New Albany
Investment Management

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Market Insight: Unspectacular First Quarter. What about the Year?

Happy Spring! Thank goodness winter is over and so is this quarter.
As this quarter draws to a close the US equity market has stalled near the same level it began the year. Despite briefly making new record highs, the market retreated back to familiar ground, as uncertainty over geopolitical events and the impact of severe weather on the economy zapped investor confidence. It may prove to be quite some time before the market can generate a straightforward period of gains. This would not be the first time that this long bull market has stalled. In fact it should be remembered that in 2011, the US market spent the whole of 2011 in a trading range, swinging more than 20%, but finishing the year only 0.4% higher. Is 2014 going to be another year of choppy markets and without any legitimate market opportunities? Perhaps, and definitely not! Let's take a look at what's happening…

Clear as Mud: Investors always want clarity before stepping into the market pool. Unfortunately, it will likely be mid-summer before there is a clearer picture of the true strength of the US economy, post winter. Meanwhile, resolution of geopolitical events move at molasses speed, thus this uncertainty is likely to continue to be a 'brake' to any upward price momentum. In addition to this, the new Fed Chairwoman, Janet Yellen, has tried to give clarity on the Fed's plan of removing stimulus while at the same time vowing 'extraordinary support to the economy for some time". So from an economic standpoint, the directional bias for the market is clear as mud.

Safety Assets Back In Vogue: A choppy market pushes investors out of riskier sectors and into perceived safe havens. Despite a flat performance overall for the S&P, performance varied widely. The more volatile sector, Consumer Discretionary, fell over (-4%), mainly due to an exceptionally weak Retail group. Meanwhile the Utility sector, considered less risky, rose +6.8%. At the same time, Bonds outperformed stocks, 'Value' stocks outperformed 'Growth', and Gold was up +9% (verses -28% in 2013). All of these sector shifts are completely opposite of the action in 2013 and reflect a return to 'safety first' mood.

Outside the US, the relative performance gap in Europe was more along geographical lines than sector specific. Italy posted a remarkable 11% gain as their economy continues to strengthen, while Germany lost (-1%) on the heels of tensions with Russia. Japan was the worst performer for the quarter, falling (-8.5%) after rising +56% in 2013 due to anticipation of the impact of domestic sales tax. And perhaps the most surprising performance was Emerging Markets where despite it being the epicenter of both currency and potential turmoil, the index was on down only -1.8%.

Flexibility and Diversification Allow for Opportunity: It has indeed been a choppy market environment, where sector rotation is abrupt and short lived. In this setting, a high portfolio concentration in any one type of asset, group of assets, or sector can add huge volatility to the overall portfolio return. So how does one navigate a portfolio through choppy waters? Flexibility and broad sector diversification are key. An investment strategy that incorporates actively managed funds and multiple sector funds will allow opportunity to capture return and reduce volatility.

Secular Bull Market Needs a Rest: The current bull mark is 5yrs old, and showing signs of slowing but not ending. The spectacular gains in 2013 perhaps borrowed from this year, such that a long period of consolidation is warranted and healthy before further gains can be justified. The market may well remain volatile through the summer, but as clarity in the economy materializes, investors will again gain the confidence to push the market higher into year end.

Investment Strategy in Volatile Markets: In early February, the investment strategy for each portfolio was realigned to better navigate a more volatile market. Risk was reduced slightly, through changing the asset mix and type of assets held. In addition, the portfolios were further diversified through reallocating some assets away from the purely 'directional' risk assets (large cap growth funds), and into 'dynamic' risk assets (funds that are flexible in adjusting risk up, down or across asset classes as market conditions change). The result has been lower volatility and better return than the broad market this quarter.

Please contact me with any questions or concerns.

Kind regards,

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