



Quarterly Commentary – April 2015 Strong Dollar Market Continues Volatile Climb

My Dear Client:

It was a volatile quarter, as investors grappled with uncertainty regarding shifting monetary policy, the impact of a strengthening dollar on corporate earnings, mixed economic growth and geopolitical events, including a potential Greek exit from the European Union. During the second week of January, we heard Saudi Prince Alwaleed bin Talal and Goldman Sachs both separately proclaim that the days of \$100 oil are gone never to be seen again. Investor sentiment shifted and uncertainty ebbed and flowed, causing markets to sell off and rebound over the quarter. Despite the heightened market volatility, indications of global economic stabilization and further global central bank easing continued to support a favorable environment for equities during the quarter. In fact, many major indexes, including the S&P 500® Index, notched a series of new record closing highs for the period.



Monetary policy continued to dominate headlines and move equity markets. Many investors believe the Federal Reserve's (Fed's) cautious stance on interest rates continues to bode well for stocks. The Fed has linked interest rate increases to evidence of an improving economy as opposed to a calendar-specific date. Historically, an improving economy has tended to benefit and boost stocks. While the Fed has signaled it may be ready to begin raising short-term interest rates as the U.S. economy expands, other central banks around the

world have continued to implement further easing measures. During the quarter, the European Central Bank (ECB) launched a \$1 trillion quantitative easing program designed to reignite growth in the region. In addition, other central banks outside of the U.S. surprised investors with interest rate reductions.

The strengthening U.S. dollar was one of the focal points for investors all over the world. The combination of a stronger U.S. economy and differing paths of monetary policy continued the strengthening of the U.S. dollar versus the euro, yen and other major currencies. A stronger dollar creates headwinds for multi-national companies based in the U.S. More specifically, a stronger dollar tends to make U.S.-made goods more expensive abroad, making it more difficult for U.S. companies to compete. In addition, goods that move off foreign shelves translate into fewer dollars, showing up as lower revenues and earnings. We saw U.S. small- and mid-cap stocks outpaced U.S. large-cap stocks in the first quarter, likely correlated to earnings for small-cap stocks are less likely to be negatively impacted by a stronger U.S. dollar. Of course, in global market even small companies seek to sell their wares to foreign customers, so we shall see if small-cap stocks are establishing a new upward trend or simply were a short-term beneficiary.

First Quarter Review

In the first quarter, the S&P 500 Index rose 0.95% and the broader Russell 3000® Index rose 1.80%. Style-wise, growth-oriented stocks generally outpaced their value-oriented



counterparts across all market capitalizations. Within the S&P 500 Index (serving as one proxy for the equity market), the Health Care sector, largely driven by strong merger and acquisition activity during the quarter, posted the strongest gain. Conversely, the Utilities sector garnered the largest loss for the quarter, as investor speculation about the potential timing of a U.S rate hike shifted from week-to-week and month-to-month; since many income-starved investors view utilities companies as an alternative to bonds because of their yields.

Easy monetary policies, pockets of improving economic data, tame inflation and cheap crude oil bolstered many non-U.S. equity markets during the quarter, including the Eurozone. This is in contrast to the second half of 2014, when the conflict in Ukraine, indications of potential deflation and slowing economic growth weighed on Europe's return prospects. Non-U.S. developed equity markets, as measured by the MSCI EAFE Index (net of taxes), advanced 4.88% in the first quarter. Emerging equity markets, as measured by the MSCI Emerging Markets Index (net of taxes), returned 2.24%.



In general, the aggressive stimulative monetary policies from central banks outside the U.S. put downward pressure on global yields during the quarter. Although the ECB formally launched its bond-buying program in March, yields on sovereign debt across the region had fallen since the beginning of the year in anticipation the program's onset. Relatively lower yields in Japan and the Eurozone continued to boost global demand for higher-yielding U.S. Treasuries. The yield on the 10-year Treasury ended the first quarter at 1.94%, down from 2.17% at the end of 2014. With investor sentiment shifting from a potential June interest rate increase in the U.S. to uncertainties about economic growth, U.S. bond yields whipsawed during the quarter. The yield on the benchmark 10-year Treasury ranged from a low of 1.68% to a high of 2.24% during the period. Similar to the fourth quarter of 2014, longer-term duration fixed income securities generally outperformed shorter-term duration fixed income securities.

