MURRAY
INVESTMENT MANAGEMENT

4th Quarter 2014 Update

Economic Review

Led by strong business and consumer spending, the U.S. economy grew 5% during the 3rd quarter, which was the fastest growth in the last 11 years. 4th quarter GDP is not expected to be as strong but likely grew around 3%.

The employment situation continued to improve with the unemployment rate falling to 5.6% from 6.7% at the beginning of the year. During 2014, the U.S. averaged 246,000 new jobs per month (2.9 million annually), which was the most since 1999, but wage growth remained flat.

The U.S. Federal Reserve ended its long-term bond buying program in October but did not change the federal funds rate. While noting that the economy is improving, the Fed stated that it will be "patient in beginning to normalize the stance of monetary policy." In other words, future rate increases will be dependent upon how the economy performs with a focus on inflation and employment.

The price of oil fell significantly (down over 40%) during the year. This gave consumers a boost at the pump but longer term may negatively impact employment and capital expenditures by oil and gas companies.

Equity Market Performance

	QTD	YTD
S&P 500	4.93%	13.69%
MSCI EAFE (International index net return)	-3.57%	-4.90%
Russell 2000 (small cap)	9.73%	4.89%

For the year, equity returns varied widely with domestic large caps posting very good results while small caps were not as strong. Domestic markets outperformed the broad international markets, which were down (-4.9%) for the year. In the U.S., the utility sector was the best performing sector while the energy sector performed the worst as falling oil prices weighed on this space.

Bond Market Performance

	QTD	YTD
Barclays US Aggregate Bond (Broad Bond Market)	1.79%	5.97%
Barclays Municipal	1.37%	9.05%
Barclays US Treasury Long	8.62%	25.07%
Barclays US Corporate	1.77%	7.46%
Barclays US Corporate High Yield	-1.00%	2.45%

The broad bond market produced strong performance for the year as the 10 year Treasury unexpectedly fell from 3.04% at the beginning of the year to 2.17%. Long Treasury bonds were among the better performers.

Economic Outlook

The U.S. economy should continue to expand at a moderate pace during 2015. An improving job market and lower energy costs should support stronger consumer spending (the largest contributor to GDP growth) while corporate investment should continue to improve.

Weighing against these factors will be slower growth overseas and potentially higher interest rates. In addition, if we have continued weakness in the energy space, it could negatively impact employment, capital expenditures and geopolitical stability.

Given the improvements in the economy, the Fed will likely raise short term interest rates at some point starting in mid-2015. Rate increases are expected to be modest as the Fed will balance an improving U.S. economy and labor market against modest inflation expectations.

Market Outlook

Lower unemployment, cheaper oil prices, modest inflation and a patient Fed could be a good combination for equity markets heading into 2015. This has to be balanced against higher equity valuations (after a 5 year bull market), weaker growth overseas and the potential for the Fed to raise rates. Given these cross currents, investors should expect increased market volatility during 2015.

It is expected that the Fed will raise rates this year. Whether investors focus on the reason for the rate change (a better economy) or the result of the rate change (increased borrowing costs) will impact the longer term direction of equity markets. It would not be surprising to see volatility increase and market multiples (P/E ratios) compress in a rising rate environment. Corporate earnings would need to be strong to offset this compression and drive markets higher.

While domestic equity valuations don't appear to be overly stretched, they are not cheap either, and further market multiple expansion should not be expected in 2015. Potential market gains will likely be driven by corporate earnings growth, and a grind-it-out type of market with modest returns would not be a surprising path for the year.

With interest rates so low, opportunities remain limited in the fixed income space. The risk / reward profile for many fixed income securities is not very favorable. In other words, for the conservative portion of an investor's portfolio, there are very few attractive options. If rates increase, however, this view could change, and portfolios would be adjusted accordingly.

Source: bls.gov, Morningstar, bea.gov, federalreserve.gov, Bloomberg and treasury.gov
The performance data shown represents past performance, which is not a guarantee of future results.
Return data is as of 12/31/2014. Except as noted, index returns are total returns.

Currently, holding a larger level of cash in the fixed income allocation seems to be a reasonable approach.

Murray Investment Management

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please give us a call. Also, please pass along our name to anyone that may be in need of investment advice.

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