Bernard Wealth Management

28411 Northwestern Hwy. Suite 200
Southfield, MI 48034
(248) 556-2900
www.bernard-wealth.com

Second Quarter 2014

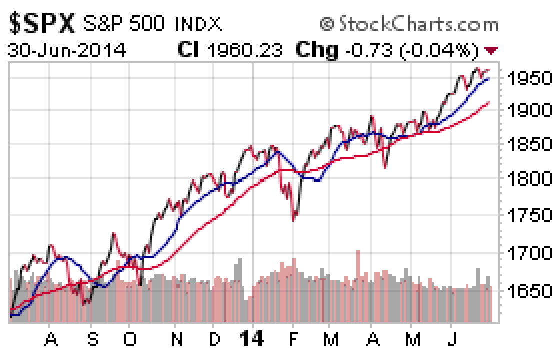

Fig. 1 – S&P 500

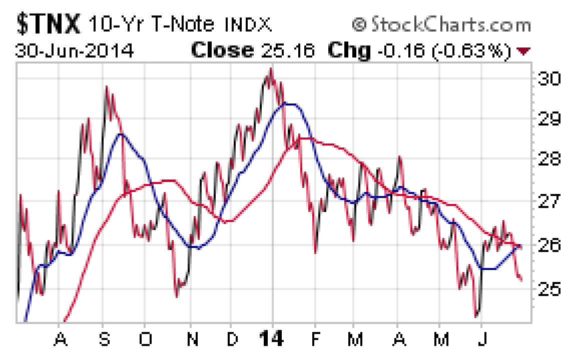

Fig. 2 – 10 Year U.S. Treasury Yield

U.S. stocks posted solid gains in the second quarter. The large cap S&P 500 rose 6.6%, and is now up 7.2% in the first half of 2014 (**Figure 1**). International indices also rose. The MSCI Europe, Australia and Far East Index rose 4.1% in the quarter, and is up 4.8% for the year. The MSCI Emerging Markets Index, playing catch-up, jumped 7.3%, and is now up 5.3% in 2014 (**Figure** 3).

According to Factset, 74% of S&P 500 companies beat first quarter earnings expectations while 54% topped revenue estimates. Earnings grew for the fifth straight quarter, rising 2.1% after gaining 3.5% in the fourth quarter of 2013. While tepid, this earnings growth came during a quarter in which GDP is estimated to have fallen 2.9%. Wall Street analysts have reduced expectations for second quarter earnings growth from 6.9% on March 31 to 5.1% as of June 27. This lowering of the bar may help set the stage for further stock gains in the upcoming earnings season.

The second quarter began with serious economic concerns, as analysts attempted to determine the extent of the slowdown caused by the extremely cold winter in much of the country. The initial reading of first quarter GDP showed a contraction of 0.9%, and this was later downgraded to -2.9%. Weakness was evident in consumer spending, and felt by retailers and other consumer discretionary stocks, which have lagged the rest of the market for most of this year (**Figure** 3).

However, many areas of the economy appeared to strengthen as weather returned to more normal (and warmer) patterns. Manufacturing surveys improved and were particularly strong at the end of the quarter. Perhaps most importantly, the spring thaw gave a boost to the moribund housing sector. Housing data generally exceeded expectations. In May, pending home sales posted the biggest increase since 2010, and new home sales also surprised, registering the highest annual rate since May 2008.

Index returns taken from Morningstar.com and iShares.com

Fig. 3 – iShares Emerging Markets

Fig. 4 – S&P Retail Index

The U.S. economy continued to add jobs in the quarter at a slow but steady pace. Job growth may be at a point where the labor force participation rate, which takes into account people who have stopped looking for work, may show modest improvement in the future. In addition, layoffs, as measured by Challenger's monthly Job Cut report and by initial unemployment claim filing, have trended lower.

Interest rates fell further in the second quarter (**Figure 2**). Tepid growth, along with continued dovish language from the Federal Reserve led to steady bond buying, even though the Fed is on course to end its bond purchases by October. New Board of Governors Chair Janet Yellen has been consistent in her message: the Fed will not allow interest rates to rise until the economy shows further strength, particularly in employment and wage growth. This stance has been supported by low annual inflation, which has stayed below the Fed's target of 2%.

The combination of low interest rates, modest inflation, steady job growth and a resurgent housing market helped consumer sentiment improve through the quarter. In the second half of the year, that confidence may well manifest in increased consumer spending. As consumption represents approximately 70% of the U.S. economy, GDP growth may rebound materially in the second half, and consumer discretionary stocks, including retailers, should post solid returns.

It is often noted that equity markets are generally weaker in the summer months than the rest of the year. As a result, many traders will cite the old saying "Sell in May, then go away". This year so far, that has been a losing strategy. The S&P 500 registered total returns of 2.4% in May, and another 2.1% in June. This highlights the difficulty of effectively timing the markets. Investors may be best served by identifying, purchasing and monitoring solid investments: returns are likely to be better over time than those earned sitting on cash.

We hope that you are enjoying a beautiful summer.

Sincerely,

Kenneth M. Bernard, CFA