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Diversified Financial Management

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Economic and Investment Forecast
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With a snowy New England winter finally transitioning to spring, global financial markets are also going through a period of change and transformation. While equity and bond markets are slightly positive for the year, investors can still find plenty to worry about. A 50% drop in the price of oil, out-of-sync global monetary policy, geopolitical unrest in Europe and the Middle East, and wild swings in the value of key currencies appear to be the primary causes of recent increased volatility in the financial markets.

In building diversified portfolios, our goal is to assemble high quality individual investments with attractive return profiles, while managing risk across various parts of the market. The recent $50 fall in oil prices came as a rude awakening to those investors that were overexposed to energy investments. Furthermore, we saw that not all oil and gas investments are created equal. Higher quality companies have held their value far better than the more aggressively managed oil businesses. While the bear market in oil may have largely run its course, it is important to note that lower energy prices serve as a financial tailwind for consumers and businesses around the world. Here in the U.S., lower commodity prices should lead to an acceleration in consumer spending in 2015, thereby helping propel the rate of GDP growth towards 3% for the year.

In assessing the health of the U.S. economy, the monthly economic readings have shown steady momentum in many key areas. Particularly impressive has been the labor market, where monthly job gains have averaged 282,000 hires over the last six months, paired with modest wage increases. U.S. businesses are also getting used to substantially lower oil prices, which over time should lead to more robust corporate investment. A key obstacle for American companies is the strengthening dollar, which has gained close to 25% against other major foreign currencies over the last eight months. Because large U.S. corporations sell products and services globally, the strong dollar has made U.S. goods more expensive to overseas buyers (and therefore less competitive).

Notwithstanding the volatility in currency and commodity markets, investors have been pleasantly surprised by the outperformance of international equity markets year-to-date. At recent check, the primary overseas stock index (MSCI EAFE) of large stocks was up 4.5% for the year, well ahead of the S&P 500 return of 1%. Just as U.S. companies are challenged by the strong dollar, the export-oriented economies in Europe and Japan have benefitted from a cheaper Euro and Yen, respectively. In both markets, local businesses are also the beneficiaries of "QE" style monetary stimulus, which has had the sought after effect of lowering interest rates and bolstering overall confidence.

As we add another year to the duration of this economic recovery and six-year-old bull market, we see risk management and diversification playing a key role in the quarters ahead. Developments in the currency and commodity markets are particularly fluid at this time, and require close attention due to the impact dollar fluctuations have on both equity and fixed income investments. Monetary policy stimulus around the world, marked by ultra-low interest rates, is still in place and supportive of global growth. Even so, our expectations are for lower returns in the years ahead, as the business cycle enters the later innings of the expansion phase.