New Albany
Investment Management

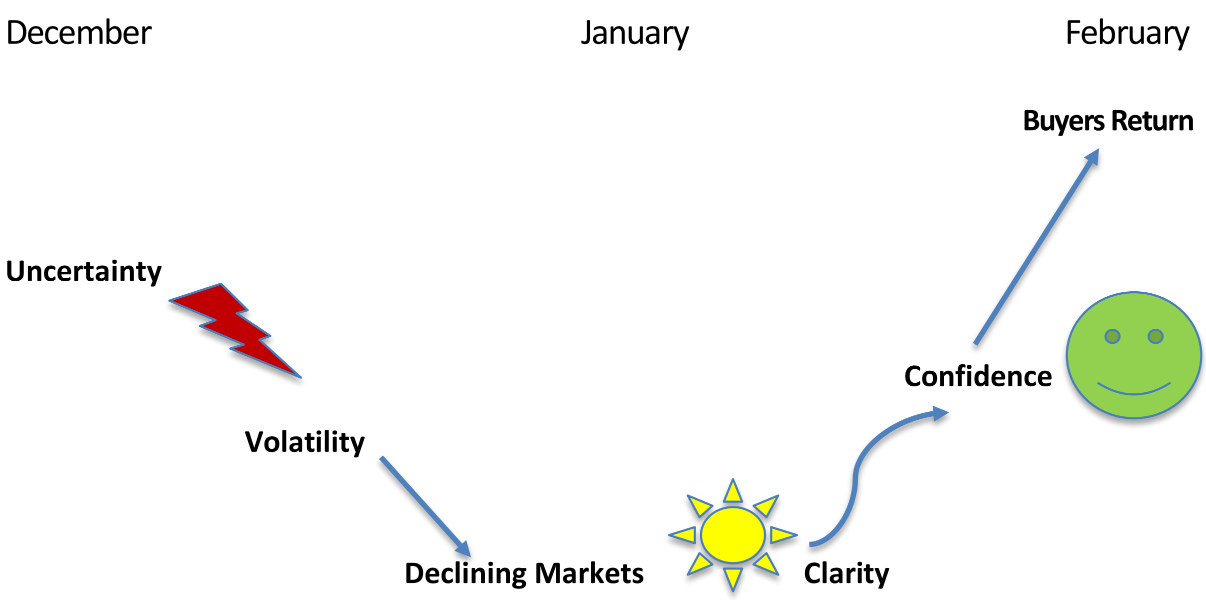
March 2, 2015

Market Insight: All Calm for Now

After two months of stormy markets, the skies cleared in February and investors found their confidence to bid some sectors of the market to record highs. The dramatic decline in oil prices, fear of slowing global growth, and unremarkable 4th quarter earnings were dark clouds that have finally passed. Now investors' are building confidence again, hoping world economies and earnings will somehow improve. Given the lofty level of prices today, are investors' naïve or smart to put more money into the market at these levels? Is it just optimism or are there legitimate building blocks to support future growth and even higher prices? The following discussion looks at some key fundamentals and give perspective on this debate.

For those of you who like graphs, this ***Market Insight*** is for you!

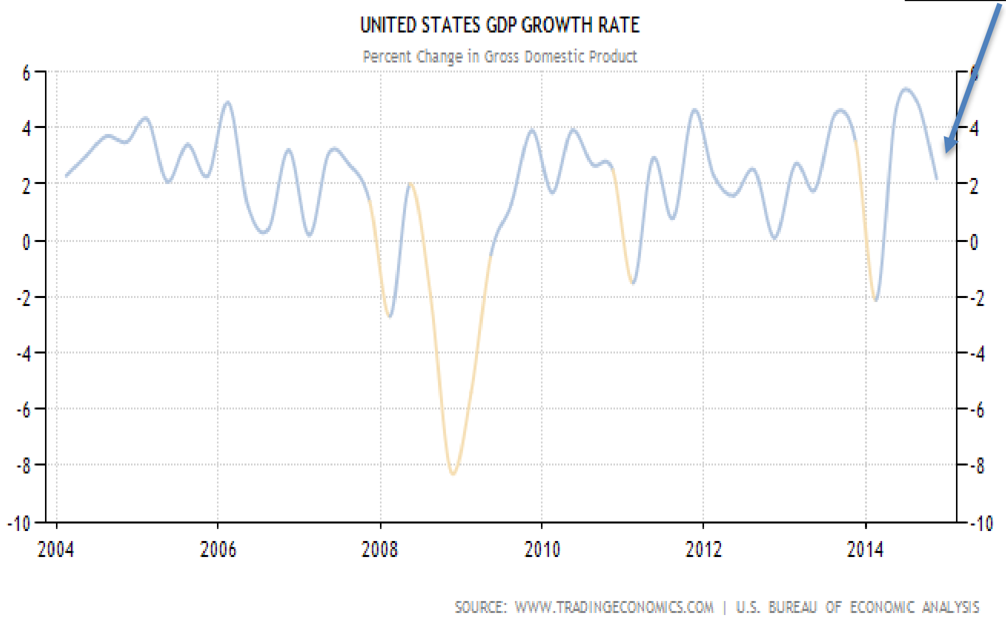
Market Action over the last three months:



