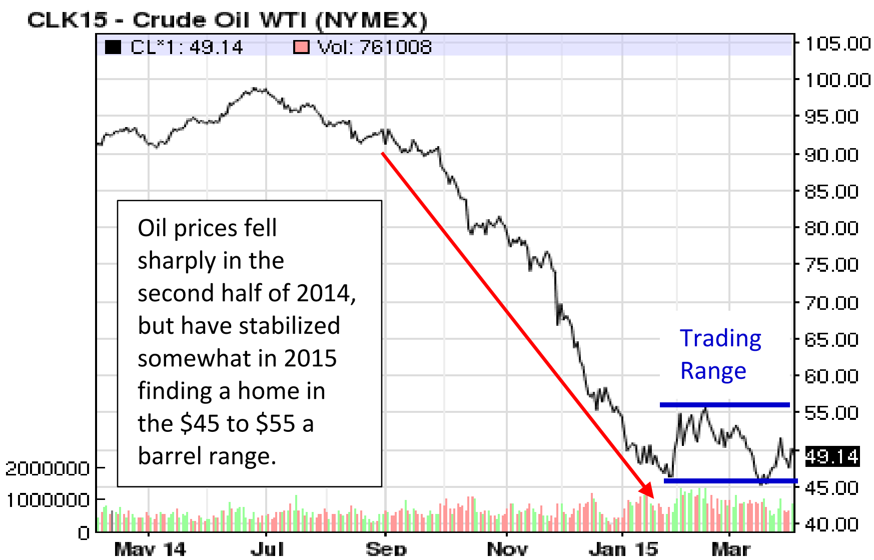
The Ten Themes of 1Q 2015

The first three months of 2015 were marked by increased uncertainties that led to rising volatility in U.S. financial markets. This is in contrast to the "Low volatility" environment (one of our themes throughout 2014) that we experienced for most of last year. Here are the ten themes that we believe impacted global financial markets the most so far this year.

1. Stabilizing energy prices
2. Destruction in S&P 500 earnings expectations
3. European Central Bank does QE
4. Fed's plan to raise interest rates
5. Diverging global central bank policies
6. Strong U.S. Dollar
7. Increased volatility
8. Grexit
9. Geopolitical risks
10. International stock market outperformance

Stabilizing energy prices

One of the big stories in the second half of 2014 was the sharp decline in the price of crude oil and the impact it would have on the economy. In 2015, oil prices have been volatile but have traded in a range of $45 to $55 a barrel. Many felt lower gasoline prices would lead to a significant rise in consumer spending and increased profits. Surprisingly, the drop in the price of crude oil was having a net negative impact on overall corporate profit expectations[1]. In addition, bad weather and an increase in personal savings have contributed to U.S. retail sales falling short of expectations over the past three months[2].



Source: NYMEX

Destruction in earnings expectations

On September 1, 2014, earnings expectations were indicating that 1Q 2015 earnings for S&P 500 companies would grow +10.5% over last year's 1Q 2014 period. On March 31, 2015, the Street expectations for 1Q 2015 earnings growth was down to -3.0%. Lower earnings expectations is not by itself newsworthy. However, the magnitude at which the numbers have come down is significant and the worst we have measured since the financial crisis of 2008[1]. Due to the dramatic drop in oil prices, the Energy sector is now forecasted to have earnings decline 60% from last year during upcoming 1Q 2015 earnings season.

S&P 500 1Q 2015 earnings growth expectations

On September 1, 2014	On March 31, 2015
+10.5%	-3.0%

Source: The Earnings Scout

European Central Bank does QE

Throughout last year, we routinely highlighted just how bad Europe's economy had cooled off. To re-inflate growth, the European Central Bank, headed by Mario Draghi, began a quantitative easing (QE) program in 2015 in which the central bank purchases European soveriegn debt as a way to devalue the Euro currency and inject liquidity into the economy. If you recall, the U.S. Federal Reserve had it's own version of QE following the financial crisis of 2008 and just ended the program last last year. While controversial, our research indicates QE was effective in the U.S. helping the economy to heal[1]. We expect the same to occur in Europe and thus far the early results are positive as European stocks have been the early winners in 2015 relative to other markets across the world.

Mario Draghi, head of the ECB, is all smiles as QE is off to a great start in Europe.

