MURRAY
INVESTMENT MANAGEMENT

4th Quarter 2013 Update

Economic Review

The U.S. economy improved over the second half of 2013 with 3rd quarter GDP up 4.1%, and expectations for the 4th quarter are around 3%. The wealth effect (better housing and stock markets) and a strong corporate sector are contributing to the pickup in growth. In addition, the employment situation is also improving with the unemployment rate falling to 7% at the end of November, which is its lowest level since 2008.

Given the improving economy, the U.S. Fed announced that it will reduce its long term bond buying program by $10 billion per month starting in January and winding up the program at the end of 2014. The Fed will, however, keep short term rates very low until additional economic data confirms the sustainability of the recent economic improvements.

Equity Market Performance

	QTD	YTD
S&P 500	10.51%	32.39%
MSCI EAFE (International index net return)	5.71%	22.78%

Domestic equity markets continued to advance strongly during the 4th quarter (up 10.51%) as investors interpreted the Fed's decision to taper as a positive view on the economy. For the year, the S&P 500 posted its best annual performance since 1997 (up 32.39%), and small cap equities were particularly strong. S&P 500 performance was broad during 2013 with all sectors posting positive returns led by the Health Care and Consumer Discretionary sectors.

Broad International markets performed well during the quarter and year but trailed domestic markets. International emerging markets were among the weaker performers.

Bond Market Performance

	QTD	YTD
Barclays US Aggregate Bond (Broad Bond Market)	-0.14%	-2.02%
Barclays Municipal	0.32%	-2.55%
Barclays US Treasury Long	-3.08%	-12.66%
Barclays US Corporate	1.11%	-1.53%
Barclays US Corporate High Yield	3.58%	7.44%

Interest rates were generally up during the year with the 10 year Treasury rate increasing to 3.04% at year end. This put pressure on fixed income markets, but the high yield space still posted strong results for 2013. Even with the increase, interest rates remain at historically low levels.

Economic Outlook

The U.S economy is expected to grow at a faster pace in 2014 than it has over the last several years. An improving jobs market, strong stock market, less fiscal restraint and strong housing are all contributing to a more robust economic environment. In addition, improving business confidence could further stimulate growth.

While higher interest rates could weigh on both the housing sector and corporate investment, this should not be a significant drag as any interest rate increase should be modest. Short term rates are expected to stay low throughout the year with increases expected on the long end of the curve. The potential for the Fed to stumble while unwinding its unprecedented stimulus is an area of concern for the economy that will be monitored closely.

Market Outlook

In 2014, investors should expect a more volatile, "grind it out" type of equity market that has the potential for some sort of market pullback. Equity prices are not so elevated (overvalued) that we should be on high alert, but they are also not cheap either. They seem to be reasonably priced with potential market gains coming from corporate earnings growth as opposed to P/E expansion.

The areas that are supportive of positive equity market performance include improving economic fundamentals, low interest rates, moderate inflation and corporate earnings growth. On the other hand, a less accommodating Fed (rising interest rates) and higher valuations will potentially weigh on equity markets throughout the year.

With strong equity performance over the last several years, many will have the tendency to chase returns and drift from an investment strategy. It is important now, as always, to maintain investment discipline and stick to an overall investment plan that includes establishing equity and fixed income targets and rebalancing as needed.

Overall, equities still appear to be more attractive than fixed income, and there is a lot of cash on the sideline that could drive equity markets higher. With many fixed income securities offering limited upside and the potential for negative returns, it appears that holding cash and shorter term securities makes sense for the more conservative portion of investors' portfolios.

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please give us a call.

Source: bls.gov, bea.gov, Morningstar, treasury.gov and wsj.com
The performance data shown represents past performance, which is not a guarantee of future results.
Return data is as of 12/31/2013. Except as noted, index returns are Total Returns.

www.murrayinvestment.com | 713.850.7444 | sammurray@murrayinvestment.com