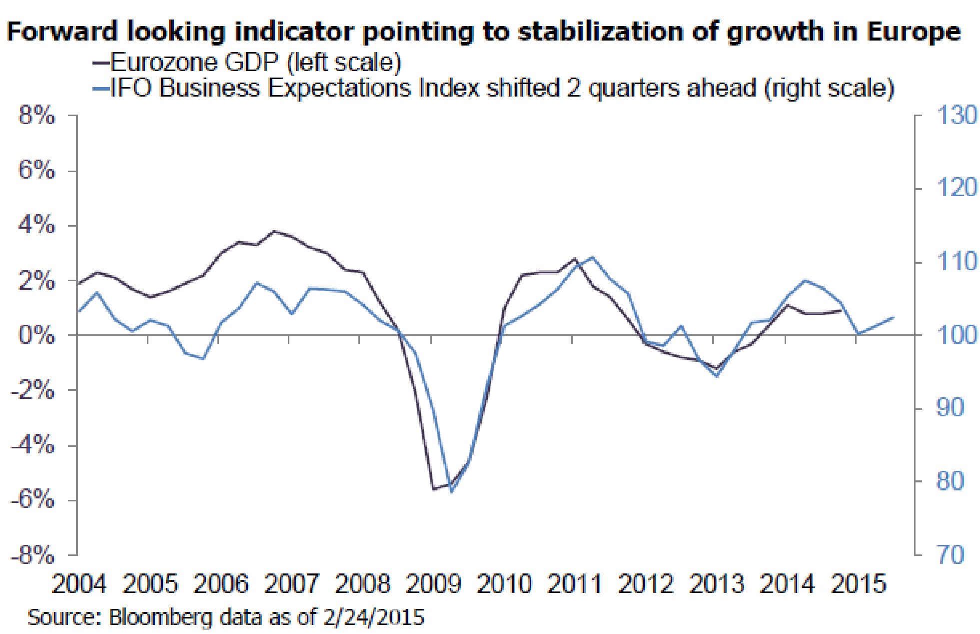
Economic Growth: Unremarkable

US GDP: Economic growth needs to pick up to support earnings growth.

