Investment Tally & Perspective

Lincoln Capital Corporation

Volume 23, Issue 4

October, 2014

Ronald E. Albert, CFP
Brittany A. Moran, CFP
Nina Walsh
Karen Jones Ariosta

40 Westminster Street
Suite 202
Providence, RI 02903

Phone: (401) 454-3040
Toll Free: (855) 768-3040
Fax: (401) 453-0678
Email: info@lccorp.com
Web: www.lincolncapitalcorp.com

INVESTMENT TALLY & PERSPECTIVE

This issue of Investment Tally & Perspective reviews recent economic and financial market activity with an updated view on investment issues and outlook.

ECONOMIC: The economic expansion following the deep recession six years ago has been slow, gradual, and uneven, yet the U.S. is clearly the "cleanest shirt in the dirty laundry" when compared to Europe and much of the globe. Investor's preference for the USA is evident in the rising dollar, which continues to be viewed as a safe haven in an unsafe world highlighted by ISIS and Mid-East cultural wars, Ebola, and aggressive territorial actions by Russia with China.

MONEY, THE FED AND INFLATION: Given the massive amount of stimulus by the Fed and other central banks in recent years, fears that money-printing will one day bring high rates of inflation have, so far, turned out to be both right and wrong at the same time. Central bank actions that have suppressed interest rates near zero have pushed savers and investors out on the risk curve in search of earning some return on their capital. The significant rise in asset prices – stocks, bonds, real estate – owe a good amount of their advance to Fed actions and policies. In essence, we have asset price inflation (rising prices of bonds, stocks, and real estate), while traditional measures of inflation, such as wage growth and consumer prices, are more indicative of disinflation or deflation. The recent declines in energy and commodity prices are a consequence and reflection of limp global growth.

MAJOR INDUSTRIALIZED COUNTRIES

	2014 Est. GDP	Unemployment	Consumer Prices	Budget Balance (as % of GDP)	Int. Rate 10-Yr Gov't
Britain	3.2%	6.2%	2.7%	-4.5%	2.34%
Canada	2.3%	7.0%	1.1%	-2.6%	2.09%
France	0.5%	10.5%	0.9%	**-4.0%**	**1.33%**
Germany	1.7%	6.7%	1.4%	**0.4%**	**0.93%**
Italy	0.0%	12.3%	0.9%	**-3.3%**	**2.31%**
Japan	1.3%	3.5%	0.9%	-7.9%	0.53%
Spain	1.1%	24.4%	0.3%	**-5.7%**	**2.16%**
Switzerland	1.9%	3.2%	0.0%	0.3%	0.56%
United States	2.0%	5.9%	1.5%	-2.8%	2.51%

Note: Interest rates in bold are Euro currency rates.

Data from The Economist, October 6, 2014

MARKET INDEX RETURNS

Fixed Income	3rd Qtr. 2014	1 Year	3 Year	5 Year
Citi Treasury Bill 3 Month	0.01%	0.04%	0.05%	0.08%
Barclays US Aggregate Bond Index	0.17%	3.96%	2.43%	4.12%
Barclays Global Aggregate Bond Ex US	-5.38%	-0.81%	0.14%	1.68%
Stock Indices				
S&P 500	1.13%	19.73%	22.99%	15.70%
Dow Jones Industrial Average	1.87%	15.29%	19.02%	14.85%
NASDAQ Composite	2.24%	20.61%	24.57%	17.51%
MSCI EAFE Index	-5.88%	4.25%	13.65%	6.56%
MSCI Emerging Markets	-3.49%	4.30%	7.19%	4.42%
Russell 2000	-7.36%	3.93%	21.26%	14.29%
Other				
Bloomberg Commodity Index	-11.83%	-6.58%	-5.34%	-1.37%
S&P GSCI Precious Metal Index	-9.79%	-10.63%	-10.87%	2.64%

*Data obtained from Morningstar; period ending 9/30/2014

*All figures are stated as trailing total returns, and returns over 1 year are annualized

MARKET PSYCHOLOGY AND THE INVESTMENT OUTLOOK

When someone as experienced and knowledgeable as former Fed Chairman Alan Greenspan states that monetary policy and economic conditions are in "unprecedented and unchartered waters", then forecasts of the future must be taken as educated guesses more than precise calculations. With this as background, it may be helpful to review the psychology of individual investors and collective market psychology, as its role in the financial markets and portfolio management may once again become prominent.

In a world with true free markets, the prices of goods, services, and asset values are ultimately determined by their buyers and sellers. In a similar manner, the level of interest rates are determined by financial market participants (the suppliers and users of money). While free markets do a good job of allocating capital and setting interest rates, todays markets are far from free, as they are greatly influenced or even rigged by government actions. The elevated price levels of bonds and the depressed level of interest rates serve as poster examples of government involvement in markets.

