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

INVESTMENT INSIGHT

1st Quarter Review

Impact of the Globalized Economy

After being spoiled in 2013, investors were faced with sideways volatility in the first quarter of 2014 as equities exhibited ups and downs that left investors looking for a reason to send markets higher. Despite this indecisiveness, the S&P 500 managed to produce a small gain, finishing the quarter up 1.3%. The NASDAQ also logged small gain on the quarter, increasing by 0.5% while the Dow Jones Industrial Average fell 0.7%. Fixed income markets had a pleasant rebound from an ugly showing in 2013; the Barclays U.S. Aggregate Bond Index registered a gain of 1.8% for the first quarter as dollars moved from more risky assets into the perceived safety of fixed income securities and other lower risk assets.

The biggest event that left investors questioning the direction of the market came in late January and early February as the S&P 500 dropped more than 5.5% over eight trading days. The primary reason behind the decline was widespread fear of possible financial disasters in emerging markets. China's economy, a large source of demand for emerging market goods, exhibited increased signs of weakness. In addition, the Federal Reserve's continued fortitude to taper their bond purchasing program lead to a fear among global investors that an increase in U.S. interest rates could have a ripple effect that would have a significant impact on emerging markets. Turkey, South Africa, Brazil, and Argentina all saw their currencies tumble as investors quickly moved their dollars out of emerging markets and into safer investments. These renewed fears of potential financial crises overseas caused much of the volatility that was felt in the first two months of the year. Despite the potential doom-and-gloom scenarios that were hyped by the media for these emerging economies, no real threat actually materialized and the market fully rebounded by the end of the quarter.

Russia further complicated things in late February when they sent troops into Ukraine's southern peninsula of Crimea. After the Ukrainian revolution earlier this year, Russia feared losing access to Crimea, one of its most important economic hubs, as Ukraine was shifting towards a stronger relationship with Europe and cutting ties with its neighbor to the east. Only a few short days after hosting the Olympics in Sochi, Russia was now seen as a bully in the international community that planned to annex Crimea from Ukraine. The continued uncertainty and potential for military conflict lead to choppy markets for much of February and March. While we remain watchful of this situation, a Russian invasion of Ukraine would likely lead to disastrous repercussions for Russia's financial markets and economy, a significant deterrent to them taking such a bold step.

The final piece of information that surprised markets took place during Janet Yellen's inaugural press conference as Fed Chair when she intimated that rates may go up as soon as six months after the Fed ends its bond buying program, which would be in the first half of 2015. However, in the same press conference, Chair Yellen indicated that the Fed had abandoned its target of 6.5% for unemployment that would have caused them to begin raising rates; the perceived intent of abandoning this target was to allow more flexibility on easy Fed policy as the unemployment rate had reached 6.7% without a significant pickup in economic growth. Despite the somewhat dovish outlook that Chair Yellen presented, the potential of rising interest rates in the first half of 2015 overshadowed her more accommodative remarks.

While the first three months presented a plethora of unique challenges, Roof Advisory Group remained at maximum equity exposure for the vast majority of the quarter in all Investment Policies. Despite choppy markets, it is expected that equities will provide more opportunity than the alternative options of fixed income and cash. We anticipate equity markets will continue to move upward throughout the year and that volatility will remain a factor. Interest rates are expected to continue their gradual climb throughout the year, especially if the Fed targets raising the Fed Funds rate in early 2015. Roof Advisory Group continues to position client portfolios to withstand this likely event, maintaining a shorter than typical duration in the fixed income portfolios of its clientele. Positioning client portfolios for volatile markets has been a focus in the first quarter; actively managed accounts have benefitted from a renewed focus on equity dividend yield and shorter duration of fixed income portfolios.