheless. Correspondingly, the Dow Jones Industrial Average's P/E ratio rose from 15.0 at the end of 2013 to 16.5 as of July 1st.	The Bull Market continues, but corporate profit growth needs to reaccelerate in order to provide better intellectual support for the rally. As the market creeps higher, weak earnings reports stand to become more impactful and market performance could become less stable.
Volatility: to be or not to be . . .	The Chicago Board Options Exchange Market Volatility Index, otherwise known as the VIX, measures the implied volatility of S&P 500 index options. There continues to be little evidence of surging volatility despite growing geopolitical tensions and the first quarter's miserable economic performance. During the first half of 2014, the VIX averaged 13.77. The last full year during which there was less evidence of volatility was 2006.	For months, many analysts have predicted greater volatility as U.S. equity markets edged higher. That remains the prediction as opinions regarding the market's near-term outlook become more divergent in the face of falling unemployment rates and growing nervousness about the Federal Reserve's next moves. Growing and spreading tensions in the Middle East are also likely to enhance volatility.
U.S. Energy Production: A Midsummer Night's Dream	A recent report by the U.S. Energy Information Administration indicates that U.S. energy production met 84 percent of the nation's demand in 2013. The fraction of U.S. energy consumption satisfied domestically has been rising since 2005, when it stood at 65 percent.	America's energy production renaissance remains the brightest spot in the U.S. economy. Job growth remains strong in many of the nation's energy-intensive markets, including Texas, Oklahoma, Louisiana and North Dakota. Last year's rise in natural gas prices has even helped to support a resurgence of demand for coal.
Much Ado About Nothing: Housing Market Retains its Momentum	Existing-home sales expanded briskly in May, rising 4.9 percent to a seasonally adjusted annual rate of 4.89 million. However, that figure is still 5.0 percent lower than the May 2013 level, a month that preceded last summer's surge in mortgage rates. Home prices are 5.1 percent higher than at the same time one year ago.	Much has been made about the recent loss of momentum in the U.S. housing market. A combination of factors was responsible, including 30-year fixed mortgage rates now above 4 percent and 15-year fixed rates above 3 percent. Student debt and cultural shifts have also played a role. But the most recent data have been more upbeat, indicating that this part of the recovery remains intact.

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Shall I Compare Foreign Markets to a Summer's Day?	As of June 20th, three of the four strongest performing markets year-to-date in 2014 were European: the Bolsa de Madrid (+14.3 percent), the Borsa Italiana (+14.2 percent), and the Euronext (+7.4 percent) exchange. Asian markets, however, have lagged behind -- The Hong Kong Exchanges (-0.6%), the Tokyo SE (-3.5%) and the Shanghai SE (-4.0%) are all down for the year. U.S. equity markets were middling performers through mid-2014.	Given relative valuations, it appears possible that at some point, global equity investors will begin to put greater weight on non-US equities. That really hasn't begun to any significant degree yet, but investors should be on the lookout for the onset of new patterns.
The Tempest	There are now U.S. advisors in Iraq, civil war in Syria, growing tensions in Lebanon, unrest on the West Bank, nuclear development in Iran, not to mention issues in Egypt, Yemen, Nigeria, Afghanistan, Pakistan and the Ukraine.	Somehow, U.S. equity markets have been able to shrug off a torrent of disturbing news from abroad. Some of these events have impacted oil and other key prices, but even that has not been enough to rattle markets. How long can the calm last?
A Winter's Tale of Woe: First Quarter GDP Worse than Expected	Real gross domestic product decreased at an annual rate of 2.9 percent during 2014's initial quarter. For a time, economists wondered whether the first three months of 2014 represented a shift in economic dynamics, or was simply a reflection of an unusually severe and durable winter. As it turns out, it was the weather.	It was as if the global supply chain congealed. Exports sat idly at ports and consumers stayed at home. Suppliers also hammered away at inventory levels by slowing down purchases, which explained much of the first quarter's malaise. With inventories now back at more comfortable levels, the economy appears on track for solid growth during the balance of the year. Consumers also look better positioned to motivate growth, with the nation recently adding more than 200,000 jobs for five consecutive months, the first time that has happened since the late-1990s.
An IPO by Any Other Name Smells Just as Sweet	The first half of 2014 saw a record number of IPOs. While U.S. companies accounted for six of the top ten performing initial stock offerings, Europe—now recovering from its debt crisis—recorded the most IPOs of any region in absolute terms. The total value of initial public offerings was up 54 percent during the first half of 2014 compared to the same period one year prior. Life sciences companies raised more money through initial public offerings during the first half of 2014 than they did during all of last year.	This has represented one of the most obvious signs of repaired capital markets. High profile public offerings are an outgrowth of a combination of decent economic performance and rapid innovation in certain aspects of human endeavor. More IPOs are on the way judging from patent and other data and the performance of the broader economy. The life sciences have been particularly prolific in terms of generating IPOs.

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