New Albany
Investment Management

September 30, 2014

3rd Quarter Review: Wide Divergence in Performance both Inside & Outside the US

It has been a choppy quarter across the global markets. In the US, Investors have grappled with the impact of eventual rising short term rates while outside the US, both the economic and geopolitical news has been unfriendly to the markets. Europe is flirting with another recession; Japan is trying to yank its economy out of deflation; and China's growth is slowing. In addition, investors are trying to assess the ramifications of War on two fronts. Thus the days where 'all boats (markets) rise in a rising tide' are over and the task of investing has become even more arduous.

The wide divergence of performance in and across global markets reflects the waning impact of easy monetary policies on economic growth and the reality of political uncertainty. The following charts and graphs give perspective on market performance and tell the story of how investors have become highly selective both in choice of Country and Market Sector, revealing an uncertain and defensive mood.

Within the US: Large Cap stocks continue to lead the charge for the quarter with Healthcare and Technology the stellar performers. On the flip side, all Small Cap sectors have struggled this year, a departure from their strong leadership the previous years. (Interestedly, over a three year period, performance is quite tight across all stock sectors.) Meanwhile the US Bond market had a great first half, benefiting from falling global rates; however, it has since stalled during this quarter as the reality of the Fed raising rates becomes apparent.

US Markets Sectors (Source: Morning Star)

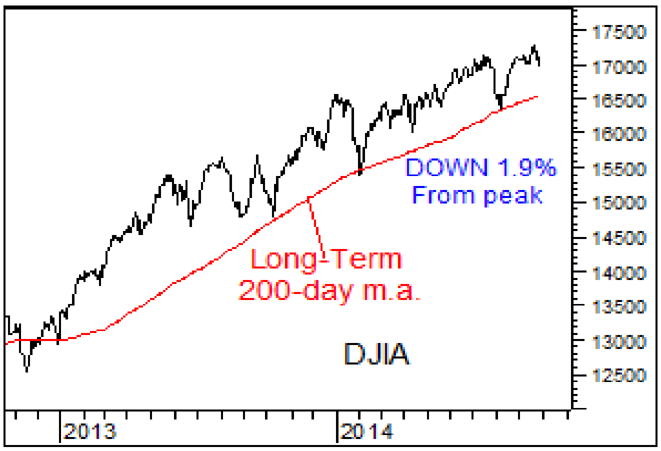
Sector	3rd Quarter to date	Year to Date	3yr
Large Cap	**1.6%**	**8.7%**	**21.9%**
Small Cap	**-4.6%**	**0.2%**	**21.6%**
US Bond	**0.3%**	**4.2%**	**2.5%**

World Markets Diverge: Economic growth and geopolitical fears weighed heavily on performance around the globe. With US growth solidly around 3%, it remains the market of choice both in terms of true earnings growth potential and a safe haven for investors.

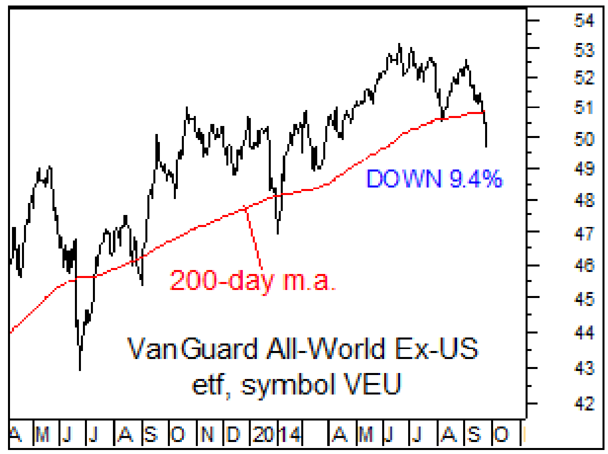
Sector	3rd Quarter to date	Year to Date	3yr
US Stocks (DJIA)	**1.9%**	**4.8%**	**18.2%**
Europe/Asia/ Far East	**-5.5%**	**-1.3%**	**12.9%**
Emerging Markets	**-3.5%**	**0.7%**	**4.1%**

