ROOF ADVISORY GROUP, INC.®
INVESTMENT ADVISORY & FINANCIAL PLANNING SERVICES

INVESTMENT INSIGHT

January 2014

4th Quarter Review: A Tale of Two Markets

For equity and bond markets, 2013 was a year of extremes. Equity markets experienced 'the best of times', where the S&P 500 logged its best gain since 1997, increasing by 29.6% and the Dow Jones Industrial Average logged its best gain since 1996, increasing by 26.5%. Meanwhile, fixed income markets experienced 'the worst of times', experiencing its worst year since 1994 with a -2.0% loss over the twelve month period. The yield on 10 year Treasury notes spiked from 1.76% at the beginning of the year and closed at its highest level during 2013 at 3.03%.

Overall performance for equity markets was positive in the fourth quarter, but it was not without drama. While it seems as though it is in the distant past, the U.S. Government closure in early October started the fourth quarter off in the seemingly wrong direction. Never before had such dysfunction in Washington, DC led to the threat of a government shutdown being used as a form of negotiation. Yet on October 1st, the federal government closed its doors due to the refusal of Congress to pass a budget. As if the government shutdown wasn't bad enough, the issue of the debt ceiling was set to come to a head two short weeks after the budget deadline had passed. With threat of U.S. default becoming a more likely possibility, Congress finally reached an agreement that would fund the government through January and alleviate the debt ceiling through February. Since that time, a bipartisan budget agreement has been reached to fund the government for two years, averting another government shutdown in January. However, the debt ceiling has not been addressed and could provide additional volatility to markets should an agreement not be reached prior to the February 7th deadline.

Despite the political skirmishes that took center stage in the media, the market's primary focus was on the Federal Reserve and their actions towards the tapering of their bond buying program, also known as Quantitative Easing (QE). Chatter surrounding the end of QE began in May of 2013 with the expectation that tapering of bond purchases would begin in September. Equity markets were largely unaffected by this revelation. Bond markets, however, viewed the move negatively and began to sell off. Then in September, the Federal Reserve meeting came and went with no hint at tapering bond purchases or even a date as to when the tapering might start. Both equity and fixed income markets rallied on the news in September, which set the stage for a stellar fourth quarter.

It wasn't until the December 2013 meeting that the Federal Reserve announced their plan to begin tapering. It was with great care that Chairman Bernanke made the announcement, indicating that there was no set path or timeframe for tapering to be complete. Contrary to the belief of many so-called financial gurus and market pundits, equity markets rallied on the news of taper; bond markets, however, continued their slide. Despite equities being pulled off of 'life support', the uncertainty surrounding the taper was now gone, which fueled equities to a strong close in 2013.

Throughout the year, Roof Advisory Group had been positioning client portfolios to deal with rising interest rates. Duration had been cut nearly in half in an effort to preserve asset valuations in the rising interest rate environment. In addition, fixed income and cash were held at the lowest levels allowed by client Investment Polices for much of the year; a focus on higher yielding equities was utilized to generate income. Equity exposure remained at maximum for much of the year, taking advantage of the run up in equities.

The coming year will provide many of the same challenges and opportunities as 2013. Interest rates are expected to rise at a modest pace throughout the year, political discourse will once again take center stage and will be exacerbated by the mid-term election year, and equity markets are anticipated to remain bullish as companies continue to report improved earnings and the economy continues to recover. Foreign equities may present a unique opportunity as the world economy continues its recovery as well. At the present time, equities remain a superior investment opportunity relative to fixed income and will remain at their current maximum weighting in client portfolios.