2014 - THE YEAR IN REVIEW

YEAR OF THE HORSE

According to Chinese astrology, the Horse is strong, energetic and fortuitous. Astrologers predicted “a fast year full of conflicts” with factions standing firm in their ideals, less likely to compromise. Businesses and mergers were to boom, but they foresaw volatility in banking, metals, politics, aviation, weather and health. Realistically, every year faces most of these issues, and as with previous years, geopolitical events ran rampant. Some of the more prominent ones include the invasion of Ukraine and the Russian appropriation of Crimea, ISIL radicalism, US airstrikes in Syria, global protests, default in Argentina and near defaults in Venezuela and Russia. We saw the European Central Bank institute a negative interest rate on overnight deposits while Russia raised its key rate to 17%. Bill Gross jumped ship from PIMCO, the Ebola crisis expanded, and the world weathered innumerable physical disasters.

Domestically, conflict was high at the local level, but we fared better in politics than in previous years. We avoided a government shutdown and Congress voted in a new set of tax laws with hardly a hiccup. November’s controversial Immigration Action won’t be dealt with until 2015. Our Horse dodged the worst stalemates such as the Fiscal Cliff, Sequestration and the debt ceiling debates we experienced throughout 2013. Time will tell how much fuel the recent Republican Senate defeat will add to the potential fires in 2015, but 2014 was relatively passive.

The Economy

The year was slow out of the gate with the US economy contracting by an annualized 2.1% pace. This was blamed on remarkably cold weather, but negative effects from Obama’s health care initiatives played a large part too. Third quarter growth was revised to an annualized 5% pace, the fastest growth since mid-2003; health care being the largest contributor here as well. Labor, manufacturing and consumer spending surged while housing merely sputtered. It’s expected that the economy will end up with a 2.5% to 3% growth rate for the year, better than previous years but down from the 3.3% long-term average.

Market Review

Domestic equity indices are at all-time highs and are outperforming most other global markets. October brought the final Federal Reserve bond purchases, ending that part of quantitative easing initiated in November 2008. The end to the bond purchases inferred that the economy is strong enough to no longer require this type of monetary stimulus. However, the Fed left short-term interest rates unchanged at 0% to 0.25% and issued a statement that they would hold off on a rate hike until mid-2015. Meant only as a ‘signal’, the implication of a hike still sent stocks plunging 7.3%. The market recovered quickly, and the Fed has since hinted it will wait until further into the year to make any move. This statement empowered an already positive stock market leading to a truly euphoric Santa rally. Many years finish with this big boost in stocks, commonly called the “December effect.” In fact, the last twenty years have ended with a December return between 0.7% and 15.7%, and only four of those twenty have yielded a negative number.

This year however the market kept rising even as crude oil prices sank nearly 50%, taking many energy stocks in its wake. The Horse had indicated a great year for energy, and oil production swelled in 2014. However demand softened as economic growth in China, Japan and most of Europe waned. Oil turned out to be one of the biggest stories of 2014 and might result in some of the biggest economic changes in 2015. Oil-exporting nations risk revenue shortfalls while importing countries welcome lower manufacturing costs. Lower oil prices generally increase discretionary spending, a boon to economies, but also have negative effects on the industry’s wages and employment. Corporations will continue to leverage even modest economic growth into faster profit growth. Third-quarter earnings were 7.7% better than the previous quarter and higher than the anticipated 4.9% growth. While certain industries have lowered expectations for the fourth-quarter, three-fourths of the third-quarter returns surpassed analysts’ estimates.

 Stocks

The S&P500 (large-cap index) ended the year up nearly 15% extending the bull rally past 200%. The S&P400 (mid-cap index) ended up just under 10% and the S&P600 (small-cap index) up about 5%. All ten S&P500 sectors advanced: eight with double digit returns, led by Utilities and Healthcare. Energy was the only negative, down over 8%. While US equities posted double-digit returns, non US stock markets posted some steep declines with the MCSI All Country World Index sinking 6.3%. Emerging markets closed down over 4%. Gold was not the haven most envisioned it to be, losing 1.9% for the year.
Bonds

Forecasters thought yields couldn’t go lower especially with the Fed poised to end all easing within the year. Detroit and Puerto Rico led many investors to shun municipal bonds altogether while favoring junk bonds and leverage. It turned out that despite the end of the Fed’s bond purchases, bond investors enjoyed a year of healthy returns and record-high debt sales. Municipal bonds rallied approximately 9%, followed by high quality corporates. Junk bonds brought up the ranks with a gain of 2.5%, but not nearly what was expected. Interest rates were basically flat out to 5 years and dramatically lower across the rest of the curve.

