WEALTHMANAGEMENT NOVEMBER 2014

VOLATILITY RETURNS

SUMMARY

In the last 45 days, market volatility has increased sharply amid renewed concerns about deteriorating economic growth prospects, particularly outside the U.S. The U.S. dollar has strengthened in recent months due to lackluster economic data in Europe, Japan, and other developed countries around the world, while oil has dropped to multi-year lows on projections of lower global demand.

Equity markets appear to be reacting to the increasing murmurs from many market pundits, managers and traders that stocks are long overdue for a pullback. Investors will be watching the current corporate earnings season very closely, as they always do, for indications as to the health of the business climate.

While sharp moves in market indexes may be disconcerting to investors, especially after several years of strong gains and historically low market volatility, experts will encourage investors to stay focused on investing to meet their financial goals and to make certain that their holdings and asset allocation are in line with their goals, time horizon, risk tolerance, and personal circumstances.

THE 2014 CORRECTION & Q3 EARNINGS

Major U.S. stock indexes have declined 5% to 10% from their all-time highs recorded just in the prior month; a drop of at least 10% is the traditional definition of a market “correction.” Corrections are funny. Everyone wants one, calls for one and hopes for one until they are here, then questions and wonders if the “end is near”. From September 18th, 2014 to October 16th, 2014 the S&P 500 lost 7.39%. Since then the markets have rallied back and nearly all of the losses have been recovered.

Q3 U.S. corporate earnings have been mostly favorable. As of October 29th, 2014, 41% of the companies in the S&P 500 have reported and 76% have beaten their earnings estimates. At the sector level, the Industrials (92%) and Health Care (86%) sectors have the highest percentages of companies reporting earnings above estimates, while the Telecom Services (36%) and Utilities (33%) sectors have the lowest percentages of companies reporting earnings above estimates. In their earnings releases and conference calls, a number of companies have cited the negative impact of the stronger dollar on both results for the third quarter and expected results for the fourth quarter. Comments from companies regarding Europe have generally been mixed, while comments regarding China have generally been positive than many expected.

Looking at forward estimates, analysts are projecting much higher earnings growth in first half of 2015 compared to Q3 2014 and Q4 2014. They are not, however, predicting a substantial improvement in revenue growth, which implies that net margins are expected to increase in future quarters as well.

MACROECONOMIC CONCERNS ARE WEIGHING ON EQUITIES

WEAKENING GLOBAL ECONOMIC GROWTH

In early October, the International Monetary Fund (IMF) reduced its forecast for global economic growth. This merely confirms what many economists have observed, economies around the world are struggling to expand and in general, demand for goods and services are lower.

Japan contracted sharply in the second quarter of 2014 following an April 1 sales tax increase; the Eurozone recovery has been faltering, with some countries at risk of slipping back into recession; and emerging countries, especially China, are continuing to decelerate from prior record levels.

While some recent U.S. economic data have been disappointing, many experts believe that the U.S. can maintain its recent growth rate in the face of an incremental global growth slowdown—assuming that the impact is limited to trade channels and is not felt substantially through a more general increase in uncertainty that causes a pullback in capital expenditures or hiring.

Investors quickly forget the U.S. had an exceptionally strong 2nd quarter GDP of 4.6% after a negative 1st quarter GDP, attributed mostly to the colder than normal winter that most of the U.S. endured.

As recently as of October 30th, early 3rd quarter GDP reports of 3.5% bolstered economist views that the U.S. is expanding and continuing to grow.

WHAT'S THE FED'S NEXT MOVE?

The Federal Reserve, as expected, finished tapering its asset purchases on October 29th, which some would say represents a reduction in Fed stimulus. Additionally, increases in short-term U.S. interest rates are projected to begin sometime around mid-2015—possibly sooner—if central bank officials believe they need to respond to strong economic data, which will be monitored closely.

While the U.S. economy seems to be one of the healthiest in the world today, rising interest rates (i.e., higher borrowing costs) could temper the pace of economic growth, which is slower than growth in previous U.S. economic recoveries.

