Economic Update- January 2015

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Happy New Year! Beginning now, BAM is introducing a bi-annual Economic Update. Please Enjoy and may you have a healthy and prosperous 2015!

- The US economy continued to rebound in the third quarter 2014 rising 5.0%, up from a previous estimate of 3.9%. The final numbers for the first and second quarters were 2.9% and 4.6%, respectively. The strong increase in real Gross Domestic Product (GDP) in the third quarter primarily reflected positive contributions from PCE (personal consumption expenditures), nonresidential fixed investment, federal government spending, exports, state and local government spending, residential fixed investment and a decrease in Imports.

- The PCE increased 3.2% in the third quarter led by durable goods which increased 9.2%, while non-durables and services lagged the average with each increasing by only 2.5%.

- According to the US Bureau of Labor Statistics, 2014 ended with a December unemployment rate of 5.6% which is 1.1% lower than the December 2013 rate of 6.7%. The year end 2014 rate was 0.08% lower than the September 2014 rate of 5.9%. The number of unemployed persons declined by 383,000 to 8.7 million. The civilian labor force participation rate edged down by 0.2 percentage point to 62.7% in December.

- According to the Department of Housing and Urban Development, the US housing market indicators improved in the third quarter of 2014. Starts for both single-family and multifamily housing continued to rebound. The purchase of new and existing homes increased, while inventories decreased for both. Third quarter construction also rebounded after a slow first quarter with starts on single-family homes at 654,000 units up 5% from the prior quarter and experienced a year over year increase of 9%. Third quarter multifamily housing starts rose to 363,000 units in the third quarter, an increase of 5% from the previous quarter and 35% from the previous year. Building permits issued also rose in the third quarter with permits for single-family homes and multifamily building up 2% and 1% respectively, over the second quarter. "The share of single-family housing starts has fallen from 85% in the 2009 when the recovery began, to 63% in the third quarter of 2014. "Delinquency and foreclosure rates on mortgage loans fell to their lowest levels in more than six years according to the Mortgage Bankers Association (MBA), and RealtyTrac® data show that foreclosure completions continued their downward trend, reaching their lowest level since the beginning of 2007." At year-end 2014, the average 30-year mortgage rate decreased to 3.86% from 4.16% in September 2014, according to Freddie Mac.

- On December 30, 2014, the Conference Board announced that its Consumer Confidence Index® (CCI) "bounce(d) back" after a decline in November. The December CCI was 92.6, up from 91.0 in the prior month. The Present Situation Index increased a dramatic 4.9 to 98.6, while the Expectations Index decreased 0.8 to 88.5 in November. The Conference Board noted that "consumer confidence rebounded modestly in December, propelled by a considerably more favorable assessment of current economic and labor market conditions. As a result, the Present Situation Index is now at its highest level since February 2008 (104.0). Consumers were moderately less optimistic about the short-term outlook in December, but even so, they are more confident at year-end than they were at the beginning of the year"

- At the end of October 2014, the Federal Reserve (FED) ended its program of purchasing mortgage and treasury bonds, commonly known as quantitative easing noting that "there has been a substantial improvement in the outlook for the labor market since the inception of its current asset purchase program. Moreover, the Committee continues to see sufficient underlying strength in the broader economy to support ongoing progress toward maximum employment in a context of price stability." On December 17, 2014 the FED stated that since the October Federal Open Market Committee meeting "Labor market conditions improved further, with solid job gains and a lower unemployment rate. On balance, a range of labor market indicators suggests that underutilization of labor resources continues to diminish. Household spending is rising moderately and business fixed investment is advancing, while the recovery in the housing sector remains slow. Inflation has continued to run below the Committee's longer-run objective, partly reflecting declines in energy prices. Market-based measures of inflation compensation have declined somewhat further; survey-based measures of longer-term inflation expectations have remained stable." In order to support continued progress toward the FED's dual mandate of maximum employment and price stability, the FED reaffirmed its view that the current 0 to 0.25% target range for the federal funds rate remains appropriate.

- Today 1/22/2015, the European Central Bank (ECB) is set to begin its own moderated financial stimulus package by announcing it is beginning to purchase government bonds in an effort to stimulate growth and ward off deflation. This is a reversal of policy previously based on fiscal tightening to battle deflation but did not produce substantive results.

- On December 4, 2104 the European Central Bank (ECB) decided that "the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.05%, 0.30% and -0.20% respectively." The ECB forecasts "real GDP increasing by 0.8% in 2014, 1.0% in 2015 and 1.5% in 2016." Compared with the September 2014 ECB projections, the projections for GDP growth have been revised substantially downwards for both domestic demand and net exports. The risks to the outlook "are on the downside" due mainly "to the weak euro area growth momentum, alongside high geopolitical risks, has the potential to dampen confidence and especially private investment. In addition, insufficient progress in structural reforms in euro area countries constitutes a key downward risk to the economic outlook."

- At year-end 2014, the S&P 500 stood at $2058.90 up 4.39% from the prior quarter and 11.39% for the year. Assuming dividends the return for the S&P 500 was 12.99%. The DJIA lagged, while the NASDAQ Composite outperformed, the S&P with returns of 7.5% and 13.4%, respectively. As measured by the SPDR sector ETFs, of the 9 sectors represented in the S&P, the Utilities sector was the strongest performer for the quarter with a gain of 13.08%. Five other sectors out-performed the broader index for the quarter including Consumer Staples (8.32%), Healthcare (7.45%), Consumer Discretionary (8.66%), Industrials (7.07%) and Financials (7.19%). The Technology sector had a positive return (4.15%) but underperformed the S&P 500 Index. Not surprisingly, the Energy sector was the largest underperformer for the quarter with a loss of 12.07%. The only other sector with a negative return for the quarter was the Materials sector (-1.39%).

- In Fixed Income, the Barclays U.S. Aggregate Bond Index ended 2014 up 5.97%, the strongest return since 2011 when the Index returned 7.84%. U.S. Treasury yields continued to fall with the 10 year note and the 30 year bond falling by about 35 and 46 basis points (less than 0.05%) ending 2014 at 2.17 and 2.75% respectively. At the beginning of 2014 the 10 year note stood at 3.00% while the 30 year bond was 3.90%. Inflation pressures weakened during the fourth quarter reflected in gold prices experiencing a small loss of about $10.75. The December 31 closing price for gold was about $1199.25 per ounce. Oil prices continued their declines through the quarter falling more than $35 per barrel to end 2014 at about $60.70 per barrel. The US Dollar Index continued to strengthen to end 2014 at 90.27 from about 84.94 on September 20, 2014.

Conclusion:

- With the end of political noise created by the mid-term election cycle, we expect the moderately positive financial news to continue as the economy recovers at a slow, manageable rate. We look for continued low interest rates coupled with slowly rising energy costs. Reduced consumer overhead expenses should drive improving consumer sentiment. Real wage improvements in 2015 should be coupled with continued earnings increases and an attractive equity market. Notwithstanding the negative political noise surrounding an elongated Presidential election cycle, we believe patient investors will continue to be rewarded.

Supplemental

- Attached below is our Charles Schwab's (one of our custodian's) most current economic report:
  http://www.aboutschwab.com/images/uploads/inline/Schwab-2015-Market-Outlook.pdf