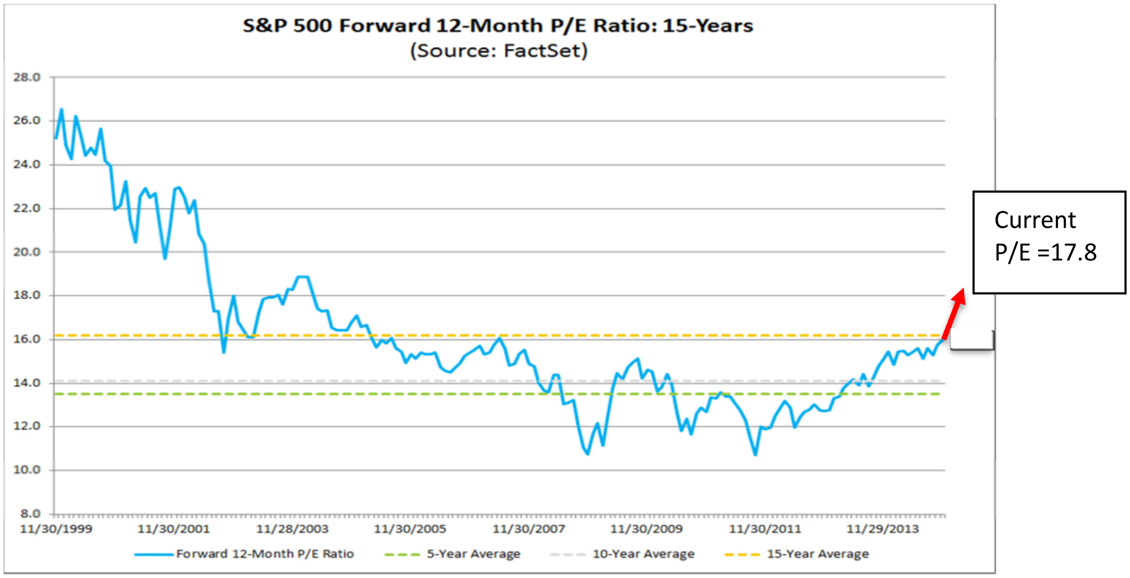
GDP falls back to 2% in 4th Qtr



European GDP: Barely growing but perhaps stabilizing.

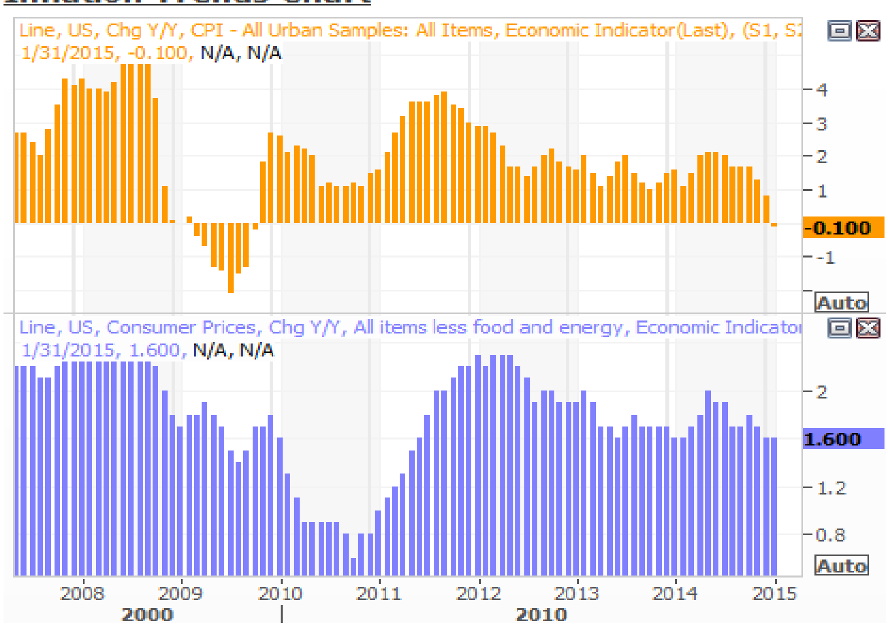


Valuation Level: Neutral-to-High 4th Qtr earning results show the forward-looking Price-to- Earnings ratio stands at 17.8, the highest since 2004. However, it is important to note long term interest rates were more than double in 2004 what they are today (10yr 4.4% then verse 2% today). Never the less, the rising P/E indicates investors are willing to pay more today for future earnings.



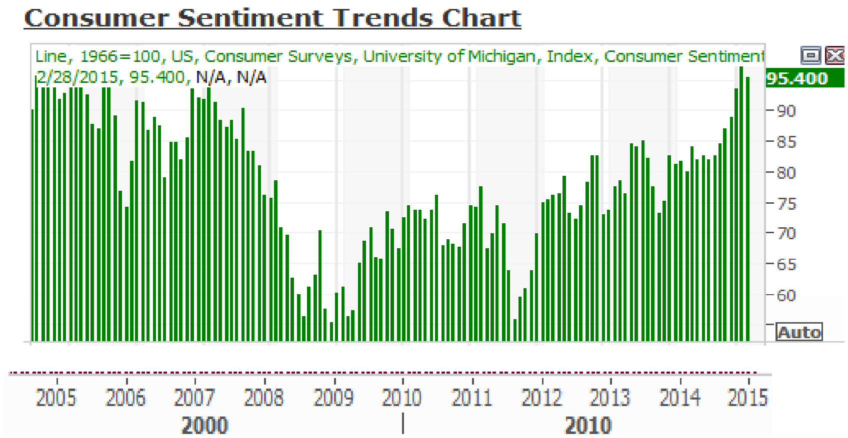
Inflation: Very Low! Annualized inflation now stands at -0.9% due to dramatic fall in oil. Ex-oil, CPI is 1.6% and still quite low. This is a positive for consumers and will keep the Fed in check from raising rates too rapidly. But if consumer prices start falling, deflation would be a big negative for company earnings. The chart below shows Total CPI (Top- Orange) and Consumer Prices (Bottom- Blue).

