Market Commentary – First Quarter 2015

April 16, 2015 – With oil prices declining so significantly over the past six months, many hoped the extra money in consumer pockets would translate into a rebound in US consumer spending in the 1Q 2015. This was not to be, as weaker retail sales data emerged throughout the quarter as well as a mixed picture of overall economic activity. Weather has been largely cited as the culprit for the slowdown early in the year, though US company earnings have been hurt by other factors including a stronger dollar depressing overseas profits and a rapid decline in capital investment and revenues across the energy industry. In the face of this uncertainty, the S&P 500 (our preferred measure of the US market) produced a small positive return of +0.95%. Small companies in the US market continued to rebound +4.32% due to growing investor preference for domestically-focused companies less exposed to currency fluctuations.

In a sharp reversal from the 4Q 2014, international stocks were the big winners this quarter. The FTSE Global AC ex-US index (how we benchmark international stock markets) earned +3.74%. The European Central Bank embarked on its long-awaited quantitative easing program (QE) driving shares of European companies higher as the Euro plunged -11% vs. the US Dollar. Though still weak, economic news emerging from the Eurozone has been gradually improving in terms of manufacturing and inflation data as well as upward revisions to GDP estimates. Japan's stock market soared in the first quarter +10.2% as the Japanese economy continued to benefit from lower oil prices, a weaker Yen that has boosted exports and continued monetary and government stimulus programs. Emerging Markets, led by rebounding stock markets across places like China, Russia and India rose +2.24%. The stock market rally in China reached a frenzied pitch in the 1Q 2015, despite a slowing economy and a government attempting to stimulate growth while pushing through reforms aimed at reducing debt and overcapacity. We remain leery of the recent Chinese market rally and believe much of it has been driven by the expectation of a never-ending fountain of government stimulus and the lack of viable investment alternatives for retail investors.

As investors, we continued to grapple with the tremendous divergence of monetary and interest rate policies across the globe. The US appears alone in its current quest to begin raising interest rates, as central banks and governments outside of the US engage in policies focused on devaluing currencies and driving down interest rates. Negative yields, a phenomenon once only discussed as an economic theory, have become a reality outside the US. Today, the interest rate on a 10 Year Swiss Government Bond is -0.25%. The interest rate on a 5 Year German Government Bond is -0.16%. Imagine taking out a loan and then being paid interest as the borrower! It is a small wonder why the US Treasury market with its juicy 10 Year yield of 1.89% continues to be viewed as an attractive investment for foreign investors. Despite widespread belief that US interest rates are headed higher later this year, bond prices continued to rise and the US bond market returned +1.61% during the first quarter.

During the quarter, portfolio investment performance benefitted from our positioning in several healthcare-focused investments. We continue to believe in the long term potential of our healthcare investment theme given ongoing global demographic changes, new developments in personalized medicine and a favorable regulatory environment for drug approvals. Client portfolio allocations to mid and small sized companies, investments in large growth companies, a small allocation to REITs and an increasing allocation to international stocks all benefitted performance. As part of our increasing stake in international stocks, we have added a new strategy that hedges against foreign currency movement given our opinion that the Euro will continue to fall vs. the US Dollar. Over the past quarter, our core bond strategy within client portfolios has remained relatively unchanged with minor adjustments to weightings. We continue to focus on higher quality short and intermediate term bonds, though have added small stakes to high yield bonds and bank loans. In accordance with past discussions, we have continued to avoid longer term bonds. At times, this positioning as resulted in giving up some potential return, but our risk/return analysis dictates the need to focus on reducing the interest rate sensitivity of client portfolios.