Investor psychology may be viewed in a cyclical manner with movements largely influenced by the human emotions of greed and fear. As markets rise in price, participants become more optimistic and eager to invest at higher prices, greedy actions that result in the assumption of more risk and the acceptance of lower returns. The opposite is also true when prices and markets fall, as fearful investors are then motivated to sell assets, thereby driving prices even lower. Rising prices entice more sellers until the volume of sellers exceed the volume of buyers, thereby halting the price rise. The opposite is also true – declining prices eventually attract more buyers until the volume of buyers then exceeds the volume of sellers, thereby producing a bottom.

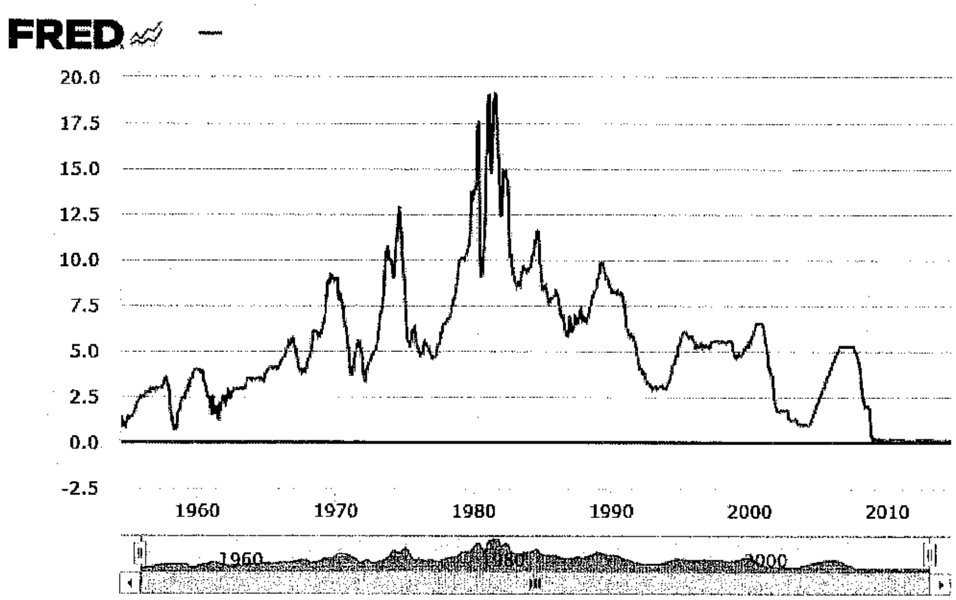
In today's world, we see that commodity and energy prices have dropped a good amount in a short period of time and these lower prices will attract more buyers, as a bottom is formed setting the stage for another advance. For the equity market in general, stocks in mid-September were on the high end of fair valuation with the decline in the past two weeks bringing valuations to more attractive levels.

In sum, the changes underway indicate that global growth, led by the U.S, will gradually accelerate, and the eventual increase in interest rates may be limited by the global surplus of savings. Market volatility is likely to remain elevated as the Fed and other central banks try to wean the markets from their monetary tonic. In short, we expect more anxiety with wider price swings, as the economic expansion continues with earnings growth providing support for stocks grinding higher, with occasional setbacks along the way.

INVESTMENT SUMMARY

- Equity prices have recently been falling, with culprits being the strengthening U.S. dollar, monetary policy changes, and geopolitical tensions. Although these worries are not new, they coincide with a general sense among investors that markets are overdue for a correction. As a result, a flight to quality is taking place in many asset classes, and within the equity market itself.
- Even strong bull markets experience corrections, yet a major bear market or severe correction is unlikely as the risk of a recession in the near-to-medium term is quite low.
- The S&P 500 has hit a wall on the back of tighter monetary conditions exemplified by the soaring U.S. dollar, which has the potential to undermine the earnings expansion and could lead to further broad market volatility.
- Periodic market setbacks are inevitable, but the long-term case for equities remains sound. Our optimism stems largely from the current economic landscape of trend growth and low inflation, typically a healthy backdrop for equities. Falling commodity prices courtesy of weak global growth and a strengthening US dollar have worked to keep inflation low.
- While a further pullback is quite possible, we know that accurately timing market movements is virtually impossible and, over the long haul, investors are best served by staying focused on their financial objectives and maintaining proper exposure to equities for income, growth of income, and capital appreciation.

The Effective Federal Funds Rate - is the central interest rate in the U.S. financial market. It influences other interest rates such as the prime rate, as well as mortgages, loans, and savings.



Shaded areas indicate US recessions - 2014 research.stlouisfed.org

Source: Board of Governors of the Federal Reserve System
Shaded areas indicate US recessions – 2014 research.stlouisfed.org