Commentary – July 1, 2014

For the first time since 1993, stocks, bonds, gold and commodities all realized gains for the first six months of the year. (Wall St. Journal July 1st, 2014) Simultaneous increases enjoyed thus far in 2014 are unusual, as stocks and commodities typically rise during times of prosperity, while bonds and gold benefit from economic weakness and market distress. The rally in the capital markets can be attributed primarily to the commitment of the world's central banks to keep interest rates low by flooding financial markets with newly minted money in an effort to keep sluggish global economies advancing.

At the beginning of the year analysts were predicting a great rotation out of bonds and into stocks, as interest rates rose and bond prices fell. The upward move in interest rates has not occurred, however, and in fact the yield on the 10 year Treasury note is down 3% since December 2013. Some investors are now skeptical of a sharp rate hike, as plodding gains by the U.S. economy are unlikely to send borrowing costs suddenly higher. A 2.9% drop in U.S. first quarter GDP growth leads some to question the idea of economic expansion in any sense, much less at a pace requiring higher interest rates. These dissenters are more concerned with geo-political risks, as events in Iraq and Ukraine grab headlines and lead some to act on their fears of an over-priced stock market and sell in the face of favorable if not robust economic conditions.

It should not come as too much of a surprise that the capital markets are doing so well in 2014. By keeping yields on CDs and similar vehicles so low that investors are driven elsewhere in search of returns, the Fed Reserve Bank's policies act as a catalyst to a rising stock market. Higher stock prices, in turn, cause a "wealth effect" whereby people, seeing higher brokerage and retirement account balances, spend more, providing the economy with a boost. The Fed has stated its intent to keep rates low for the foreseeable future in an attempt to prompt the economy forward. The ultimate result of its quantitative easing policy and the current "not too hot - not too cold" environment should be a continuation of the positive returns enjoyed the past few years.

As always I invite you to contact me with your questions and concerns and am available to meet at your convenience.