MARKET
PERSPECTIVES

STC Investment Committee

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If January is a precursor to the rest of 2015, investors are in for a bumpy ride. The commodity and currency markets were amazingly volatile, with oil down 9.4%, the Euro down 6.7%, commodity-country currencies down 5% - 9% and the Swiss franc up 8% following its Central Bank's surprise decision to remove its currency ceiling. The Swiss move and a larger than expected quantitative easing program from the European Central Bank led to a ripple effect of rate cuts from Canada, China, India and Russia. The rapidly growing number of countries with negative interest rates drove an 8% rally in gold prices, despite the headwind of a stronger dollar.

While the familiar themes of lower oil prices, a stronger dollar, central bank easing and European turmoil continued, a noteworthy change was that U.S. equities were the global underperformer. They lost 2.8%, while EAFE (Europe, Australasia, and Far East) and emerging markets gained 0.5%. Whether this was due to the "push" effect out of the U.S. in terms of extended valuations, disappointing earnings and possible interest rate hikes or the "pull" effect of earnings growth potential and renewed monetary accommodation remains to be seen. However, there is a growing view that international equity markets will outperform (finally) the U.S. despite real challenges in Japan and Europe and a slowing Chinese economy.

Among developed markets, Japan gained 2.3% on the back of good news on export and corporate earnings. The Eurozone gained modestly, despite having local market gains nearly erased by the Euro's fall. Elsewhere, Indian equities once again took top spot at +7.3%, with Asian emerging-market gains outweighing losses of commodity-oriented peers such as Brazil, down 6.5%.

Global bond yields reached record low levels as investors responded to extreme monetary accommodation (negative short-term rates), evidenced by the European Central Bank's new support package and the Federal Reserve Board's communication that it would factor in "international developments" in assessing monetary policy. Accordingly, longer-dated sovereign and high-quality bonds did the best, with the overall domestic bond investment-grade index up 2.1% and the similar foreign index up 1.7%, despite dollar strength. In contrast, global high-yield bonds lost 1%, with even domestic high-yield bonds returning only 0.7%, as spreads widened.

Our portfolio positioning is little changed from January. Domestic equities remain unappealing, as it is difficult to construct a high-quality equity portfolio with more than a 3% return expectation. International equity exposure is back down to target levels following our brief tactical overweight, after developed markets have returned 6% this year (versus 2% for the U.S.). I am not yet increasing municipal bond exposure because the relative value of municipals versus Treasuries eroded somewhat this month. I've increased cash a bit and continued a strong overweight in hedge fund strategies. Finally, we are increasing floating-rate high-yield loan exposure (as spreads have widened to moderately attractive levels) and are maintaining our underweight in high-yield bonds (due to low benchmark interest-rate levels).

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