Fed's signal to raise interest rates

Over the past several years, the U.S. Fed has provided unprecedented levels of stimulus via QE and other measures. The Fed has also kept short-term interest rates near zero. We believe this accommodation has been instrumental in the economic recovery and allowed corporate earnings to exceed all-time highs. In turn, U.S. stocks, as measured by the S&P 500 index, have also hit all-time highs. With this improvement in the economy, Janet Yellen, the chairperson of the Fed, has started to signal her intentions to normalize interest rates by raising them at some point this year.

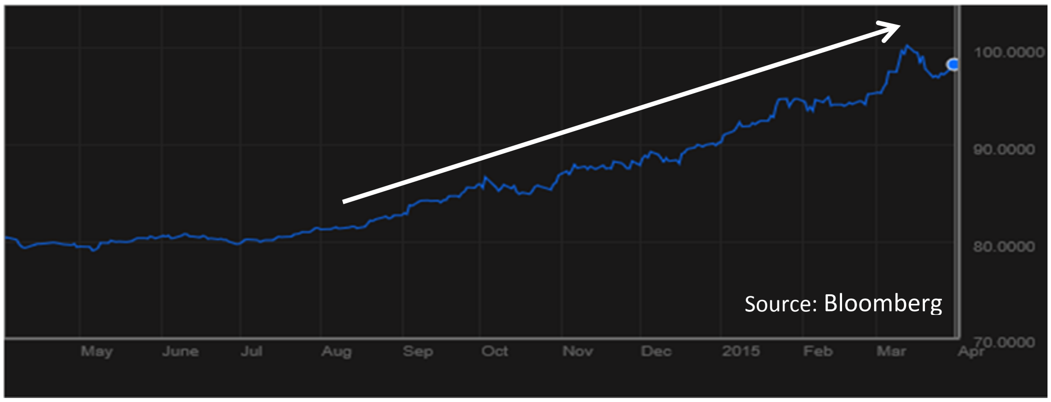
Diverging global central bank policies

The U.S. Fed's signal of their intentions to begin tightnening monetary policy by raising short-term interest rates is in stark contrast to other central banks in China, Europe and Japan, where they have not only loosened policies but are expected to provide even more stimulus later this year. These diverging policies are wreaking havoc on currency markets and our research has found it is also starting to impact global trade to the detriment of large U.S. multinational companies[1].

Strong U.S. dollar

With stronger relative economic growth, extraordinarily low European yields and the Fed's hope to soon start raising interest rates, the U.S. dollar has rallied sharply against most other currencies. While a strong dollar gives us good feelings of patriotism, the downside is the strong dollar is likely a major reason why U.S. multinational earnings expectations have fallen so rapidly over the past six months. In our opinion, the dollar's rapid ascent upwards combined with the diverging global central bank policies present quite a challenge for the Fed if it is really serious about normalizing interest rates and not derailing economic growth.

U.S. Dollar Index (DXY) – measures the dollar against a basket of other major currencies[3]



Increased Volatility

During the 1Q 2015 period, the Dow Jones Industrial Average fell -0.26% with the S&P 500 faring just a bit better by posting a meager +0.44% gain, not including dividends. Daily +/- 100 point moves on the Dow became commonplace, especially in March where the amount of volatility rose, as investors became more confused based on a string of disappointing data and the timing of a Fed rate hike. Considering the fact markets have exhibited very low volatility over the past three years, the increase in volatility is more of a return to normalcy in our opinion. At the same time we expect more economic uncertainties to carry over into 2Q 2015 trading.

Grexit

A Grexit is a combination of the words "Greece" and "exit." It has been brought up because many anticipate Greece to either leave or get kicked out of the 19 country Eurozone. Greece has been struggling financially and likely would have already defaulted on its debt obligations had it not received bailout funds. As a condition of receiving bailout money, strict austerity measures have been placed on it, especially from Germany. These austerity measures have stifled the chances for the Greek economy to grow and the Greeks do not like it. This has increased the possibility of a Grexit, which could add to the increased turbulence in financial markets.

Geopolitical risks

Geopolitical risks will never go away. As one conflict subsides another springs up in another part of the world. At any time, the escalation of any of these risks have the potential to create more turmoil in the market. However, we note over the past several years, geopolitical risks have been more headline grabbing than actual drags on the U.S. economy. In our opinion, the continued Russian / Ukraine conflict has the potential to have the most dramatic impact on the global economy. Although, this does not diminish the threats that could arise at any time from the Middle East or North Africa.

