Financial Services Advisory
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Fortress America Carries the World in 2014, But Can it Continue?

Year End Market Review From Your Portfolio Management Team—January 16, 2015

As 2014 comes to a close and we ring in the new year, we can celebrate another solid year for stocks and bonds which have pushed our accounts to all-time highs. Stocks have generally rallied since the terrible financial crisis of 2008, carrying the S&P 500 index to an all-time high.

In addition, the economy seems to be finally gathering strength, with the most recent reading of economic growth hitting 5%, a level not seen since 2003. As long as the economy is strong and the Federal Reserve is keeping an accommodative policy towards interest rates, the consensus view is that the stock markets should continue to generate good returns for investors.

While we celebrate the gains, we also continue to be on our guard for signs of market stress. In 2014, we benefitted from the strong returns in the U.S. (particularly among bigger companies). In addition, the U.S. dollar was up over 10%, which dragged down returns of foreign investments. As a result, Japan was down 4%, Europe was down 6% and emerging markets were down 2%. While diversification is typically a good thing for investor portfolios, last year any diversification away from US large-cap stocks resulted in reduced returns.

Even within the generally rosy large-cap stock indexes the strength was in only a few areas. Technology and health care really drove returns in 2014, while a number of sectors lagged considerably—energy stocks being a notable example.

As we've mentioned in the past, this lack of broad participation is a warning sign for us. In a healthy environment, we like to see small-cap stocks leading the way, along with emerging markets stocks. We also like to see high yield bonds participating with the stock market. Unfortunately, high yield bonds have reversed course recently and finished the year up only 3%. These observations, along with a pick-up in market volatility, are the reasons we have money market allocations slightly elevated currently. In most portfolios, the money market position is between 15% - 20%.

Early Look into 2015

Historically speaking, there are some cross currents as we head into the new year. The current bull market run is seven years old, which is longer than average. Conventional wisdom suggests we should be on the lookout for a strong correction or even a bear market. On the other hand, 2015 is the third year of the 4-year Presidential cycle, which is historically the strongest.

The good news, on the economic front, is that the economy seems to be finally gathering strength, with the most recent reading of economic growth hitting 5%, a level not seen since 2003. As long as the economy is strong and the Federal Reserve is keeping an accommodative policy towards interest rates, the consensus view is that the stock markets should continue to generate good returns for investors.

With most stock indexes in uptrends, as well as most bond indexes (with the exception of high yield bonds), we will enter 2015 with a measure of optimism. Nevertheless, as is our style, we will be sensitive to recognizing a change in the environment that might put stocks and/or bonds on a more negative course.

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)
While bonds, in general, stalled out in December, for the most part, they finished the year with solid returns. We removed the modest high yield positions and floating rate note funds we held, as those areas weakened. We have the money market allocation a little high in this strategy, but plan to reduce the allocation in January if bonds can break out of their recent trading range.

Income & Growth (Strategy #2)
This strategy took a cautious path in 2014 and finished the year with positive returns—our main focus for this conservative strategy. We sold the high yield bond and floating rate note positions, as those areas rolled over in November/December.

Conservative Growth (Strategy #3)
It was another consistent year for this balanced strategy. We sold the 20% allocation to high yield bonds in the fourth quarter and moved some of those proceeds to high quality bonds and some to equities. The money market levels are a bit higher than earlier in the year, but remain relatively low at 10% - 15%. We can use this cash early in the new year as new trends become apparent.

Core Equity (Strategy #4)
There were a number of successes for this strategy during the year, including its holdings in health care, REITs, and Transportation. Those strong results were offset by struggling returns from the high yield bond positions. We sold the high yield positions during the fourth quarter and moved those proceeds to the Retail sector and the Industrials sector, in addition to some general diversified funds.

Tactical Growth (Strategy #5)
This strategy had the most challenging year, as the narrow market was not conducive to the more active trading style of Tactical Growth. In addition, our forays into foreign funds, as well as anything invested outside of domestic large company stocks, did not work out. In spite of the challenges, there were a number of bright spots, including our long-term holding in an S&P index fund, plus positions in biotechnology and transportation. We sold the high yield positions in the fourth quarter and redeployed that money to general stock funds, as well as a gold fund and a small-cap fund. The elevated money market position gives us ammunition to add to our positions once the trends of the new year become evident.

Make sure to reach out to us if there are any changes to your personal situation that might suggest some changes to your investment objectives. Changes to your long-term goals may have an impact on what strategies we suggest for your portfolios.

In closing, we wish you and your families and friends a wonderful New Year of health and happiness.

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