EMERALD ASSET ADVISORS, LLC

Investment Strategists for **Successful Families**

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Thank you for reading GreenThought$. It is our privilege to provide you with our insight on current financial market events and our outlook on topics relevant to you.

Fourth Quarter 2014: Looking Back and Looking Forward

Dear Valued Clients,

Looking back

While the bull market in U.S. equities continued for its 5th straight year, the impressive 13.7% return for the S&P 500 far outpaced the return of other asset classes. As a result, in 2014 many fully diversified portfolios significantly underperformed the headline numbers often touted in the financial press. The following Periodic Table of Investment Returns is from Callan, one of the largest institutional investment consultants in the country (Please click here for the Periodic Table »).The column on the far right shows the performance of various asset classes in 2014, and illustrates the returns of the S&P 500 versus other investment choices. However, if you look at previous years you'll note how different asset classes outperform in different years. That's why we remain strong proponents of having a diversified asset mix in the portfolio. Asset allocation studies have shown that up to 91.5% of a portfolio's performance is due to the asset mix (stocks, bonds, real estate, etc.) with only 8.5% attributable to other factors like security selection and market timing.

The major theme of 2014 was the continuing strength of the dollar which had negative implications for assets not denominated in dollars regardless of the underlying fundamentals. This contributed to the weak performance of emerging market equities. Oil prices declined 50% in the second half of the year, which resulted in energy related assets being sold off. As a large amount of high yield bond issuance comes from energy companies, the high yield bond sector saw large outflows coincident with the decline of oil prices. The U.S. 10 year Treasury yield started the year at 3% and ended at 2.17%, defying virtually every prognosticator who predicted that the end of the FED's QE (bond buying) program would result in a spike in Treasury rates. China, Japan and Europe are all facing economic slowdowns and dealing with deflationary pressures. Finally, the HFRX Global Hedge Fund index was down .6%, as central bank intervention around the world has distorted the historic relative pricing of asset classes (ie. the French 10 year bond, yielding .54%, is considered less risky than the U.S. 10 year bond that is currently yielding 1.77%).

Looking forward

Most of the news stories from 2014 continue into 2015. The dollar continues to strengthen, oil prices haven't yet stabilized and the U.S. still seems to be the best house in a bad neighborhood. Add to the mix the instability in the Middle East, the election of the far left (anti-austerity) party in Greece and the gains of the far right political parties in other European countries and the expectation that the FED will begin tightening rates this year. From a technical perspective, the market seems valued in line with historical metrics. However, it's worth noting that while a stock market correction of 10% or more typically occurs every 1.5 years, the last such correction happened back in August 2011. That makes this uninterrupted bull run the 5th longest in history. Also, if the S&P 500 has a positive year in 2015, it will be the first time in history that the S&P has had seven positive years in a row.

So where are the investment opportunities in 2015? Given the price of equities and the low bond yields that exist in this zero interest rate (ZIRP) environment, asset allocation is more important than ever. The reach for yield that has pushed investors to take on risk the last few years is something that needs to be closely monitored as investor sentiment can be quite fickle. But attractive investments do exist. We continue to look for managers having good track records in both strong and weak markets and compelling investment themes. We want to have some investments with low correlation to traditional stock and bond markets, which may afford opportunities to profit regardless of market conditions. This may include investments in real estate or commodities, or using managers that invest with "absolute return" as a goal. Most of all, we stick to our conviction that we should manage client portfolios with risk adjusted returns in mind. As always, we're available to answer any questions you may have.

Regards,

The Emerald Team

About Emerald

Emerald Asset Advisors, LLC is a Registered Investment Advisor (RIA) founded in 1998. For more information, please visit our website.
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