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Market Rally Endures

By Louis E. Conrad II, CFA

- The stock and bond markets have both rallied year-to-date, with the bond market's gain especially noteworthy, as interest rates have unexpectedly declined.
- COMPASS' outlook for the capital markets for the balance of 2014 is relatively subdued, however, given the gains already enjoyed by investors and the underlying economic backdrop.

As of late August, the S&P 500, a proxy for U.S. stocks, had advanced 8.0% year-to-date, while international, developed market stocks had gained only 0.4% and emerging market stocks had risen 8.4%. The U.S. bond market also continued its 2014 rally, increasing 4.8%, as the interest rate on the 10-year Treasury unexpectedly declined by 0.70% from 3.0% at year-end 2013.

This year's unexpected bond rally has been supported by less issuance of Treasuries (i.e., less supply) as federal tax receipts have improved with the economy, as well as Treasury purchases by foreigners (i.e., more demand) as yields on European sovereign debt fell below comparable maturity Treasuries.

Stock Market Outlook

COMPASS' expectation for stocks this year is for appreciation roughly in line with underlying earnings, or in the mid- to upper-single digit area. Consequently, given the stock market's gains year-to-date, COMPASS does not expect much further appreciation during the balance of 2014.

For nearly one year, COMPASS has believed the stock market was susceptible to a pause or even a correction (a decline of 10% or more) due to its unusual strength in 2013 and a lack of a meaningful correction since the summer of 2011. However, the largest decline we have experienced over the past twelve months was a six percent decline in early 2014. Corrections are a normal occurrence; in fact, according to research by Capital Research and Management Company, corrections occur, on average, about once per year and last nearly four months.

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More about COMPASS Wealth Management, LLC

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COMPASS Wealth Management, LLC is a client-focused wealth management firm dedicated to providing superior advice to individuals, families, and corporate retirement plans.

Our wealth management services include investment management, retirement and gift planning, education funding, and other advisory services.

We take pride in offering you expert financial advice along with personalized service. Assisting you in reaching your financial goals is our business and we take that responsibility very seriously.

For details on the selection criteria used to determine the recipients of the FIVE STAR Wealth Manager award, please visit our web site.

Market Rally Endures, continued

Stock market corrections that reflect a pause in a bull market advance are not of great concern to COMPASS. However, stock market corrections that reflect the end of a bull market, normally due to an economic decline, are of concern as they will often cause COMPASS to reallocate a client's portfolio. Deciphering which type of correction the stock market is telegraphing is then the key judgment.

Any stock market correction in the near term is expected to be just a pause in the current bull market advance. The U.S. economy is now on solid footing and economic data bears this out. Despite the fact that the current economic expansion has entered its sixth year, COMPASS does not expect an economic recession in the U.S. for at least 1 – 2 more years.

Economic and market cycles have historically lasted about five years on average, so this economic expansion is long in the tooth. However, the growth experienced during the current expansion has been subdued as leverage has been withdrawn from the financial system and the economy has healed from the Great Recession. COMPASS believes this will lead to a longer economic expansion this cycle.

Bond Market Outlook

In regard to the bond market's prospects, the underlying fundamentals of the economy and U.S. bond market point to higher yields, but the lingering effect of the Federal Reserve's policies, low European sovereign debt yields, and a reduction in Treasury debt issuance, have allowed Treasury yields to drift lower year-to-date, leading to an unexpected Treasury bond market rally. COMPASS believes these influences will subside and bond yields will again rise, leading to pressure on bond prices, especially longer term maturities.

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