



Paul R. Ried Financial Group, LLC

Security for your future

A MESSAGE FROM YOUR FINANCIAL TEAM

Market Commentary - November 12, 2014

Dear Clients,

It was great seeing so many of you at our Client Economic Outlook event this year. We were pleased to have had the 38th Director of the United States Mint, Edmund Moy, as our guest speaker. We hope that you all enjoyed it. For those of you who were not able to attend, we will be sending out an e-mail notification when a video of that is available on our website.

If I were to quickly summarize some of Mr. Moy's main points, I would say his general themes were the following:

- While the US economy continues to recover, it has a long ways to go. However, it does look relatively robust when compared to the global economy (including much of Europe which is wavering on a triple dip recession).
- We should expect slower global economic growth and greater volatility with the Fed's timing on raising interest rates and unwinding of the stimulus being key drivers of that volatility.
- The number of possible negative "black swan" (low probability but high impact) events have only increased over the years as systems and economies have continued to become even more interconnected and co-dependent.
- Be cautious and stay focused on broad diversification in long term investments with solid fundamentals.

The Election Results Mean What?

Some of the articles that come out after elections can be quite amusing. Oftentimes they are articles with "factoids" that seem quite interesting on the surface, until you realize that in reality they mean essentially nothing, particularly as they relate to the market.

As just one of many possible examples, a USA Today article¹ quoted a financial strategist saying "Investors may have forgotten that the combination of a Democratic President and a unified Republican Congress has been accompanied by the best average performance for the S&P 500 since 1945," and then the article went on to point out the average return during those years was 15.1% vs 8.8% for all years.

That may sound compelling until you realize that the combination of a Republican Congress and a Democratic President has only occurred in 8 of those past 70 years. Furthermore, 6 of those years were the go-go dot-com years of 1995-2000 which ultimately resulted in a major market crash. A phrase from statistics 101 is a very useful reminder whenever you hear those types of factoids, and that is "Correlation does not imply causation".

The returns of markets in any given year are driven by a wide array of factors far outside the realm of who happens to be in Congress, despite politicians' desires to take credit for all that is good and shift blame for all that is bad.

One of the few predictable outcomes from this election is that President Obama will likely start using his veto power that has been largely absent the last 6 years. Obama is on pace to enter his 7th year as President having issued only two vetoes. Other than George W. Bush who went into his 7th year with just one, that is the lowest since James Monroe.

However, George W. Bush ended up issuing 11 vetoes his last 2 years when Congress was controlled by his opposing party. A similar, if not greater, increase seems likely from Obama. As an interesting comparison, FDR issued 505 vetoes over his first two terms despite Congress being controlled by his own party

Divergent Stock Market Returns

It is interesting when someone asks how stocks have performed recently because the only real response to that, especially this year, is "Which ones?"

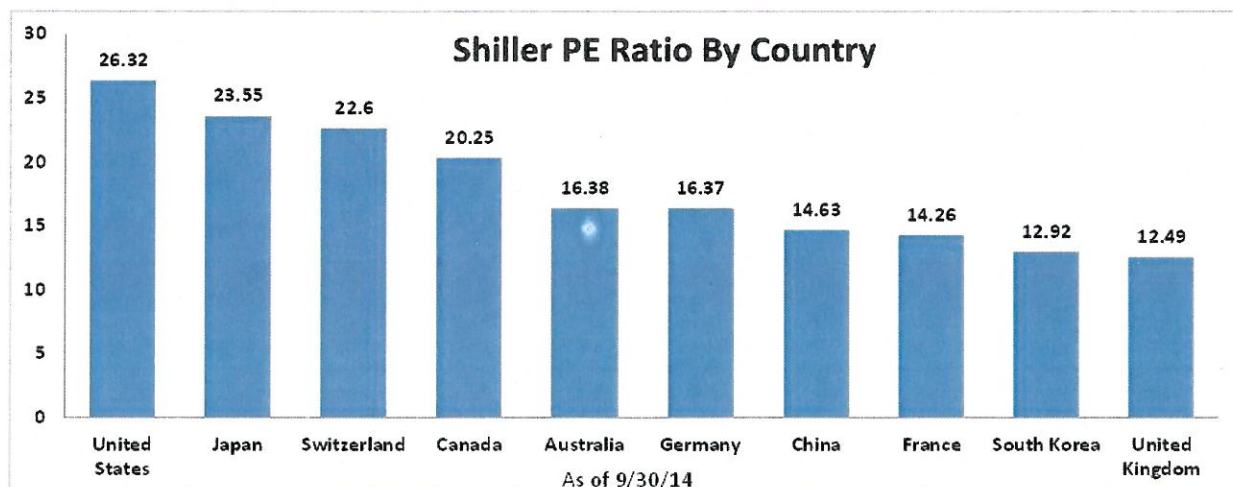
For instance, Large U.S. stocks (measured by the S&P 500) ended October up 11% for the year while smaller U.S. stocks (measured by the Russell 2000) were only up 1.9%. Furthermore, when we look around the world these divergences are even more pronounced. Below I have listed the returns by country for the 10 largest investable markets.

Year-to-date return through 10/31/2014		Year-to-date return through 10/31/2014	
1) United States	11.0%	6) France	-8.3%
2) United Kingdom	-3.5%	7) Germany	-11.8%
3) Japan	-2.9%	8) Australia	5.5%
4) Canada	3.5%	9) China	5.1%
5) Switzerland	1.4%	10) South Korea	-6.6%

Source: Morningstar Direct. United States = S&P 500 TR, United Kingdom = MSCI United Kingdom NR USD, Japan = MSCI Japan NR USD, Canada = MSCI Canada NR USD, Switzerland = MSCI Switzerland NR USD, France = MSCI France NR USD, Germany = MSCI Germany NR USD, Australia = MSCI Australia NR USD, China = MSCI China NR USD, South Korea = Korea NR USD

It should be noted that China would actually have the 2nd or 3rd largest market but a large portion of their market is not investable by foreigners, although significant changes are underway in that regard.

While U.S Stocks continue to outperform, on a valuation basis they appear to be among the most expensive. This can be illustrated by using the Shiller PE ratio popularized by Nobel Prize winner Robert Shiller (a ratio which takes the average inflation adjusted earnings of the last ten years, divided by price). Below is the ratio for the same 10 markets referenced above.



Source: Research Affiliates, MSCI, Bloomberg as of 9/30/14

As a point of comparison, the long-term median ratio for the U.S. is approximately 16 and it has only been higher than its current reading 9% of the time².

Diversification

While large company U.S. stocks continue to march ahead of the pack, the case for international diversification is only growing. While U.S. stocks continue to be a key component of a well-diversified portfolio, it is important to resist the urge of chasing recent returns and becoming too concentrated in one area.

We have customized diversified portfolios which we have developed for each of you based on your individual risk tolerances and objectives. These portfolios include active fund managers who are able to adjust to the ever changing investment landscape. We continue to monitor your overall portfolios and each individual fund management team, and make changes as necessary.

As always, we are here to serve you, should you have any questions don't hesitate to e-mail or call.

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1 – 11/5/2014, USA Today, "Dow, S&P 500 close at record highs as GOP takes Senate"
2 - www.econ.yale.edu/~shiller/data.htm

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