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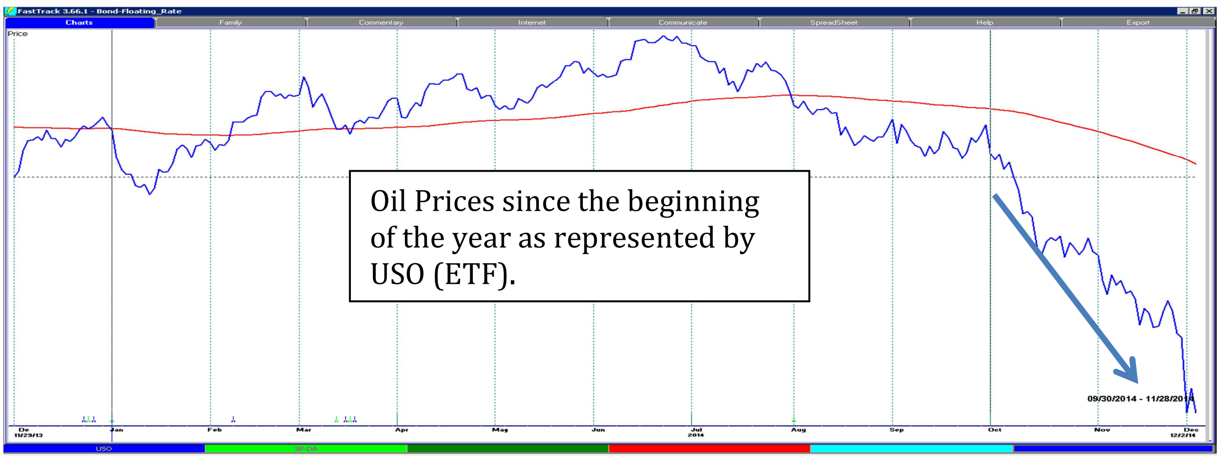
Will Falling Oil Prices Give Investors a Holiday Gift?

November Market Review From Your Portfolio Management Team—December 10, 2014

The U.S. stock and bond markets have surprised most observers this year with their consistent gains. Most presumed a more choppy affair for stocks in 2014 and that bonds would continue down the dismal path they began in 2013. Well, true to form, the S&P 500 index has managed to prove the experts wrong and has posted very respectable results in 2014, well ahead of its long-term average of 10%. And rather than turning in another negative result like last year, bonds have managed to post solid results near 6% for the year.

Why have the markets turned so favorable this year, especially given all the concerns as we entered the year? As is often the case, reality turns out not to be as bad as forecasted. As one example, economic growth in the U.S. has continued to remain strong enough for employment to improve, allowing consumers to feel better. The election has once again managed to create a condition of complete gridlock in Washington. That should mean that neither party gets to push a narrow agenda through the political system—which is usually good news for Wall Street.

Another recent bonus has been the drop in oil prices. The price of a barrel of oil was around $115 in late June, but has recently been trading below $70. The graph below shows the dramatic drop since the summer, with most of the damage coming over the past two months. What does this mean for you? Well, unless you work for company that is tied to the oil industry, it could mean more money in your pocket. Falling oil prices usually translate into falling gasoline prices, which means it won’t take as much money to fill up your car. This could be a handy boost in income, especially as we have entered the holiday season.



Source: Fasttrack

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The only potential concern could be that these falling oil prices suggest weakening global demand which could be setting the stage for another global recession. And we all remember what happened the last time we had one of those. It wasn't pretty. While global growth is below average in many parts of the world—in particular in Japan and Europe—growth is strong enough in the U.S. and China to keep the economic engine moving forward, for now.

Another interesting development from the drop in oil prices has been the impact on high yield bonds. Energy holdings represent nearly 20% of the typical high yield bond fund, which helps explain their struggling performance over the past few months. The behavior of these funds is certainly at odds with the performance of the major stock averages. As you know, we hold roughly 20% of these types of funds in your portfolios. We have begun to trim back those positions, and if their performance continues to lag, we will remove them completely from the portfolios.

Fortunately, there are other places to invest the money, so at least there are alternatives to just keeping the money in money markets.

For those of you with taxable accounts, we will be sensitive over the next several weeks to the reality that mutual funds will be paying their year-end distributions. To avoid saddling you with that taxable event, we may delay purchases until after the funds pay those distributions, or try to find reasonable alternatives that are not making large distributions. After we cross in to the new year, we will re-align the taxable portfolios back to their current strategies.

In closing, we want to express our appreciation for your friendship and loyalty over the years. We wish you a wonderful holiday season with family and friends.

Ronald Rough, CFA
Director of Portfolio Management