Commentary

March 23, 2015

The Markets

Financial markets gave the Federal Reserve a standing ovation last week. At least, that was *Barron's* interpretation. What did the Fed do to deserve it?

"…the Fed did what everyone expected, signaling that it could raise interest rates at any meeting starting in June. Yet, Yellen and team still found a way to assure the market that it wouldn't do anything rash, insisting that the labor market would need to strengthen further, and that inflation would have to be heading for its 2 percent target before they make a move. Even then, the projected path of interest-rate hikes would be slow and steady – and unlikely to undermine the market."

Stock markets in the United States weren't the only ones heading toward, or surpassing, new highs. The Fed's reassurances about the pace at which it would normalize monetary policy pushed markets across the Eurozone higher, too. *Reuters* reported global investors were feeling confident a weaker euro could goose the region's economy.

There is some optimism about shorter-term market potential. Experts cited by *Barron's* suggested the chance for a stock "melt-up," which would lift the Standard & Poor's 500 Index (S&P 500) higher, were pretty good.

However, others believe the longer-term outlook for stocks, as a whole, may temper investors' enthusiasm. *Barron's* explained earnings growth for the S&P 500 is well below its 30-year average, dividend yields are well below their 20-year average, and the index's valuation is "so high that it is projected to subtract 2.6 percent annualized from returns. Put it together and investors are likely to earn just 0.4 percent after inflation."

One thing is for sure: It's awfully difficult to predict the future with any accuracy. *Barron's* warned about the quirks of market forecasts, offering an example from a decade ago. "In January 2005, expected returns were just 0.4 percent, yet the S&P 500 gained 5.6 percent annualized during the next 10 years."

Data as of 3/20/15	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	2.7%	2.4%	12.6%	14.5%	12.6%	5.9%
10-year Treasury Note (Yield Only)	1.9	NA	2.8	2.4	3.7	4.5
Gold (per ounce)	2.7	-1.4	-10.8	-10.6	1.5	10.6
Bloomberg Commodity Index	2.0	-4.6	-25.3	-11.7	-5.5	-4.8
DJ Equity All REIT Total Return Index	5.4	6.8	28.4	15.3	15.8	9.7

S&P 500, Gold, Bloomberg 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 Total Return 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.

IT MAY SEEM LIKE A GOOD IDEA TODAY... If anyone needs more evidence that focusing on short-term corporate performance can be detrimental to longer-term outcomes, look no further than the effect of the strengthening U.S. dollar on companies outside the United States that issued debt denominated in U.S. dollars. *The Economist* explained:

"Dollar borrowing is everywhere, but the biggest growth has been in emerging markets. Between 2009 and 2014 the dollar-denominated debts of the developing world, in the form of both bank loans and bonds, more than doubled, from around $2 trillion to some $4.5 trillion, according to the Bank for International Settlements (BIS)… Recent months have seen… an Indian property developer… a South African power generator, and… a Turkish firm that makes TV dinners, sell dollar-denominated bonds. By borrowing dollars at several percentage points below the prevailing interest rate in their domestic currency, CEOs have pepped up profits in the short term."

As it turns out, dollar-denominated debt may not work out so well in the long run. In recent weeks, the value of currency in many countries has declined relative to the U.S. dollar which has been strengthening. As a result, the amount of interest owed on bonds issued and loans taken in U.S. dollars has increased significantly when measured in local currency terms. Unless a company has U.S. dollar earnings to help offset the expense, the higher cost of its debt can hurt the company.

The New York Times cited a leading electric utility in India that is selling facilities and renegotiating debt after its debts increased thirty-fold in just a few years. In Brazil, some sugar producers have declared bankruptcy, in part, because of U.S. dollar debt and falling sugar prices.

The *Times* also pointed out, "…the rising dollar and falling emerging-market currencies cut both ways for the economies in question. Even as companies that gorged on dollar debt run into trouble, falling currency values make exporters more competitive on global markets." In January, the International Monetary Fund projected economic growth in emerging countries will increase from 4.3 percent in 2015 to 4.7 percent in 2016.

Weekly Focus – Think About It

"If you obey all the rules you miss all the fun."

--Katharine Hepburn, Actress

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*Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.
* 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 afternoon gold price as reported by the London Bullion Market Association. The gold price is set twice daily by the London Gold Fixing Company at 10:30 and 15:00 and is expressed in U.S. dollars per fine troy ounce.
* The Bloomberg 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 Total Return 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.
* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
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* Stock investing involves risk including loss of principal.

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