EFFECTS OF A STRONGER DOLLAR

In anticipation of higher U.S. rates next year and the weakening economic profile of other countries, the dollar has strengthened significantly against most currencies in the last 30 days. U.S. corporations earn a significant percentage of their profits from overseas operations, which means that a stronger dollar—all other things being equal—reduces the value of foreign earnings in dollar terms. The market's downturn could reflect fears of weaker-than-expected earnings in the third quarter and in future quarters if the dollar continues to rise. However, the stronger dollar also benefits domestic consumption, which can also improve prospects for many businesses.

SPREADING EBOLA VIRUS

Ebola has become an epidemic in West Africa, yet sporadic reports of patients on U.S. soil with the Ebola virus or Ebola-like symptoms are raising concerns that hospitals and medical authorities are not prepared to stop a possibly wider outbreak, especially if the virus mutates and becomes airborne. If fears of contamination discourage domestic and international travel or commerce, economic growth could be affected, as well.

DON'T PANIC. MARKETS CORRECT

While the recent market decline is relatively mild when you factor in the last two years of solid gains and low volatility the sell-off was short and violent and scared many people. Many investors who lived through the steep market declines of 2008 and 2009 may be inclined to "get out now" because they are afraid that the current correction will become worse—which, of course, no one knows for certain.
Historically, corrections happen on a regular basis; the most recent correction for the S&P 500 Index lasted from late April through early October 2011 when the S& P 500 lost roughly 18%. Since then, it has been relatively calm in the volatility department with the worst monthly drop in the S & P 500 being the -6.27% in May of 2012.

However, not all corrections turn into bear markets, which are declines of 20% or more. In fact, over the last 50 years we have seen nearly one 5% correction every year. Most investors probably have a long time frame during which corrections, bear markets as well as bull markets, will occur on a pretty regular basis. This is why understanding your risk profile is so important.

TAKE TIME TO REVIEW YOUR GOALS AND RISK TOLERANCE

At WT Wealth Management we help our clients stay focused on their long-term goals by having the appropriate risk models in place. Risk modeling, in our opinion, is the most important ingredient in a successful financial plan. Speculators attempt to time the markets or adjust their portfolios every time the market gyrates. Investors are disciplined, block out the noise, and have a strategy to mitigate risk and always stay fully invested.

Before making any significant strategy changes, we insist that clients come in for a “one-on-one” review in order to insure that their portfolios allocations reflect their personal risk tolerance.

WE ARE HERE TO HELP

It is our job to assist in making sure your risk tolerance is appropriate for your overall investment objectives. An inappropriate mix of investments could jeopardize your chances of achieving your financial goals—be it growth or income or both. At WT Wealth Management we preach that you should always have a broadly diversified portfolio and your asset mix should become more conservative as you get closer to your goal. Of course, diversification cannot assure a profit or protect against loss in a declining market, but it may help you sleep better if you understand your plan.

Investing is nearly counter intuitive; when the stock market is not rising, you may feel as if your equity investments are not really earning anything, and you might feel inclined to curtail your exposure. While you may be tempted to redirect your investments to more stable alternatives during times of heightened volatility, this course of action could lead you to miss a stock market rally.

If we have done the proper planning and understand your goals and objectives, maintaining your allocations is nearly always the best plan. If your time horizon has shortened and/or you have a lower tolerance for volatility than the last time we met, we should revisit your risk tolerance immediately.

DISCLOSURE

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Any opinions expressed are the opinions of WT Wealth Management and its associates only. Information is neither an offer to buy or sell securities nor should it be interpreted as personal financial advice. You should always seek out the advice of a qualified investment professional before deciding to invest. Investing in stocks, bonds, mutual funds and ETF’s carry certain specific risks and part or all of your account value can be lost.

In addition to the normal risks associated with investing, narrowly focused investments, investments in smaller companies, sector ETF’s and investments in single countries typically exhibit higher volatility. International and Emerging Market ETF’s investments may involve risk of capital loss from unfavorable fluctuations in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Bonds and bond funds will decrease in value as interest rates rise. A portion of a municipal bond fund’s income may be subject to federal or state income taxes or the alternative minimum tax. Capital gains, if any, are subject to capital gains tax.

Diversification and asset allocation may not protect against market risk or a loss in your investment.

At WT Wealth Management we strongly suggest having a personal financial plan in place before making any investment decisions including understanding your personal risk tolerance and having clearly outlined investment objectives.

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