Financial Services Advisory
GROW WISER®

Taking a Rest at the Next Landing

First Quarter Market Review From Your Portfolio Management Team—April 8, 2014

Ever since we moved out of the shadow of the financial crisis five years ago, we have been accustomed to strong returns in the first quarter. From 2010 – 2013 the average return for Q1 was over 8%. When you consider that the average long-term return from stocks is roughly 10% (back to 1926), you get the idea that we have gotten the majority of the returns for the year in the first quarter.

So, it comes as a bit of a surprise that the returns for stocks this year have come in so modestly. The S&P rose less than 2%, while the Dow Jones Industrial Average (of 30 large US companies) actually posted a slightly negative return. Also somewhat surprisingly, bonds, which have been much-maligned recently, actually matched the return from stocks in the first quarter—with much less volatility. As a result, clients in more conservative strategies (which tend to hold more bond funds) performed as well or better than clients in more aggressive strategies. It goes to show that markets are fickle, and sometimes patience and a willingness to ignore the media can be a good recipe for investment success.

At FSA, we often talk about markets moving in a staircase pattern until they hit a ‘landing’ or stalling out period, before the next staircase continues (either up or down). Most stocks were exhibiting this pattern of stalling out in the first quarter. Even though the overall trend of the market looks healthy, we are paying attention to this recent landing to see if the next staircase direction turns down.

Index	*Q1*
Dow Jones 30	-0.7%
S&P 500 Index	1.8%
EAFE	-0.3%
Barclays Bond	1.8%
90-Day T-bills	0.0%

Source: Ned Davis Research
Note: EAFE represents the MSCI index of foreign stocks; Dow Jones 30 represents the Dow Jones Industrial Average; Barclays Bond represents the Barclays Capital Aggregate Bond Index. Q1 covers the period from 12/31/13 – 3/31/14.

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Portfolio Review

Below we review the five broad strategies that FSA manages. Keep in mind that your specific portfolio may differ to some degree from the averages, as our portfolios are individually managed.

Income (Strategy #1)

Most bonds posted consistent and positive returns in the first quarter, a welcome change from the difficulties of last year. These portfolios are pretty well diversified across a range of bond types, including high yield, investment grade, and floating rate funds. During the quarter we added an emerging markets bond fund to some of the portfolios that had some available cash.

Income & Growth (Strategy #2)

With a high allocation to bonds, this strategy also managed a solid result in the first quarter. The 40% allocated to stock funds includes funds that are more conservative than the broad market, and these funds performed right in line with expectations. We made no changes to this strategy during the quarter.

Conservative Growth (Strategy #3)

With a balanced allocation among stocks (50%) high yield bonds (20%) and high quality bond funds (20%), Conservative Growth portfolios posted a solid return as all three of these areas moved up in the first quarter. During the quarter we added a large cap fund to most portfolios, as well as trimmed back the Consumer Staples sector fund, as these stocks struggled a bit in the first quarter. We also added a balanced fund that has a focus on both high yield bonds as well as utilities stocks.

Core Equity (Strategy #4)

This strategy managed to post a positive return in the first quarter on the strength of health care and transportation sectors, as well as, the high yield bond positions. We sold the retail sector fund and reduced the leisure fund position, as those areas weakened. In addition, we sold the emerging markets position as those stocks stumbled in January. That is an area of opportunity in 2014, so we may look to emerging market stocks later in the year, if the trends reverse. Finally, we added a real estate fund to most portfolios, as these stocks, which lagged in 2013, appear to have turned a corner this year.

Tactical Growth (Strategy #5)

Market weakness in January lead us to reduce a few areas where we had an overweight (including small-cap stocks and Consumer Staples), as well as, shift that money into stronger areas—biotech, silver, and internet. Unfortunately, these areas sold off in late March and pulled down the returns. We also added an inverse emerging markets fund late in the quarter, which has yet to pay off. As a result, Tactical Growth finished the quarter slightly negative.

*These allocations represent the money market levels of our various strategies, including trades through March 31, 2014. Performance numbers for FSA portfolios represent composite results. A complete Performance History of all FSA strategies is available upon request.

What's Ahead

We are moving into a period when greed returns to the stage, and not only is making money paramount, but it will be important to measure how much. Complacency will set in as investors want to participate in the growing mania. There are nearly 9,000 stocks listed on the exchanges in the U.S., so during any year, there will be a handful with spectacular returns. Unfortunately, many of those stocks will give up most of those returns in the following year. The hot areas of the market these days include: social media stocks, electric cars, and biotechnology. Last year, companies involved in 3-D printing technology were the rage, but they have already begun to retreat in 2014.

Stocks have had a strong run over the past five years, so now is a good time to keep expectations in check. Stocks are currently marking time at a landing and we can't predict which direction stocks will move next. We remain poised to increase our allocation to stocks if they break out in an upward direction, but recognize that stocks could also break down from these levels, and we need to remain vigilant for a reappearance of the bear market—an animal we have not seen in over five years.

Please let us know if there are any changes to your personal situation that might suggest some changes to your investment objectives.

Ronald Rough, CFA
Director of Portfolio Management