ROOF ADVISORY GROUP, INC.®
INVESTMENT ADVISORY & FINANCIAL PLANNING SERVICES

INVESTMENT INSIGHT

3rd Quarter Review

Third Quarter Driven by Conflicts Abroad and Economic Data

The quarter ending September 30th offered small gains for all of the major market indices. The S&P 500 inched forward, gaining 0.6% and the Nasdaq increased by 1.9% in the quarter. Fixed income markets managed a small gain as well; the Barclays U.S. Aggregate Bond Index increased by 0.2%. Year to date, all the major indices have shown significant returns—the S&P 500 has increased by 6.7%, the Nasdaq is up 7.6%, and the Barclays U.S. Aggregate Index has increased by 4.1%. While the third quarter has been fairly uneventful from a market movement standpoint, there are a number of positive forces that point to the possibility of a bullish fourth quarter.

According to Bespoke Investment Management, the S&P 500 has averaged a gain of 2.6% in the fourth quarter of every year dating back to 1928. However, stocks have performed even better in years with midterm elections—averaging a return of 6.5% in the fourth quarter in those years. The United States economy remains strong as well, real GDP growth was upwardly revised to 4.6% for the second quarter and jobs growth has also been strong, exhibiting gains of 212,000 new jobs in July and 142,000 new jobs in August. With 2014 being a midterm election year, this sets the market up nicely for additional gains to finish off an already positive year. However, this potentially bullish quarter could be derailed based on certain geopolitical events that may come to a head in the near term, most notably issues surrounding Russia and the Middle East.

Russia has continued to spar with the West over economic sanctions that the European Union and United States placed on them for their involvement in Ukraine. While a cease fire was agreed upon in early September and has largely been followed, a comprehensive peace deal in Ukraine will continue to require additional time and work. Until such a deal is finalized, the European Union and United States will continue with the sanctions that target Russia's oil and banking industries. Russia has voiced its displeasure with the sanctions and has threatened to retaliate utilizing economic sanctions of its own. While significant progress has been made towards finding a peaceful resolution, there remains the possibility of market flare ups until Ukraine regains full control of its country and a peace deal has been completed.

President Obama recently announced that the U.S. and its allies would commence air strikes on the ISIS in Iraq and Syria. The Islamic State has continued to gain momentum in the Middle East in recent months, leading to a strong international response. While financial markets have continually shrugged off the issues in the region, there is certainly potential for markets to be agitated should instability spread from the Middle East to other parts of the world.

The Federal Reserve also neglected to give the market any clear direction with the release of their most recent meeting minutes in September. Leading up to the release of the FOMC minutes, media outlets had speculated that the Fed might leave out or change their wording of a "considerable time" relating to raising interest rates. If this was the case, analysts assumed that it could be taken to mean that the Fed would be raising interest rates much sooner than anticipated, which could hinder equity and fixed income performance for the remainder of 2014. However, on September 17th, the FOMC released their minutes, which included the "considerable time" wording and the market was unaffected. While the outcome was essentially insignificant, this kind of unsubstantiated media hype will assuredly continue to become more and more prevalent and has the potential to periodically increase day-to-day market volatility until rates actually do rise.

Despite these factors, Roof Advisory Group currently maintains its maximum equity position in all client investment policies as equity markets continue to provide more positive upside potential than fixed income. Dividends available for equity holdings also provide more advantage than yields available on most fixed income holdings. Portfolio Betas have been reduced across the board from sales of preferred equity and convertible bond positions designed to lock in gains and shorten fixed income duration. Proceeds from the sales have been reallocated to short duration individual fixed income and short duration bond funds to protect against rising interest rates in the near term.