International Stock Market Outperformance in 2015

Country	Index	1Q 2015 YTD Return	January	February	March	2014 Return
Portugal	PSI	24.37%	7.20%	10.60%	4.90%	-26.83%
Germany	DAX	22.03%	9.06%	6.61%	4.95%	2.65%
Italy	MIB	21.80%	7.84%	8.95%	3.67%	0.23%
France	CAC	17.81%	7.76%	7.54%	1.66%	-0.54%
Russia	MICEX	16.44%	17.98%	6.75%	-7.55%	-7.10%
China	Shanghai Composite	15.87%	-0.75%	3.11%	13.22%	52.87%
Ireland	ISE	15.22%	4.73%	9.24%	0.71%	15.09%
Spain	IBEX	12.08%	1.20%	7.45%	3.07%	3.66%
Japan	Nikkei 225	10.06%	1.28%	6.36%	2.18%	7.12%
Philippines	PSEi	9.82%	6.35%	0.53%	2.72%	22.76%
South Korea	KOSPI	6.55%	1.76%	1.87%	2.78%	-4.76%
Indonesia	JSE Composite	5.58%	1.19%	3.04%	1.25%	22.29%
South Africa	FTSE/JSE All Share	4.84%	3.01%	4.05%	-2.18%	7.60%
U.S. Small Cap	Russell 2000 Index	3.99%	-3.26%	5.83%	1.57%	3.53%
Hong Kong	Hang Seng	3.95%	1.14%	2.24%	0.53%	-5.66%
U.K.	FTSE	3.15%	2.79%	2.92%	-2.50%	-2.71%
Taiwan	TSE	3.00%	0.59%	2.78%	-0.37%	8.08%
Brazil	Ibovespa	2.29%	-6.20%	9.97%	-0.84%	-2.91%
Canada	TSX Composite	1.85%	0.28%	3.82%	-2.18%	7.42%
India	SENSEX	1.67%	6.11%	0.62%	-4.78%	29.89%
Mexico	Bolsa IPC	1.34%	-5.09%	7.91%	-1.05%	0.98%
Vietnam	Ho Chi Minh	1.01%	5.58%	2.86%	-6.99%	8.12%
Thailand	SET Index	0.55%	5.58%	0.36%	-5.11%	15.32%
U.S. Large Cap	S&P 500	0.44%	-3.10%	5.49%	-1.74%	11.39%
Greece	ASE	-6.14%	-12.62%	21.96%	-11.93%	-28.94%
Turkey	BIST 30	-6.67%	3.79%	-6.16%	-4.17%	28.75%

Source: Bloomberg

Conclusion

As we begin 2Q 2015, our research indicates more volatility in financial markets is likely. The good news is that volatility can create long-term investment opportunities. The major reason we could see more turbulence this year stems from Janet Yellen and the Fed's signal of their intention to raise short-term interest rates. The Fed's decision will likely impact the dollar and affect global trade as other central banks around the world loosen their monetary policies. The anticipation of the Fed's action later this year has contributed to U.S. large cap stocks being one of the worst performers out of the gate in 2015 as the strong dollar has taken its toll on the expectations for U.S. multinational corporate profits.

While we take great pride in our measurement and understanding of economic and earnings data, it is impossible for us to know every major market factor in advance. Because of this we continue to apply our fundamental beliefs that risk and return are related, markets are efficient over time, profitability matters and diversification is key. These fundamental beliefs continue to be the core of our short term and long term investment approach.

We hope you found this information useful, and encourage you to approach us with any questions you may have. We look forward to our next conversation.

Strategic Investment Advisors Investment Committee,

Scott Hohman, CFP®, AIF® **Mark Klopfenstein, AIF®** **Nick Raich, CFA®**

Endnotes:

1. Research conducted by Nick Raich of "The Earning Scout".
2. U.S. Retail Sales data taken from: www.census.gov/retail
3. The US Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of US trade partners' currencies. It is a weighted geometric mean of the dollar's value relative to other select currencies as follows: Euro 57.6%, Japanese yen 13.6%, Pound sterling 11.9%, Canadian dollar 9.1%, Swedish krona 4.3%, Swiss franc 3.6%.