2nd Quarter 2014

MARKET OUTLOOK

As we indicated in our last Newsletter, we do have headwinds that continue to be of concern for our economy and our markets. The first quarter was nothing if not volatile. You might say that it matched our weather pattern! Thank goodness, at least the weather seems to have calmed down now that spring is finally here. Many economists continue to suggest that weather was a large factor contributing to the disappointing data in January.

Geopolitical events continue in Ukraine and Russia with sanctions that could affect our European allies as well as energy markets. The good news for the U.S. is that our energy market is showing strong growth in oil and natural gas production. Some suggest that we are well on our way to energy independence. This could be the growth engine out of this slow growth economy to a more robust economy.

Stocks still look attractive, relative to other options. Although some economists suggest that we may be in another bubble, we do not see a bubble – not like the tech bubble in 2000 or the housing bubble in 2007/2008. Stocks appear to be priced fairly by historical standards. Does that mean a calm market? Not at all. We expect volatility to continue with corrections along the way.

It is important to understand the effect that movement in interest rates has on the economy and markets. The Federal Reserve has kept rates low for so long, it is reasonable to be concerned about the effect of the phase out of bond purchasing. That being said, new Fed Chair, Janet Yellen, has indicated that they will have a watchful eye on the economy as they maneuver through these uncharted waters. Those of us who have been around for a very long time, never expected to see rates this low and we certainly have been anticipating a return to normal at some point. Again, the process may take longer to accomplish than we thought, but rates will increase as the Fed sees a stronger economic environment that can withstand small adjustments upward. And we do mean "small" moves in the ¼ percent range. And we expect the Fed to provide warning well in advance of such moves. The last thing they want is to stall the growth of our economy.

So let's look at what an increase in rates would actually signal, when the time comes. It would mean that consumer confidence is up and more people are feeling better about spending. This would mean lower unemployment as employers hire to meet increased demand. It would indicate that corporations are spending the buildup of cash on their balance sheets as they have started to hire and make capital improvements. All of this should be good news for markets! Additionally, savers who lend money to corporations or to the government (via bond purchases) will be rewarded with higher coupon payments and greater cash flow.

A leading indicator of anticipated earnings growth is corporations increasing their dividends paid to shareholders. We are seeing many doing exactly that. As companies are currently reporting, many are beating expectations. This is not surprising given the efficiencies put in place to weather the economic downturn. In hard times, employers cut payroll and expenses that are not essential as they become more efficient and productive. As the economy picks up steam, CEOs put the cash to work for their companies.

This model is not unlike our own at HFRG. We have been using cash in portfolios as an asset class and it has served us well. It has made the volatile ride of the markets a little calmer and has provided us with the opportunity to take advantage of the dips to add to positions at lower prices. We do this as we rebalance portfolios. We sell positions that have run up in value (capturing the upside) and buy positions that have been out of favor (buy low). We would love to share this process with you at your next meeting. Technology is a wonderful tool and we love providing a more in-depth look at how we arrive at strategies and implement them in our portfolios. Recently, in a client meeting, we were asked why we had several investment options representing various asset classes. The question was, why not just one. We were able to illustrate our methodology and how we are able to provide a calmer market experience while increasing the return on a risk adjusted basis. Having started my career as a math teacher, it was such fun to have a teaching moment!

We continue to have exciting news here at HFRG. Carlton and Alyssa will be married June 21st at a ceremony in Maine. We shall all be there to celebrate together. My oldest granddaughter and Sean's daughter, Lexi, will be returning from a very successful freshman year at Virginia Tech where she has decided to double major in finance and accounting. (You know her grandmother LOVES that!) Ryan and Melissa's daughter, Keelin, celebrated her 3rd birthday March 28th and Finley turned 10 months and took 4 steps over Easter. We hope your spring and summer are full of enjoyable and relaxing vacations with family and friends. As always, we enjoy being part of your lives and appreciate your trust in us.

Patti, Ryan, Carlton, Sean and Kristal