Plimoth Investment Advisors®
INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

FIRST QUARTER – SPRING 2015

INVESTMENT SPOTLIGHT

"In communication, familiarity breeds apathy." – William Bernbach

On all accounts, the recovery from the Great Recession of 2008 has been slow and uneven relative to past economic recoveries, particularly given the severity of the decline. With the closing of the last quarter, we have now experienced twenty-seven months of recovery. Despite this long string of growth, the sheepish magnitude has resulted in regular questioning of its veracity and sustainability. Within this prolonged cycle of slow growth, we have witnessed "mini-patterns" develop. Specifically, growth in the first half of each new calendar year, particularly the first quarter, has been slow. Slow growth then has given way to stronger activity in the middle and latter half of the year.

At the beginning of 2015, we anticipated stronger business activity and improved consumer spending, which we believed would break the mini-pattern of first quarter weakness. Alas, the first quarter fell victim to the pattern. Weak data across manufacturing combined with soft business and consumer spending will likely result in a first quarter GDP report that falls well below 2%.

While reviewing economists' analysis and reports, we see a familiar theme developing, with most analysts calling for a second quarter pickup and increasing momentum into the summer months, reminiscent of the past several years. However, we need to be mindful that the recent patterns are not pre-determined to continue. There is a risk in becoming overly optimistic concerning an outcome based on the familiarity of the recent past. While the expectation might be reasonable given underlying fundamentals, we cannot fall victim to assuming a foregone conclusion based solely on trends. For that reason, we must ignore what has happened in prior years and focus solely on the current economic fundaments to consider both the specific reasons for the first quarter weakness, and the potential for activity in the coming quarters. ■

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Economic Review & Outlook

The softness in the economy can be isolated to three main areas, with two of those areas being significantly impacted by larger global themes. The first global theme was the appreciation of the U.S. dollar relative to foreign currencies. The strengthening U.S. economy relative to other global economies, combined with the introduction of the European Central Bank's quantitative easing program, drove the value of the U.S. dollar higher. The strengthening dollar made U.S. produced goods more expensive for overseas buyers, thus export activity weakened during the quarter. Dramatically lower oil prices, which should provide long-term benefits in the area of consumption, resulted in a rapid reduction in business investment across the energy sector. Year-over-year oil exploration in the U.S. is down 46.5%, while gas exploration is down 29.7%. Drilling rigs in the U.S. have been slashed from 1,818 this time last year to 1,028 currently. Employment in this area has fallen in a consistent manner. High oil prices and improving technology combined to create a shale oil boom in the U.S. that provided a significant component of growth to the overall economy. Activity and production will likely remain challenged until oil prices bounce off of the current trading range. Finally, manufacturing activity, which we expected to remain relatively stable during the first quarter based on historically reasonable inventory levels, declined in similar fashion, as has been the case over the past several years.

S & P 500 Sector Performance

	Q1-2015	YTD-2015
Consumer Disc.	4.80%	4.80%
Consumer Staples	0.99%	0.99%
Energy	-2.85%	-2.85%
Financial	-2.05%	-2.05%
Healthcare	6.53%	6.53%
Industrial	-0.86%	-0.86%
Info. Technology	0.57%	0.57%
Materials	0.99%	0.99%
Telecommunications	1.54%	1.54%
Utilities	-5.17%	-5.17%

The March employment report corroborated the data from the manufacturing sector of the economy. After showing 12 consecutive months of strong job growth through February, the March report saw private sector job growth slow to the weakest pace since December of 2013 (126,000 new jobs), with the manufacturing sector actually losing jobs. The contraction in the manufacturing and goods-producing sector had a dampening impact on the service sector, which helped pull down aggregate job creation. Negative revisions to the prior month's report pulled the average monthly job gain over the last 12 months down to 196,000. Although this is a respectable number, it is softer than most had come to expect.

While the unemployment rate remained at 5.5%, other data released in the report suggests that significant slack remains in the employment market. This gives the Federal Reserve more latitude with respect to the timing of an anticipated Federal Funds rate increase. Despite the moderating data, job creation and stability remains supportive of incremental consumer spending. Combined with the decline in energy prices, we believe U.S. consumers are more likely to pick up activity as the weather breaks and pent up demand translates into greater spending activity.

Many economists attribute some of the first quarter weakness to the extreme weather conditions across the U.S. No doubt anyone living here in the Northeast will concur that weather had an impact on all activity, economic and otherwise. It seemed as though crippling weather events were popping up across the country throughout the winter. Perhaps this was most evident in the housing data, which was generally stagnant through the winter months. Existing home sales remained relatively flat through January and February, and will likely post a similar number when March data is released. Lean inventory levels are partially to blame for this, which may improve with the spring thaw. Housing Starts plummeted during the worst of the weather in February, but are likely set to rebound as building permits remained steady. Thus we expect an improvement in housing activity that is consistent with the normal seasonal trend, but we also anticipate a relatively stable pricing environment with little significant price escalation.

