ECONOMIC AND INVESTMENT OUTLOOK FOR 2015

Every year brings its surprising stories. At the beginning of 2014, when oil was still around $100 a barrel, no one foresaw oil dropping below $60 a barrel by year-end, but it did. This is yet another humbling reminder of the difficulty, or impossibility, of gazing into the crystal ball and peering into the economic and investment future. Nevertheless, as investors, we still must develop an informed view and structure our investments based on that view, so let’s take a peek at 2015.

The Economy

Is the decline in oil prices a good or bad thing? Perhaps it is both. Declining global demand for oil is a worrisome sign of sluggish growth. On the other hand, plunging oil prices is also a good thing for consumers and many industries. For example, airlines and chemical companies both benefit from lower oil prices.

The U.S. economy continues its slow but steady forward march, in contrast to Europe, which remains just an inch away from another recession. With the improving U.S. economy and labor market, the Federal Reserve seems finally poised to begin a long-anticipated increase in interest rates by mid-2015. However, few expect more than a modest initial increase, with future increases phased-in over time. The U.S. was the first big economy to enter and then to exit recession, and will also be the first to move interest rates back up.

It is a different story in Europe and Japan, where monetary authorities are still using low rates to prop up or jump start their economies. With the U.S. economy doing better and with the anticipation of U.S. interest rates increasing, the dollar has been rising in value vs. many foreign currencies. This dollar strength is expected to continue in 2015.

Global politics impact the economy and markets and are, in turn, impacted by the economy and markets. Hot spots such as Russia and the Middle East, and the specter of terrorism can always affect the global economy in unexpected ways.

Cash Investments

Traditional savers with bank and money market accounts have suffered for years, earning next to nothing on their hard-earned money. A move by the Federal Reserve to begin raising rates will finally bring some relief to savers, although it most likely will just be a modest increase.

Bonds and Fixed Income

The decline in oil prices and concern over the global economy resulted in yields on U.S. Treasury Bonds declining in 2014 (which means the prices of those bonds increased). A year ago, 10-Year Treasury Bonds yielded about 2.8% and are currently yielding just 2.1%. If oil continues falling, and if the global economy worsens, bond yields could drop even lower, rewarding investors in those bonds. On the other hand, improving global growth should result in bond yields moving back up. Investment-grade and high-yield corporate bonds offer better risk-adjusted returns than government bonds.

Stocks

The current bull market for stocks began in March, 2009 and is now the 4th longest bull market on record. Despite several pullbacks along the way, the stock market has continued churning higher. Today's market is not cheap, but neither is it outrageously expensive.

How will stocks respond to rising interest rates? At times, rising rates have negatively impacted stocks. Rising rates mean that savings accounts and bonds offer stocks more competition for investor money. In addition, corporations borrow money, so rising rates mean their borrowing costs go up. However, rising rates are not necessarily bad for stocks. When rates are increasing due to improving economic conditions, stocks can benefit, assuming rate increases are modest and measured.

The U.S. stock market deservedly outperformed most foreign markets in 2014 and may continue besting their foreign rivals in 2015. However, because of this outperformance, many foreign stocks are much cheaper than U.S. stocks.

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