Inflation Trends Chart



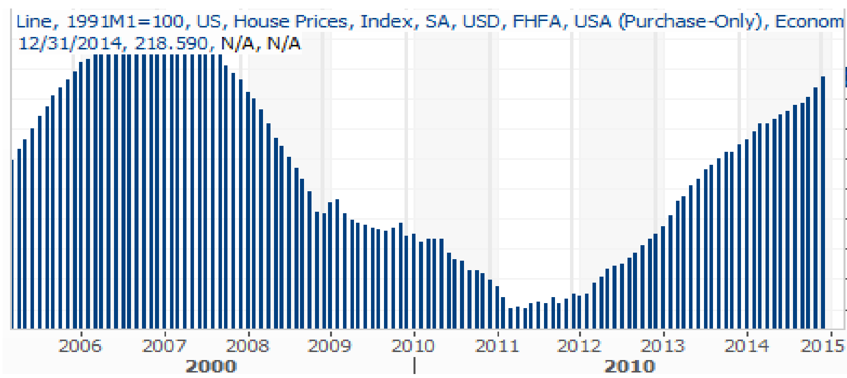
Source: Thomson Reuters Eikon

Consumer Sentiment: Strong! This is a leading indicator of Consumer Spending which makes up about 69% of GDP. So when sentiment is rising, that implies future growth.



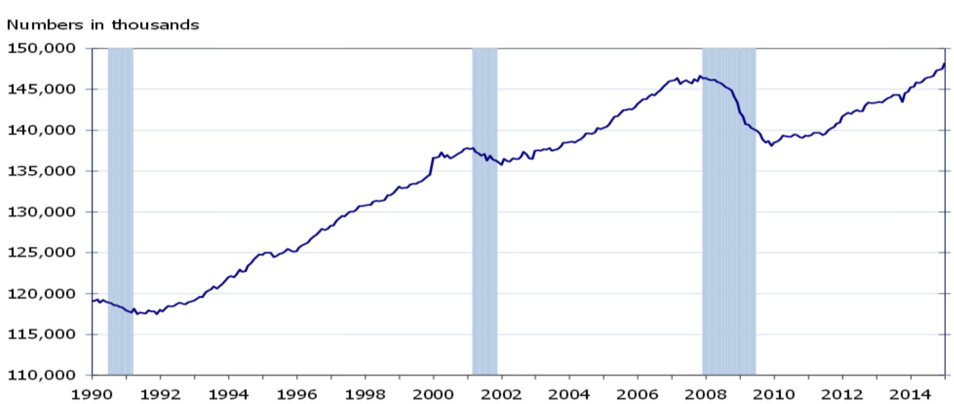
Home Price Trends: Strong! When home prices rise, consumers feel wealthier and will spend more. Thus another leading indicator showing future growth.

Home Prices



Employment: Strong! Improving employment is <u>essential to a healthy, growing economy</u>. In another sign of strength, last week the world's largest retailer, Walmart, agreed to raise wages for 500,000 employees and other retailers are considering following. This will be a boost for growth as long as prices don't rise too.

Civilian Employment



What does it all mean for the Investor?

- **Growth is positive but slow**
- **The consumer is more confident which should foster accelerating growth**
- **Exceptionally low inflation and interest rates and rising employment are a huge positive**
- **Earning growth will be positive albeit at a slowing rate compared to previous years**
- **Markets will be subject to higher volatility (more down days) but should drift higher**
- **Returns will be positive but lower than years past**

Investment Strategy: No change in positions over the last month. Portfolios are broadly diversified across asset classes to ride through the volatility and each portfolio is performing quite well. Smooth sailing for now!

As always, please contact me with any questions or concerns.

Kind Regards,

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