Expect the Unexpected: Reflections about 2014 and the Requirement for Patience

We thought we would share some insight about calendar year 2014, framed alongside some of the data and research compiled by Weston Wellington of Dimensional Funds Advisors. It is he to whom we owe credit for many of the statistical references below.

You'll note that forecasters often cite a figure of 8%–10% as a likely outcome for stock market performance in the year ahead, and 2014 was no exception. As sensible as this may sound, it is worth pointing out that over the past 89 years, the S&P 500 index and its predecessors have never delivered a total return between 8% and 10% in any single calendar year—in every case it has been higher or lower, often by a substantial amount.

For example, starting in 1926, there have been 28 years with a **gain** or a **loss** in excess of 25%. Investors would do well to expect the unexpected every year.

Achieving the market rate of return in 2014 required a level of patience and equanimity that eluded many investors—individuals and so-called professionals alike. After five years of positive equity returns, many investors were easily persuaded that stocks were dangerously overvalued and overdue for a "correction"—customarily defined as a decline of 10% or more from the previous peak.

A popular *Wall Street Journal* columnist warned in January 2014, "The US stock market is more overvalued than it was at the majority of the past century's peaks, according to six well-known valuation ratios." *Money* magazine chimed in, observing that "stock prices by at least one measure are among the frothiest in history."

Stock prices fell sharply in January 2014, with the S&P 500 index sliding 3.56% and the Dow Jones Industrial Average dropping 5.30%. Followers of the so-called January Indicator were quick to point out that a rocky first month often signals poor performance for the remainder of the year. The market's weak performance in January appeared to justify the concern that stock prices were out of whack with business conditions.

On February 5, a *Wall Street Journal* reporter observed, "Increasingly, however, it looks like stock markets are off to a terrible start mainly because hopes for economic growth and the profits that go with it got too high." As it turned out, stock prices had already touched their low for the year two days earlier, and the S&P 500 was destined to rise over 19% from February 3 through December 31.

In recent years, a number of market commentators have argued that low interest rates allegedly engineered by the Federal Reserve and the European Central Bank have artificially boosted share prices to unsustainable levels. These experts say stocks are likely to fall decisively when interest rates begin to rise again. To an overwhelming degree, professional investors were confident that interest rates would rise in 2014, but the yield on 10-year US Treasury notes instead fell sharply from 3.03% at year-end 2013 to 2.19%.

If we could measure collective investor anxiety, it would likely have reached its peak for the year in mid-October. On October 15, the Dow Jones Industrial Average plunged as much as 460 points during the day. At that point, the Dow was

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down 2.6% for the year while the S&P 500 clung to a slim gain of 0.76%.

The sell-off was front-page news the following day in the *New York Times*, which observed, "The party is over. Waves of nervous selling buffeted the stock market in the United States on Wednesday, after a steep sell-off in Europe. Since their peak a month ago, American stocks have lost over $2 trillion in value, losses that may ripple through the wider economy. The faltering global recovery after the 2008 financial crisis may now be in jeopardy, particularly in Europe." What caused such a fierce selling squall? Market commentators cited selling by momentum-oriented hedge funds, fears of a weakening global economy, and gloom associated with another reported US case of the Ebola virus.

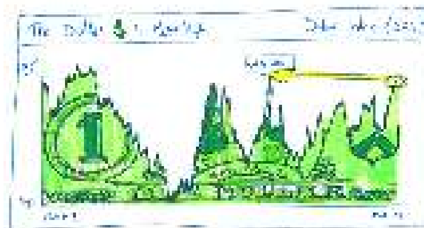
Many investors braced themselves for a continuing slide in stock prices that never occurred. Year-to-date stock returns were back in the plus column the following day and kept rising through December.

While many Wall Street experts fretted all year over monetary policy and valuation ratios, companies on Main Street plodded along, generally selling more goods and services, earning larger profits, and sending bigger dividend checks to shareholders. Twenty-eight of the 30 firms in the Dow Jones Industrial Average paid a higher dividend at year-end 2014 compared to the previous year, with an average increase of 11.65%.

Stock returns in non-US markets were generally positive in 2014, but with a wide range of results. Among 45 developed and emerging markets tracked by MSCI, total return expressed in local currency ranged from 38.66% in Israel to -31.59% in Greece. Thirty-five non-US markets had positive returns, including 17 with higher returns than the US. With so many pessimistic discussions of the European economy in recent months, many investors might be surprised to learn that stocks in Belgium, Denmark, Finland, Ireland, and Sweden outperformed US stocks when expressed in local currency.

Appreciation of the US dollar relative to every major currency significantly penalized net results for US investors like us. Even the Swiss franc, long associated with fiscal rectitude, slumped relative to the US dollar. Total return for the MSCI World ex USA Index was 6.80% in local currency but -3.88% in US dollar terms.

The recent strength of the US dollar stands in stark contrast to the gloomy predictions we heard from some quarters just a few years ago. For example, in the book *Aftershock*, published in 2011, the authors argued that the financial crisis of 2008–2009 was "relatively small compared to the coming dollar crisis" and predicted that this "unsustainable currency bubble" was destined to burst with disastrous consequences.



Exchange rates fluctuate in unpredictable ways, and it would not surprise us to see such arguments resurface in a few years, particularly after a prolonged period of dollar weakness.

The year 2014 was a challenging one in many respects, but perhaps the biggest challenge was to resist the urge to dip and dart in response to the cascade of news events and opinions that suggested action of some sort was imperative for financial success.

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Plus Two, Minus One

One of our business family members here at Rockwood, Ian Harvey, is relocating to New York City at the end of the month. We are truly sorry to see him go, but equally happy for him on a personal level, as a move will allow him to live in the same neighborhood as loved ones and friends, and continue his passion for financial planning in an independent firm similar to Rockwood.

We have absolutely no doubt that he will go on to make a distinguished name for himself in the financial planning profession, and that he will bring considerable honor to his humble professional beginnings here in New Hope. We are grateful for his years of dedicated service, his unrelenting candor, his tremendous work ethic, and the positivism he espouses.

Coincidentally, we would also like to take the opportunity to introduce two new team members to the Rockwood business family. Ian takes great pleasure in wryly suggesting that it takes two great hires to replace him. We'll take up that friendly discussion at his going-away party later this month.

We are immensely proud to introduce both Megan Lottier and Robert Stephenson.

Megan Lottier, CPA, MST, brings with her over 15 years of experience in strategic tax and finance. She has risen steadily through the ranks of Arthur Andersen, the Susquehanna International Group, and KPMG as her family settled here in Solebury, Pennsylvania. Her insight, professionalism, and well-honed expertise provide an invaluable resource for Rockwood's clients.

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Robert Stephenson comes to Rockwood with expertise in the qualified plan space including ERISA regulations, investment platforms, and compliance functions. His follow-on experience

at SEI in the mutual fund industry coupled with his previous work experience at Ascensus provides Robert with a unique perspective on the value that Rockwood provides to its clients.

Most important, both Robert and Megan fit seamlessly into the culture of our family here at Rockwood that places the clients' best interest, ethical conduct, and integrity above all else. We welcome them knowing that their arrival makes Rockwood a stronger firm, and enhances our ability to provide world-class service to our clients.

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