The graphs below show several world market indices' performance (black line) over the last two years in comparison to their 200-day moving average price. Notice two facts: The US market (DJIA) is the only market to make new highs during the quarter and the only market to still be above its 200-day moving average. What does this mean? The US market, in particular the Large Cap sector, is still firmly in an uptrend while the other markets have capped out for now and may be entering a downtrend. (Noteworthy but not shown in these graphs is that the US Small Cap sector also shows a breakdown of trend.)

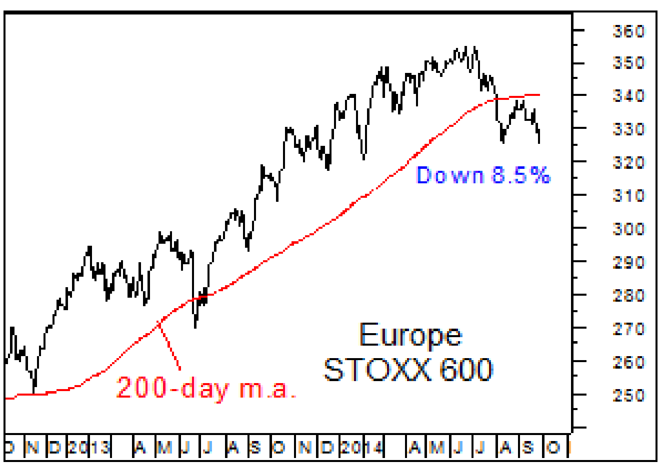
Dow Jones Industrials (DJIA):



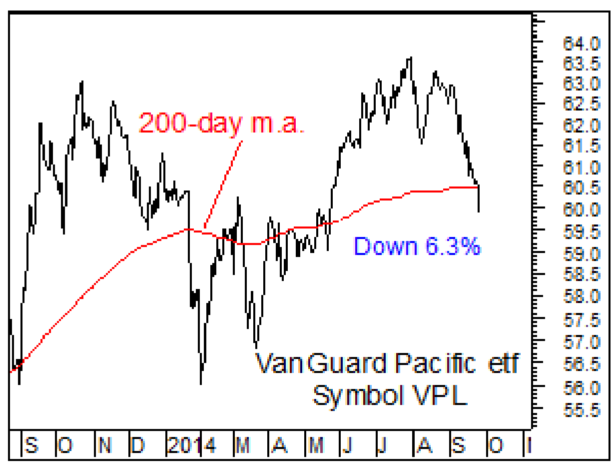
Combined World Markets Ex-US:



Europe:



Asia Pacific:



Still Positive: Despite all the headwinds markets are facing, there is still good reason to be positive about investing in the US. With solid trend like growth, low inflation, a strong dollar, and very low rates (even after the Fed moves) it actually is a healthy environment for stocks. Corporate balance sheets are very strong and have the capacity to spend. The labor market is continually improving, and consumers are spending. And with heightened geopolitical fears, the US is the 'go to' place for investors. Remember, the last thing the Fed wants is to impede growth!

Getting back to Normal Market Volatility: We have been lulled to sleep with below normal volatility over the last three years and the recent volatility has been a bit of a wakeup call. The market environment has indeed changed. With economies now moving more independently, heighten geopolitical risk, and narrow sector leadership, volatility will be higher and moving back to more normal levels (1-2% swings in a day). That being said, once earnings season is over (late October) the markets should gain traction again and remain firm into year end.

Investment Strategy: Portfolios are fully invested however early in the third quarter, risk was reduced in anticipation of choppy markets. Equity positions were further diversified across asset classes to minimize volatility and High yield exposure was reduced and allocated into investment grade short term bonds.

Please contact me with any questions or concerns.

Kind Regards,
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