Financial Services Advisory
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The Last Shall be First

January Market Review From Your Portfolio Management Team—February 11, 2014

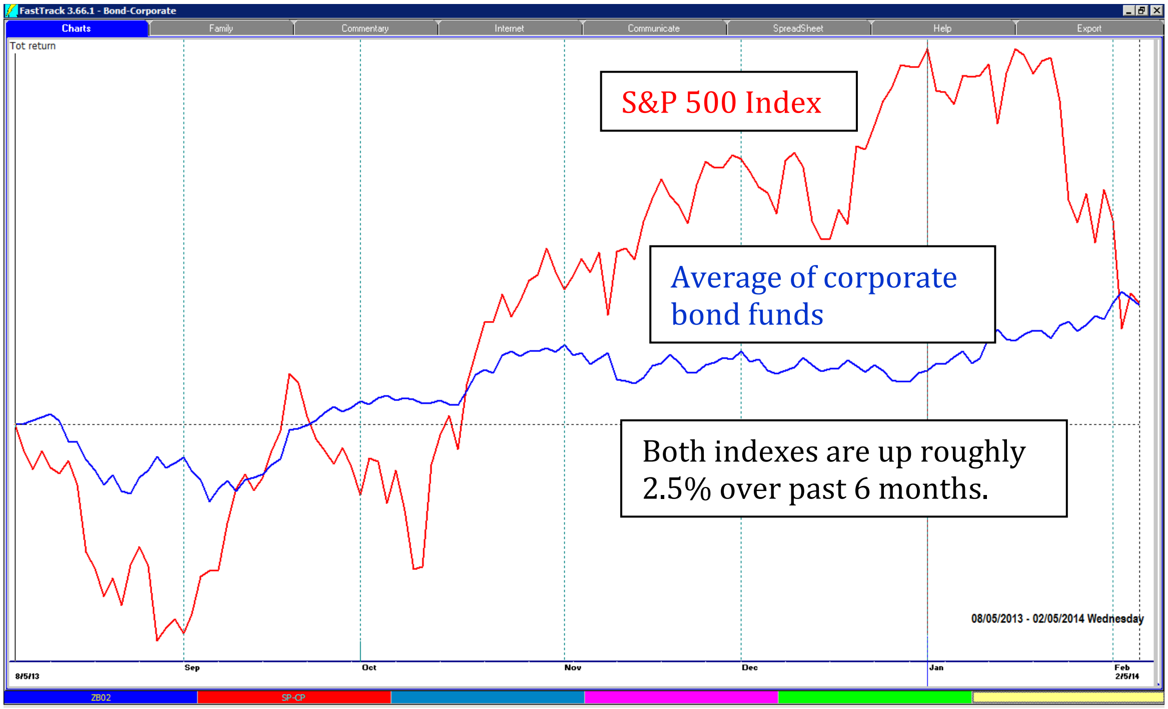
U.S. stocks and bonds were on two completely different paths last year, with most stocks finishing over 20% higher and plain vanilla bonds actually posting slightly negative returns. Many experts are expecting that trend to continue in the years ahead (i.e. stocks up, bonds down).

Well, one month into the new year of 2014, and we are witnessing a curious thing; namely, stocks have stumbled out of the gate to their worst one-month performance since May 2012. Bonds, on the other hand, are moving consistently higher. The S&P 500 index finished the month down over 3% while the standard bond index finished the month up over 1%. As a result, portfolios that include a higher percentage in bonds are performing ahead of more aggressive portfolios that contain mostly stock funds.

We would caution against reading too much into a one-month result. Stocks performed so well last year that they were past due for a decent correction. And at this point, with stocks down only about 5%, we cannot even call this a correction; however, investors are clearly on edge right now, so we may see more selling pressure in the days or weeks ahead.

The chart below is telling, if not surprising. It shows that over the past 6 months, stocks and bonds have returned essentially the same—both up just over 2%. In spite of the strong returns from stocks over the past 12 months, the past 6 months show stocks and bonds running dead even.

Bottom Line: We are not giving up on bonds just yet, as long as the trends continue to move higher. They deserve a place in more conservative portfolios.



Outlook

Historically speaking, a negative return in January often suggests a flat-to-down year for stocks. Additionally, in the three previous occurrences when bond returns were negative, they bounced back the next year with double digit returns. So, this year may turn out more positively for bonds and less positively for stocks. Of course, these occurrences are historical tendencies that do not necessarily hold true every year.

On the other hand, if we are at the beginning of a longer term secular decline in bond prices, we should see another weak year for bond returns (less than 2%). So, we will be paying close attention to the bond market this year to see if we are at the cusp of a true sea-change in bond prices. So far, bonds are behaving quite well.

As for stocks, with the general exception of emerging markets—which are behaving poorly—most areas are in solid uptrends (in spite of the rocky start to the year). If the weakness in January extends into February, you will begin to see some defensive actions in many of the FSA portfolios. However, at this time, the weight of the evidence is with the bulls, so we will maintain our positions until market weakness trips our FSA Safety Nets®.

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