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

INVESTMENT INSIGHT

2nd Quarter Review

Profitable Second Quarter Highlighted by Economic Data and Problems Abroad

The second quarter of 2014 provided a much welcomed increase in equity and fixed income prices compared to the first quarter of the year. While there were a handful of disappointing economic readings, markets remained resilient; the S&P managed a 4.7% increase and the NASDAQ improved by 5.0%. The Barclay's U.S. Aggregate Bond Index also managed to show strong gains for the quarter, rising by 1.9%. Many of the foreign issues that held markets back in the first quarter remained ongoing, but have been erased from the memory of investors, which lead to gains in the major indices. Once again, familiar events domestically, as well as abroad, played a role in financial market performance in the second quarter.

The most notable data point released during the quarter was the estimate of first quarter Gross Domestic Product (GDP) and its subsequent revisions. The initial reading in April had indicated that the economy had grown by 0.1% in the first quarter. Then, in May and June, this figure was twice revised downward and was estimated in June to have contracted by -2.9% in the first quarter of the year. The revisions were the result of two primary adjustments—lower than expected healthcare expenditures and the impact on consumption and the housing market of an abnormally erratic winter. Despite the underwhelming data on economic growth, the Federal Reserve continued to implement its plan for Quantitative Easing (QE) by reducing purchases of Treasury and mortgage backed securities by $10 billion a month. Remaining steadfast on their plan to reduce purchases helped to eliminate much of the market uncertainty surrounding QE, sending stocks higher. We anticipate that the economy likely recovered in the second quarter with a positive growth reading, which is due to be released at the end of July; we similarly anticipate that the economy will continue to grow, albeit slowly, in the second half of the year.

The market stumbled slightly in June as President Obama addressed the nation about recent events in Iraq. The ISIS militant group had been capturing major cities in Iraq and had their sights set on the Iraqi capital of Baghdad. The uncertainty of potential U.S. involvement in Iraq's conflict left markets uneasy, leading to some short-term volatility in June. Roof Advisory Group contemplated reducing equity exposure pre-emptively to protect against these events, but ultimately decided to remain steadfast at the current level given the unlikely involvement of the U.S. military. Shortly thereafter, President Obama indicated that there would be no U.S. troops deployed to help in Iraq, providing enough reassurance for the market to continue its climb into the end of the quarter.

The Russia and Ukraine conflict persisted into the second quarter as well. The referendum vote held in Crimea that affirmed its absorption into Russia was deemed illegal by the United Nations. Russian President Vladimir Putin later admitted that Russia had been involved in the conflict from the beginning and had sided with Crimea in an effort to aid in Crimea's "self-defense" from the rest of Ukraine. While there is still a need for resolution in the region, military conflict seems unpalatable for both sides and a diplomatic resolution is a more likely outcome. The events in Ukraine have been monitored closely and will continue to be an area of focus while considering investment strategies for the third quarter.

While there were a few ups-and-downs in the quarter, financial market performance was overall favorable. Roof Advisory Group remains positioned with a bias towards equities over fixed income given risk-adjusted return potential. Client portfolios remained at maximum equity exposure for the quarter across all Investment Policies. Equity portfolio Beta remained unchanged during the quarter, despite fairly significant changes to composition of equity portfolios in many Investment Policies. Roof Advisory Group's current bias is to remain at maximum equity exposure with a focus on high quality, dividend paying equities.

Fixed income markets have provided a surprising boost to portfolio performance through the first half of the year as well. Many individual bonds have outperformed indexes for both fixed income and equities. Convertible bonds and preferred equity holdings have significantly enhanced overall portfolio returns so far this year. Despite the surprising performance thus far, we expect that return potential in bonds is limited for the remainder of 2014 and the likelihood of a major rate increase is significantly higher than that of a meaningful rate decrease; fixed income portfolio duration remains below historical norms as a result.