Kalos *Market Commentary*

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Jobs Improving, Markets Poised to Remain Strong

The final month of 2014 ushers in an economy that appears to be on pretty solid footing along with a stock market that continues to test and set new highs. While not all the news is great, particularly outside of the U.S., various factors ranging from economies to capital access to corporate profits remain strong. Moreover, domestic and international projections appear to make it likely that stocks will not only hold onto past gains, but keep adding to them.

Recent profit reports largely confirmed U.S. corporate health. Of the S&P 500 companies that have reported earnings through November 22, 79% beat profit estimates and 60% surpassed revenue projections, according to data compiled by Bloomberg.

Corporate strength is now steadily translating into job gains. The unemployment rate dropped to a six-year low of 5.8% in October, and payrolls are on track for their biggest gain since 1999, according to Labor Department data.

In the U.S., the recovery is finally benefitting people on the lower end of the economic spectrum. Lower-wage workers nearly always benefit last from an economic turnaround, and this particularly slow recovery has been exceedingly slow to flow down to those nearer the bottom. But, over the past year, lower-wage workers enjoyed bigger pay gains than the highest earners during 2014, according to economists at RBS Securities Inc. and Goldman Sachs Group Inc. Not surprisingly, in 2014 Americans making from $15,000 to $25,000 a year experienced the biggest jump in confidence, according to data from the Conference Board, a New York-based research group.

Workers aged 20-34 are also enjoying stronger wage growth. Entry and junior-level workers took a bigger hit in the recession's aftermath, partially resulting from a higher percentage of layoffs, and now increased demand for lower level and cheaper skill sets is leading to more hiring and faster earnings growth for this group. While younger workers still remain below pre-recession levels, gains are picking up, which not only benefits them, but also many others across the economy (including their parents!).

Recovery for lower level and younger workers immediately impacts the economy. A greater percentage of these bigger paychecks are translated into spending rather than savings, often resulting in more immediate economic impact. And, longer term strength helps a wide range of industries ranging from consumer products to housing.

Beyond just these segments, rising use of credit cards provides more tangible evidence of rising consumer confidence across the entire population which is leading to an increased willingness to spend. Growth in credit card use has picked up for the first time in nearly six years. The uptrend is good news for retail sales in general, and holiday sales more specifically, which are likely to climb 4.5% from last year. Lower gas pump prices should also lead to greater consumer spending.

Looking beyond the U.S., news has also improved a bit. Higher confidence in outlooks in Europe and China has helped propel the market higher in recent weeks. China cut its benchmark interest rates for the first time since July 2012, and The People's Bank of China lowered its one-year

deposit rate along with their one-year lending rate. Easier monetary policy, after significant tightening over the past couple years, has increased expectations for China's ongoing growth while reducing fears that a wide range of industries, particularly housing, may stagnate.

In Europe, a stronger-than-expected German business survey offered more hope for the euro-zone. A monthly business climate index also rebounded in November, signally that Europe's largest economy is likely gaining momentum after narrowly avoiding a recession in the third quarter. While Europe's growth or lack thereof isn't a major determinant of U.S. corporate profits and market direction, good – or at least better - news provides encouragement for U.S. investors regarding export markets and the global economy.

European Central Bank President Mario Draghi also said that he will do whatever is necessary to raise inflation in the euro zone as fast as possible. While inflation is often viewed negatively, Europe's growth has been so anemic that deflation has been feared. Deflation is particularly worrisome because it can lead to a death spiral of a deeper recession as people delay purchases waiting for prices to continue to drop. The ECB President said that if the current policy is not effective, the ECB will "broaden even more the channels" through which it intervenes, by adjusting the size, pace and composition of asset purchases. Echoing European Central Bank policymakers, Bank of Japan Governor, Haruhiko Kuroda, made similar commitments to fighting deflation on November 25th.

China, Japan, and European bank announcements that they are all acting to spur growth heightened expectations regarding many U.S. and global materials companies which saw their shares broadly rise to almost two-month highs in late November. Materials ranging from gold to copper to zinc all saw prices move up on higher demand expectations. Oil prices have been an obvious exception and have continued to decline, largely because of dramatically increased U.S. production. Still, even oil prices rose briefly on the specter of improved international growth.

Against this backdrop, the U.S. dollar appears likely to continue strengthening. The U.S. is poised next year for its best annual growth in a decade, while both Japan and the euro zone are likely to barely creep forward. In the U.S. the Federal Reserve has finally ended its stimulus program while the European Central Bank, the Bank of Japan, and China are all expanding their efforts to stimulate economic growth. The actions are likely to help the various economies, but should strengthen the dollar likely offering better deals for overseas travelers in the coming year.

U.S. markets appear to have resumed their steady climb upward. Various economic and market indicators in the U.S. and around the globe suggest that the ascent could continue. We believe that various factors and ongoing trends should propel markets forward over the foreseeable future. However, one major caveat remains. The market is about plus or minus 10% of its average historical valuation depending on which measures and timeframes are used. As a result, stocks are not cheap, so bad news, unexpected events, general volatility, or any host of issues could easily drive markets down, possibly sharply as we saw in October. Still, for those with a longer term view, we believe U.S. markets continue to offer attractive opportunities. And beyond the U.S., valuations are generally more attractive offering possible greater opportunities – along with unique risks.

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