Year of the Ram

Most people think of the end as a termination. Yet the conclusion of one thing always leads to the commencement of something else. That means a fresh start and new goals. This is the Year of the Ram. As this bull market heads into its sixth year, some think the Horse might have stolen some of the Ram’s potential. This year’s Santa effect was extraordinarily strong, and as mentioned, fourth-quarter earnings could be rough. If the Fed tightens, earnings might contract even more. That said, it appears that most analysts are considering a 6.5% return for stocks with interest rates considerably higher. We thought 2014 would bring between 8% and 12% and so were in line with results. We agree that 2015 will likely be positive but less robust. In Chinese astrology, the Ram is weaker than the Horse. However, in 2015, this Year of the Ram, “diligence applied to hard work ensures prosperity.” We’ll go for that.

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SAVING FOR RETIREMENT

In the movie Caddy Shack, two golfers were talking. One mentioned that he doesn’t keep score when he plays. The other asked, “How do you measure yourself to other golfers?” He replied, “By height.” Most people are curious as to how they are doing. Some comparisons are easy, for example, if you run in a sponsored race, you can usually find results online of all the runners. Other things are more private. Take, for instance, saving for retirement. Are you saving as much as your peers? People don’t openly talk about how much they are saving. Companies like Vanguard and Fidelity publish studies which can give us some insight into how people are saving. Let’s review two recent studies and then take a look at changes for 2015.

Employer sponsored plans

A Vanguard study of defined contribution plans in 2013 reported the average 401k account balance was $101,650, an 18% increase from last year. Plan participation of eligible employees was 76%, with an average deferral rate of 7%. When taking into account a company match, the average deferral rate was 10.2%. The rise in plan participation is partly attributed to more employers offering automatic enrollment. By year-end 2013, 34% of Vanguard plans offered automatic enrollment where an employee has to manually opt out of participation, rather than opt in.

Hopefully, if your company offers a 401k, or other defined contribution plan, you are taking advantage of it. Try to get your deferral election at least to the maximum of what your company is willing to match. According to Vanguard’s study, the most common company match is $0.50 for every $1 you defer, up to 6% of your pay. The company match is basically free money from your employer, and who doesn’t like free money?

Individual Retirement Accounts

Another option for retirement saving is an IRA, or Individual Retirement Account. Fidelity looked at a sample of its IRA customers and found that savings in 2013 increased nearly 10% over 2012. The average balance was $89,100. They further looked at how savings differ based on the age of the saver. They found that people over the age of 50 increased their contributions in IRAs the most. They averaged over 8% growth in contributions from 2012 to 2013. There are many reasons why older people are contributing more. Their incomes are higher than younger workers, and the concept of retirement is looking more real. Also, there are catch-up contributions for people over the age of 50 allowing them to contribute more each year...more on that later.

The importance of starting to save early cannot be overstated. If young adults start saving as soon as they become eligible in their first job, they will begin a habit that will reward them when they retire. Just imagine the power of over 40 years of tax deferred, compounding growth that might even include employer matches and profit sharing! Really, the only question left to ask is, “how much can I contribute!?”

Changes in 2015

In 2015, you will be able to contribute up to $18,000 into a 401k, 403b, most 457 plans and Thrift Savings plans. This is a $500 increase over 2014, and the catch-up contribution limits for people over age 50 will also increase by $500 to $6,000. This is an extra contribution amount to help older people who may have started saving later in life.

Once you’ve contributed to your 401k, if available, there are still more options to supplement your retirement savings, like an IRA. In 2015, you can contribute up to $5,500. If you are over the age of 50, you can contribute an additional $1,000 as a catch-up contribution. The same limits apply to Roth IRAs as well. These amounts are the same as last year. If you haven’t already contributed in 2014, you actually have until April 15, 2015 to do so.

The New Year brings a new opportunity to take charge of your retirement savings plan. Why not make a resolution that will be difficult to break? Enroll in your employer’s defined contribution plan if available. If you already participate, increase your deferral amount. Set your IRA to make automatic transfers. Simple steps like these will help you rise to the top of the pack. And remember, we are always here to help you with any questions you may have. Happy New Year!

The information contained herein is not to be construed as tax advice, and you should seek advice concerning your specific circumstances from your tax advisor.

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