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ECONOMIC AND INVESTMENT FORECAST
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Following a strong U.S. stock market in 2013 that saw record highs, 2014 is off to a sluggish start thanks to uninspiring economic data, disruptive weather in the U.S., and geopolitical tensions overseas. Looking past the choppy beginning to the year, expectations are for improving economic growth in the months ahead and an extension of the 5-year-old bull market. Although much good news is already reflected in current stock prices, the market still has key factors in place that are supportive of further appreciation, including low interest rates, stable and low inflation, and overall healthy global growth. Analysts predict a total return of 8-9% for stocks this year, consisting of a 2% dividend yield combined with mid-single digit price appreciation.

The U.S. market has been a haven of stability for investors while international investment alternatives suffer from continued volatility. But there are signs of improvement overseas, particularly in Europe, where a multi-year recession is giving way to improving business trends. Led by Germany, the Euro zone is showing strength in many areas, including higher factory orders, healthy retail sales, and rising capacity utilization. A lingering concern in Europe is the weaker peripheral countries (i.e., Portugal, Greece, Spain), and the state of their banking system. As a backstop, the European Central Bank is on standby to ease monetary policy if the regional banks were to stumble. In Asia, China's ability to avoid a hard landing will be a key determinant in how the global recovery progresses in 2014. After many years of heady growth, China is turning its attention to much needed financial sector reform in an effort to integrate further with global markets. China's goals include deregulating their interest rate markets, and further introducing their currency, the renminbi, as a global trade alternative to the U.S. dollar.

On the policy side, new Fed Chief Janet Yellen has chosen to maintain the general course of monetary policy inherited from Ben Bernanke. In her first open market committee meeting as chairwoman, Yellen stated, "there is sufficient underlying strength in the economy." Yellen's constructive comments on the recovery serve the dual purpose of signaling her confidence in the overall economy as well as putting market participants on notice that interest rates may have an upward bias in the months ahead. With more positive economic data in hand, combined with an improving labor market, the Fed has begun tapering their bond buying program which is expected to be completed this fall.

Low interest rates in the developed markets have provided stimulus to the recovery, affording businesses and individuals the opportunity to borrow inexpensively. While low interest rates have been a boon for consumption, the same low rates present mediocre investment options for fixed income investors. Despite U.S. Treasury 10 year yields increasing from approximately 2% to 3% in 2013 (currently 2.7%), we still find that bonds offer less than compelling return potential after factoring in average annual inflation rates of 2%.

While we maintain our cautiously optimistic view towards the economic recovery, we also note that the U.S. stock market has not had a correction (a contraction of 10% or more) in over two years. And although it is challenging to precisely forecast the timing of a market correction, we can alternatively identify risks that can serve as catalysts for market pullbacks. For example, political dysfunction in Washington, D.C. has been an enduring risk to the markets, and bears close attention as we approach high-stake fall elections. Conversely, easy monetary policy, pent-up demand on behalf of businesses and households, and fading government spending cuts, together could keep investor focus on the positive fundamentals of the market, relegating U.S. political gridlock to a mere sideshow.