Given the strong market returns we have experienced over the past several years, it is not uncommon to hear clients ask "*Is now time to take profits and get out?*" We always begin our answer with the statement that we aren't market timers, and attempting to time the market consistently is a near impossible feat. Too many studies highlight the risk of trying to call market tops and bottoms and conclude investors are better off maintaining a well-diversified portfolio and ignoring the "noise." Having said this, it is understandable why clients would be concerned given the last financial crisis remains fresh in many minds. Despite hitting new highs, valuations across the US market are not as stretched as we have seen during past market peaks. As of March 31st, the S&P 500 traded at 16.9x the next 12 months earnings estimates, only modestly above the historical 25 year average of 15.7x. We rarely focus solely on the price levels of indices, but rather put the price levels of broad indices into context by comparing the growth of the underlying company earnings to the cost per share (Price/Earnings Ratio). To us, it is not a surprise to see elevated valuations for growing companies given the current interest rate environment. Low interest rates boost stock valuations and provide companies with a low cost of capital, while forcing investors seeking higher returns than those offered in banks and bonds into stocks. Other factors impacting US market valuations include downward revisions to earnings estimates across the energy industry, as well as a stronger dollar depressing overseas earnings for multinational companies. As we look overseas, valuations across many developed and emerging international markets are more appealing, particularly where central banks are in a much earlier stage of providing monetary stimulus.

*So, what are the biggest risks we see going forward?* One concern is the potential for future returns to be lower than historical averages. Bonds face an uphill struggle given the low level of current rates, while further stock price appreciation will rest heavily on earnings growth. Higher rates would eventually result in higher income for savers and retirees, though the road to higher rates would result in initial falling bond prices and principal losses. If anything is clear, it is that bond investors do not agree with the Federal Reserve. The Federal Reserve continues to see interest rates and inflation rising higher than is priced into the term structure of interest rates (the difference in interest rates across different bond maturities which can be used to gauge market opinion). We believe if the Federal Reserve does move forward with raising its benchmark rate in June we may see some market volatility as investor expectations reset. Beyond US markets, we believe issues surrounding Greece's "cat and mouse" game with the European Central Bank will continue to dominate international headlines. We see minimal chance of Greece ever being able to repay its debts in their current format, leaving European officials with an unenviable set of options. Though we believe it is far more likely for the debt to be forgiven or adjusted in some format than for a Eurozone exit (referred to as "Grexit"), the risk certainly remains that events transpire differently raising concerns about other indebted members of the Euro. Finally, we believe risks associated with China's continued economic slowdown remain elevated. The accuracy of economic data emerging from China is questionable at best, so when official reports continue to reflect disappointing figures there is always the potential that things are actually much worse. With burgeoning debt levels across the shadow-banking industry, government officials have attempted to reign in unauthorized lending while simultaneously boosting business lending. Enacting reforms to address overcapacity and competition are difficult at best, and when push comes to shove party officials have prioritized boosting growth (ie. keep people employed to prevent unhappy thoughts about revolt) over these reforms. China remains a critical trade partner for many commodity-exporting countries and a key source of demand for consumer and business products from the US and other developed markets. As we move forward, we remain largely upbeat for the remainder of 2015 but wary of some of the risks discussed here.

We encourage you to reach out to us via phone or email to discuss your portfolio, our investment outlook or any financial planning items that we can assist with. We are also available to schedule a client review at a time that works for you. Thank you again for your trust in Timmons Wealth Management and we wish you and your family a healthy and prosperous Spring!

Sincerely,

Liam Timmons, President
Timmons Wealth Management

First Quarter 2015 Market Data:

| **Broad Market Benchmarks** | **1Q2015** |
|---|---|
| S&P500 | 0.95% |
| DJIA | 0.33% |
| Russell 2000 | 4.32% |
| FTSE Global All-Cap ex-US | 3.74% |
| MSCI Europe | 3.45% |
| S&P Developed Ex US Small Cap | 4.43% |
| MSCI Emerging Markets | 2.24% |
| Barclays US Aggregate Bond Index | 1.61% |
| Barclays US Treasury Bill 1-3 Months | 0.00% |
| Bloomberg Commodity Index | -5.94% |
| CBOE Interest Rate 10 Yr Treasury | 1.93% |
| Consumer Price Index (CPI-U) 12 Month Core | 1.70% |
| | |
| **TWM Client Benchmarks** | **1Q2015** |
| Aggressive Growth Strategy | 1.51% |
| Capital Appreciation Strategy | 1.58% |
| Balanced Return Strategy | 1.54% |
| Capital Preservation & Income | 1.40% |
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| general comparison purposes only, and generally do not reflect the deduction of transaction and/or | |
| custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence | |
| of which would have the effect of decreasing historical performance results. You cannot directly invest in an index. | |
| Index return information is sourced from Morningstar Office. | |