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First Quarter 2015

Fig. 1 – MSCI Europe, Australia, Far East

Fig. 2 – S&P 500

After lagging the U.S. significantly for the past two years, international markets posted solid returns in the first quarter of 2015. The MSCI Europe, Australia and Far East Index (**Figure 1**) rose 4.9%, boosted in large part by the European Central Bank's bond purchasing initiative. The MSCI Emerging Markets Index also rose, gaining 1.9%. Emerging market performance varied widely. China and India logged solid returns, while commodity exporters Russia and Brazil suffered steep declines. U.S. large cap stocks barely eked out gains, as the S&P 500 (**Figure 2**) posted a total return of under 1%. Small companies fared better: the Russell 2000 Small Cap index added 4.3%, after trailing large caps most of last year.

U.S. earnings reported in the last three months were generally better than expected, helping to sustain stock prices. According to market research firm Factset, 75% of S&P 500 companies topped analyst estimates, and 58% beat revenue expectations. These numbers are roughly in line with results from recent quarters. Falling oil prices had weighed heavily on the energy sector, and this led to large downward revisions in earnings forecasts. However, earnings rose 3.7%, much better than the 1.7% growth rate feared at the beginning of the last earnings season. Looking forward, energy company earnings continue to pull down market expectations, with aggregate S&P 500 earnings expected to decline 4.6% in the first quarter of 2015. As earnings season begins, traders will be watching for signs that earnings will turn positive in the remaining quarters of the year.

In January, the European Central Bank (ECB) announced its long awaited bond buying program. This quantitative easing initiative, with at least 1.1 trillion euros committed to bond purchases, is designed to combat potential deflation in the stagnant Eurozone economies. The results thus far have been positive for financial markets overseas, boosting Eurozone stocks. The benefits of the bond buying can be seen in at least two important areas beyond European interest rates, which were already low. First, a large proportion of the euros added to circulation appear to be invested in stocks, pushing indexes higher. Second, the buying has accelerated the decline of the euro relative to the U.S. dollar, which may improve the cost structures and competitive positions of some Eurozone companies versus their U.S. peers. Most Eurozone economies will also benefit from the decline in oil prices.

In the U.S., economic readings for the quarter were mixed, and some showed signs of weakness. Manufacturing data and surveys were generally lighter than expected, with some forecasting an overall contraction. Some of this may be due to the strengthening of the dollar, making our exports less competitive. Another factor is the slowdown in energy-

Index returns taken from Morningstar.com

related activity. Following the rapid fall in the price of oil, many exploration projects have been halted or postponed, and corresponding equipment orders have likely been reduced.

Retail sales data has also been somewhat disappointing, although some companies have reported solid same store sales in the past two months. This has been a conundrum for market watchers, who have been expecting consumers to spend more in other areas as they benefit from lower gasoline prices. It may be the case that those immediately negatively impacted by falling crude prices, like oil field workers, are making rapid consumption cuts, while others are waiting to see if the benefits will be lasting before changing their spending habits.

Other data, including housing and employment, was generally stronger during the quarter. Home price indices rose, and pending home sales for February were much better than expected, shrugging off the effects of the harsh winter. At the same time, the economy added jobs in January and February at a robust pace not seen since the 1990s. In addition, weekly initial unemployment claims have remained historically low. Potential home buyers may be growing more secure in their employment situation, which could lead to further strength in the housing sector. Services demand, which is generally less volatile than manufacturing, has remained solid throughout.

Fig. 3 – U.S. Dollar Index

Fig. 4 – Russell 2000 Small Cap Index

Looking ahead, the European Central Bank's bond buying is likely to keep interest rates in the U.S. low, as fixed income investors gravitate to the higher yields available here. Bond returns are likely to remain positive, if modest. The flood of euros will also add to U.S. dollar strength (**Figure 3**), hampering our exporters, as noted earlier. This is likely to be more of an issue for large U.S. companies, which tend to have a higher percentage of their business overseas. Smaller company stocks will feel less impact from the stronger dollar, and may also benefit as global investors add to dollar-based investments (**Figure 4**).

We will continue to look across the globe for the investment opportunities needed to help our clients achieve their financial goals. We look forward to speaking with you in the coming months, and encourage you to contact us any time.