Capital Market Expectations

My capital market expectations and outlook are unchanged. ***Patience*** is still the word for 2015 and one way to define it is *calm acceptance that things can happen in a different order than the one you have in mind*. I saw nothing this first quarter that would lead me to not see the balance of this year to be more of the same: global monetary policies will continue to diverge and remain a dominant theme, global economic growth will remain uneven, U.S. dollar is dominant, heightened volatility likely persist, and geopolitical events will continue to create "hot spots." We are now watching as the Fed reframes investors' focus on "***economic data***" instead of a calendar-specific target to begin gradually raising interest rates. The year-long anticipation of a higher interest rate by so many pundits, prognosticators, and investors is likely to increase stock market volatility. Yet, it is mostly a waste of time for us, as when the inevitable First Hike since 2008 occurs it is not the reaction of the market on that day that matters as much as the assets that you own and are seeking to buy the days and months after the raise(s). The likely onset later this year of incremental steps toward a more normal U.S. monetary policy environment (as the economy continues to expand) means expect U.S. monetary policy to remain



accommodative. In my view, especially in advance of the 2016 presidential election, the increases in short-term U.S. interest rates is likely to be gradual and measured. Inflationary pressures, one of the gauges of when the Fed may start raising interest rates, currently remains low. Since this is both out of our control or influence and nearly a given scenario, “shouldn’t we focus on what we can control and influence?” while being mindful of that which is happening around us.

In the world of alternative illiquid investments we should note that, private equity investment volume remained strong in Q1 despite a seasonal slowdown in overall private equity activity, according to the Private Equity Growth Capital Council’s (PEGCC) Trends Report for the first quarter of 2015. Investment volume for Q1 was \$116 billion, the second highest level for first quarter reporting since 2009.

Highlights of the First Quarter include:

- Callable capital reserves increased from \$431 billion in December 2014 to \$466 billion.
- The total percent of equity financing for leveraged buyouts remained at 42 percent.
- First quarter numbers outpaced seven of the last nine first quarters reported since 2005.

“Following a record-breaking fourth quarter in 2014, PE investment deal volume remains strong,” said Steve Judge, President and CEO of the PEGCC. “The industry is poised to continue to act on opportunities to help grow our economy and create jobs through investments in businesses.” “We usually see a seasonal slowdown in private equity activity in the first quarter,” said Bronwyn Bailey, Vice President of Research at the PEGCC. “For 2015, that trend has been tempered by stronger deal and exit volume than in previous first quarters.”

While the net job creation via private equity investments is often in dispute, it is clear that investment volume remained strong in Q1 2015 and presently the pipeline of investment opportunities for the balance of the year into 2016 look solid.

The Look Ahead

The shifts in sentiment as well as the market’s dips and swoons during the first quarter served as a reminder that complex undercurrents often determine market direction and its balance. While the secular bull market has continued, it is important to remember that market leadership shifts at different points in a market cycle. Rather than flocking to the latest winners or getting swayed by short-term events, I believe we should continue with laser focus on a well-thought-out, disciplined investment plan that aligns with your long-term wealth objectives. In addition, I believe that active portfolio and risk management remain paramount to navigating your accounts through tumultuous and dynamic market environments. Allocation from fully-valued and somewhat over-valued assets into lower-valued and rising assets, or lower-valued yet reasonably-priced assets... and in some cases cheap perhaps even unloved/despised assets remain the pragmatic move for 2015.

International markets particularly emerging, as well as non-U.S. small & mid cap companies are looking more attractive with better valuations and growth projections. Global allocation



strategies should be considered too. Paradoxically while central banks have washed the globe in expansive money supply policies there are opportunities arising in illiquid and less liquid private equity investments. We should continue to look to the second half of the year for opportunities that could emerge as *energy contracts expire* fully exposing various participants to current oil market pricing. Also those in need of liquidity and/or capital are also prime candidates for investment. Thus the private equity investments in areas of energy related, distressed, growth or opportunistic buy-out including direct/co-investment, and secondary funds (focused on and legacy partnerships/businesses in need of an exit) remain on the radar.

Yet in the short term of the next 2-4 quarters the U.S market could continue to set new highs, *and give pause to selling some of those gains to buy into assets that are rising slower or worse that are momentarily in decline.* Maintain your discipline and continue to diversify a.k.a buy low and sell high.

At our next meeting we will discuss the challenges and opportunities that the current market may present for your specific situation, or if you have questions or concerns about your investments or your long-term strategy. I look forward, as always, to working with you toward your financial goals. If you have any concerns, questions, or general thoughts about your portfolio or any other matter, please never hesitate to contact me.

Let us enjoy the arrival of spring and the emergence of new ideas.

Appreciatively,

Walid L. Petiri

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Sources: Barclays Capital, MSCI Barra, Russell Investments, Standard & Poors, Reuters, Federal Reserve Board