Bull Market celebrates its 5th Birthday
But we were too cold to celebrate

Both stock and bond markets had a volatile first quarter, and each finished up about 1.8%. The S&P 500 Index moved sideways from 1/1 to 1/22, then fell about 5.6% by February 3rd. That loss was recovered by 2/24, and the index continued slightly upward until 3/31. According to Lipper, Midcap blend stocks did better, up 4.86% for the quarter. Large growth stocks lost 0.08% and small growth stocks lost 1.10%. Healthcare, real estate and utilities were the leading sectors. Consumer cyclical stocks were down 2.11%, led by double digit declines by Amazon (-15.6%) and Best Buy (-33.3%). Interest rates are higher than they were a year ago, but for maturities of 7 years or longer, rates dropped slightly in the first quarter. U.S. treasuries became more popular by weaker than expected economic news, mostly blamed on cold weather. I believe cold weather received too much credit, overshadowing the geopolitical issues and low consumer spending. The yield on 10 year treasuries fell 31 basis points, to finish the quarter at 2.72%. I expect this yield to rise to between 3.25% and 3.75% in 2015, keeping the ten year treasury yield at 200 to 250 basis points over the rate of inflation. The Fed seems determined to keep rates low for the remainder of 2014.

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"What do you do from here?" – Michael Cuggino, President, Permanent Portfolio

Are we due for a stock market correction? The average bull market runs 4.5 years; this current bull market just passed its fifth birthday. From the low on March 9, 2009 to March 7, 2014 the S&P 500 Index is up 177.6%. The Nasdaq index is up 241.8% over the same period, soaring to the sky like the above Penobscot Narrows Bridge in Bucksport, ME. Over the past five years, U.S. stocks returned an average of 18.13% to 28.83% annually. Only 3 of the last 11 bull markets made it to their 6th birthday. However, those three returned about 26% in year six. As usual, the signals are mixed. Stocks are more fully valued now, and slow earnings growth will continue to hold back consumer spending. Interest rates and inflation remain low, and the economy is growing slowly. The large stock market benchmarks are trading in narrow ranges, but there has been significant sector rotation. I am expecting continued volatility, and some level of correction in the next quarter, possibly 10%. While this may be "nerve-wracking" for many investors, for portfolios with a five or more year time horizon this too shall pass. Quarterly rebalancing and dollar cost averaging are still the best tools for smoothing out returns over time.

The movement to passive investing in index funds and exchange traded funds continues at a brisk pace. Back in 2003, about 12% of stock funds were passive; that number is now 27% and rising. In the large blend category 64% is now passively managed, due to the popularity of S&P 500 Index funds. With index investing, you can expect lower costs and average returns. However, indexing does not always outperform active management. For example, index funds do not increase their cash position in volatile markets, then buy back in after a correction. In the first quarter, only 10.5% of active managers in the large blend style beat their index. But in the small cap growth style, 77.3% of active managers beat their index. More than 62% of active large value and large growth style managers also beat their index. I continue to believe that a combination of active and passive styles is the best approach.

Protecting your most valuable asset

Many people fail to realize that their most valuable asset is their ability to continue to earn income. I just read a good article in HR MAGAZINE, a Society of Human Resources publication, reminding me of the importance of disability insurance. According the Social Security Administration, one in four of today's 20 year olds will experience an income-interrupting disability before reaching retirement age. As 90% of all disabilities are caused by illness not accidents, your lifestyle is a factor. A 35 year old non-smoker, with average weight health history and a healthy lifestyle has a 24% to 27% change of experiencing a disability before their mid-60's. However, for a 35 year old, overweight smoker with an unhealthy lifestyle, the chance of disability rises to **74% to 77%!** A recent college graduate earning $40,000 annually could earn more than $3.5 million during their lifetime; an amount worth protecting. The Council for Disability Awareness has developed the Personal Disability Quotient Calculator, which can be found at www.whatsmyPDQ.org. Take the time to determine what your disability risk is. You should have enough disability insurance coverage to replace about 60% of your income. Review what coverage you may have through your job, and from Social Security. Then determine if you need additional coverage. Disability insurance is complicated and can be expensive. I would be happy to answer any questions you have.

Dennis P. Lynch

The views and opinions expressed are those of Dennis Lynch as of 4/16/2014 and are subject to change based upon market conditions. Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk. Past performance is not a guarantee of future results.
*The S&P 500 Index is a price weighted index of 500 actively traded stocks. Investments cannot be made directly into an index.
**Lipper, a division of Thompson Reuters, manages a mutual fund performance tracking and rating system. Lipper Indexes allow an investor to compare a particular mutual fund to other funds utilizing a similar investment style. A Lipper index is composed of the 30 largest funds of a given investment style. For more information about Lipper's methodology, visit their web site at www.lipperweb.com/research/IndexComponents.aspx.