KALOS *Market Commentary*

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Earnings and Outlook Looking Good

After rattled investors drove the U.S. stock market down in late January and early February, markets have rebounded as investors chose to focus more on ongoing solid news. Severe weather disruptions in January and February contributed to weak economic data, but this weakness should be short lived. Atlanta, my home town, provided a clear picture of how much snow and ice can impact a region. During Snowmageddon, several of my co-workers abandoned their cars and walked home. One person hiked the last 10 miles – in street clothes! Events like this illustrate our human abilities to triumph in spite of difficulties, but obviously take a toll on immediate productivity as people can't make it to jobs, stores, car lots, and for-sale real estate.

Still, even with a slow start, growth should remain solid with various analysts predicting a U.S. 2014 GDP increase of around 2.7% with growth possibly topping 3% by the end of the year. While economists have been projecting increased growth for years, and the U.S. economy never quite seems to make it, numbers are already a bit higher than they have been, and economic progress in Europe and some emerging markets make this prediction appear more likely to materialize.

Average earnings for the companies in the S&P 500 illustrate more strength. Fourth-quarter earnings growth is expected to register 9.5% above year-ago results, which would be the best quarterly increase in more than two years and far surpasses the 7.6% growth expected when the period began. Revenue forecasts are also exceeding expectations which should lead to future good news.

The energy sector continues to shine. The State Department should approve the Keystone XL pipeline system within months, clearing the way for President Obama to grant final approval. The president will take some heat over his likely decision from various factions, particularly environmentalists, but the pipeline has now officially been declared as a cleaner and safer way than railcars to transport oil extracted from tar sands. Recent train derailments of oil shipments have highlighted current risks, and increased regulations continue to drive up shipping costs making the pipeline still more attractive. Once permits are issued, the pipeline will take about two years to build and is expected to provide around 9,000 jobs to welders, pipe fitters and other contractors.

Beyond just the Keystone project, spending on pipelines and related infrastructure continues to skyrocket. Already, $6 billion is pouring into new lines to carry the surge of oil and gas. Capturing and shipping more gas will require hundreds of miles of additional pipeline. Gas processing plants will need to be built requiring more highly skilled workers, many of whom will be particularly thankful for work after the long-lasting dearth of construction.

The results of the more pragmatic U.S. approach to energy development are hard to argue against. The U.S. has managed to markedly reduce its carbon footprint while Europe has expanded theirs. The U.S. decrease, while our economy is growing faster than theirs, has resulted from displacing coal and oil with much cleaner natural gas. And, pipeline expansion should continue the trend. For example, oil producers are rushing to capture the natural gas that North Dakota's prolific oil wells burn off as waste.

Home builders are expected to enjoy another good year in 2014. New-home construction should climb by 16% or so as builders respond to tight inventories. Remodelers should also enjoy a good year as consumers are more optimistic about home prices and are showing greater interest in enlarging and upgrading.

Technology companies are poised to benefit from long awaited legislation to limit patent trolls – persons or companies that build a portfolio of patents for the sole purpose of suing businesses potentially infringing on patents they control. The trolls account for nearly two-thirds of patent lawsuits. New firms that often introduce the greatest technological advancements are easy prey. The Innovation Act, if passed, will make it costlier and more difficult to file a lawsuit and will allow defendants to recoup costs of defending themselves. The notable change will encourage more defendants to challenge trolls in court. Benefits could come quickly as technology innovations reach consumers and impact markets rapidly.

Encouraging news also continues to come from Europe. The euro zone economy grew more than expected in the last quarter of 2013 helped by stronger expansion of its biggest countries France and Germany. The combined economies of the 17 countries that share the euro as their currency quarter returned to growth with a GDP increase of 0.3% in fourth quarter after a 0.1% rise in the third quarter.

Germany, the currency union's powerhouse, looks primed to expand more rapidly in 2014. France and Italy are expected to perform better in 2014 with modest GDP gains of 0.5%. Spain should at least be neutral with expectations for a flat year. Greece is even showing some signs of life with industrial production up recently for the first time in months. There is substantial hope that the euro zone's economic expansion will be permanent, ending the long lasting struggle to move past the recession brought on by the financial crisis. The euro zone's structural problems almost ensure ongoing slow growth. But the European Commission expects their combined economies to grow 1.1% in 2014. As a result, the block should contribute to the global economy rather than hurt it as it has during much of the last several years.

Beyond the developed markets of Europe, emerging economies have continued to struggle. Shocking headlines from Kiev, Cairo, and Caracas, along with ongoing currency and political issues in Turkey and other countries have left investors nervous, driving many markets down again in 2014. China, the world's second-largest economy, has received much attention, but recent trade data showed solid demand with exports rising in January. While emerging markets differ markedly, it appears that investor fears are likely overdone, and lower valuations in many markets could present investors with some very attractive opportunities, even if stocks go lower in the near-term.

Across the U.S. and beyond our borders, there is enough good news still coming that I expect the market will continue meandering upward, even if the pace of increase slows considerably given today's higher valuations. Also, expect to see ongoing volatility similar to the January/February dip because higher valuations leave less padding under stocks. Markets outside of the U.S. also deserve increased attention given their generally more attractive valuations.

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