

RBF Weekly Market Commentary

February 10, 2014

The Markets

American stocks bounced last week like a skier pounding moguls on an Olympic freestyle course. Some found it difficult to understand why stocks had their best week since December of 2013. *Barron's* said:

“We just can’t figure out why the markets were strong. It’s not like the news this week was terribly good. The Institute for Supply Management’s manufacturing survey fell to 51.3, well below forecasts for 56.5. The U.S. added just 117,000 jobs, well below forecasts for 170,000. You would think investors would be worried that the economy was running out of steam.”

Experts cited in the article suggested banks have been easing lending standards. Historically, that has been a positive for the economy and may offer insight to gross domestic product growth, industrial production, employment, and profit margins months from now. Others believe the downturn was due to hedge funds derisking their portfolios, and some credit earnings with stocks’ positive movement as almost 66 percent of companies in the Standard & Poor’s 500 Index that have reported this quarter have exceeded earnings expectations forecast by analysts.

Bonds aren’t doing what they were expected to do either. When the Federal Reserve sounded the bell in January – marking the beginning of the end for its third and biggest round of bond buying (called quantitative easing or QE) – it seemed logical bond prices would fall and interest rates rise. After all, basic economic theory suggests less demand should drive prices lower. Perversely, despite the Fed reducing its purchases, Treasury bonds have gained value and yields have fallen. The same thing happened when the Fed ended the first two rounds of quantitative easing and may reflect fear that economies will lose momentum without the Fed’s strong monetary support.

Let’s hope markets continue to do as well as America’s snowboarders. Last week, Americans took Olympic gold (in the men’s and women’s events) on a slope-style course many competitors had trouble navigating and believed might be too risky.

Data as of 2/7/14	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	0.8%	-2.8%	19.1%	10.9%	15.6%	4.7%
10-year Treasury Note (Yield Only)	2.7	NA	2.0	3.6	3.0	4.1
Gold (per ounce)	0.7	4.8	-24.5	-2.2	7.1	12.0
DJ-UBS Commodity Index	1.9	2.2	-9.0	-7.6	2.6	-0.7
DJ Equity All REIT TR Index	0.7	4.3	3.1	9.6	21.0	8.4

Notes: S&P 500, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, *Barron's*, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable.

HOW HAVE LOW INTEREST RATES AFFECTED ECONOMIES, GOVERNMENTS, AND INDIVIDUALS DURING THE PAST FEW YEARS? Late last year, *McKinsey & Company* released a report that took a closer look at “the distributional affects and risks” of

quantitative easing (QE) and low interest rates. In other words, who was affected by QE and low rates and how?

If you're an investor with an interest in income, you've probably got a pretty good idea about how it affected you! The report found, from 2007 through 2012, households in the United Kingdom and the United States:

“...together lost \$630 billion in net interest income, although the impact varies across groups. Younger households that are net borrowers have benefited, while older households with significant interest-bearing assets have lost income.”

The other side of that coin is declining yields caused the value of previously-issued bonds to increase. *McKinsey* estimated corporate and government bonds in the Eurozone, United Kingdom, and United States gained about \$16 trillion in value during the period. Housing prices also may have benefitted as the cost of mortgage credit fell.

British and American households weren't the only ones affected by central bank policies. *McKinsey* found governments in both regions benefited to the tune of about \$1.6 trillion! In part, this was because debt service costs – the money required to cover the payment of interest and principal on debts – was significantly reduced during the period.

Corporate profits also got a boost from low rates. The study found U.S. and U.K. corporate profits also benefitted as companies in each country gained about 5 percent during 2012 because of ultra-low interest rates. Higher profits, unfortunately, did not translate into higher investment possibly because of tighter lending standards and uncertainty over recovery. According to *The Economist*:

“In the United States, net private non-residential investment fell by 80 percent as a percentage of GDP between 2007 and 2009. Although it has recovered since then, U.S. business investment is still at its lowest level as a share of GDP since at least 1947. Investment in Europe is similarly weak.”

Why look at distributional impacts? It helps economists identify risks countries may face in the future. For instance, *The Economist* estimated governments may see debt service costs increase by as much as 20 percent. In the United States, that would translate into \$75 billion annually.

Weekly Focus – Think About It

“The best and most beautiful things in the world cannot be seen or even touched – they must be felt with the heart.”

--*Helen Keller, American author and political activist*

Best regards,

Tony Kalinowski

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- * The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. You cannot invest directly in this index.
- * The Standard & Poor's 500 (S&P 500) is an unmanaged index. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.
- * The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
- * Gold represents the London afternoon gold price fix as reported by the London Bullion Market Association.
- * The DJ Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
- * The DJ Equity All REIT TR Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
- * Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
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- * Consult your financial professional before making any investment decision.
- * Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.
- * Stock investing involves risk including loss of principal.

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