While the manufacturing sector was weak, the service sector of the economy continued to grow at a slightly softer, but steady and solid pace during the first quarter. As the service sector accounts for roughly 70% of U.S. GDP, it was clear that the final GDP number for Q1 will be service-sector driven. What remains to be seen is whether the weakening in the manufacturing sector and challenging global growth will weigh down the domestic service sector of the U.S. economy. Or, as in past cycles, will resurgence in spending and production activity foster better growth numbers in the coming quarters? We maintain the latter is the most likely outcome. ■

Bond Market Review & Outlook

Interest rates moved within a relatively tight range throughout the quarter. Low rates across the globe continued to pressure the long-end of the U.S. yield curve while short rates moved up and down based on the data of the day and its potential impact on Federal Reserve rate policy. At the beginning of the year, the average investor forecasted a June 2015 increase in the Federal Funds rate. However, the conviction of that position softened steadily, with expectations moving to September, then December after the release of the March employment report.

The weak economic data, particularly the employment data, has given the Federal Reserve sufficient rationale to remain patient with respect to increasing short-term interest rates. As such, low short-term rates appear likely well into 2015 and possibly 2016. While the Federal Reserve has absolute control over short-term interest rates, long-term rates remain more a function of investor activity, particularly since the Federal Reserve has successfully ended the quantitative easing program. With the European Central Bank filling those shoes, it appears likely that U.S. rates will remain mired in the current trading range for the next few quarters.

Fixed income investing remains a purely defensive position used to provide a safe haven as equity markets will likely continue to trade with a good amount of volatility in the coming quarter. With the expectation of stable rates, the down-side potential of fixed income appears small. For the quarter, fixed income returns were positive across all bonds, including high-yield, which fell out of favor last year. ■

	Q1-2015	YTD-2015
Cash:		
T-Bill Index	0.01%	0.01%
Taxable Fixed Income:		
Barclay's US Agg. Bond	1.61%	1.61%
Barclay's Govt./Credit Int.	1.45%	1.45%
Barclay's Govt./Credit Long	3.36%	3.36%
BofAML High Yield Index	2.54%	2.54%
Tax Exempt Fixed Income:		
Barclay's Muni. 5 Yr.	0.76%	0.76%
Barclay's Muni. 7 Yr.	1.09%	1.09%
Barclay's Muni. TR	1.01%	1.01%

Stock Market Review & Outlook

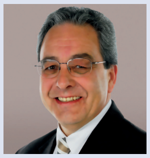
After a late-year surge, the S&P 500 closed at 2,059. Based on earnings, it is fair to suggest that stocks have been trading within a range of fair value throughout the first quarter. After years of trading at a level below fair value, or relatively cheaply, our outlook for potential returns in 2015 must be moderated.

On a purely fundamental basis, if stocks are trading in fair value range, all things being equal, two things could likely drive markets higher. First, earnings growth would have to accelerate above normal levels to justify a significant move higher in stocks. Second, investors would need to drive markets higher to a point where they would become overvalued on an earnings basis. This could happen if long-term investors become increasingly optimistic about economic prospects, and thus eventually an improvement in corporate earnings. Speculators and traders could also drive markets higher, seeing stocks as the best game in town, at least for the short-term. In the current environment, we do not think either is particularly likely. We continue to believe, as we did at the beginning of the year, that stock prices will move in line with earnings growth, which should be in the single-digits. We also continue to believe that volatility will be high, with short-term investors and speculators trading the news headlines.

	Q1-2015	YTD-2015
DJIA Index	0.33%	0.33%
S&P 500 Index	0.95%	0.95%
Russell 2000 Index	4.32%	4.32%
EAFE Index	5.00%	5.00%

Over the long-term, we believe fundamental analysis is the most sound and pragmatic way to invest assets. We nonetheless recognize that on a day-to-day basis non-fundamental factors will drive market speculation. Throughout the first quarter, the anticipation over Federal Reserve policy has been a primary driver of market activity and volatility. As investors anticipated a quicker increase in the Federal Funds rate, markets sold off. When economic data softened, equity markets rallied on the anticipation of pro-longed short-term rates. The headlines concerning the Greek relationship with the Eurozone was also a primary driver of volatility. In an environment of fair-value, we can expect a continuation of back and forth with respect to the level of equity market indices, but continue to believe that by year-end equity markets will have posted another year of positive returns, albeit muted compared to recent history. ■

Meet the Plimoth Investment Advisors Executive Leadership Team



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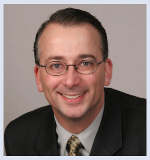

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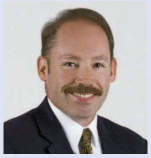

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Closing Thoughts

As the U.S. Economy downshifted during the first quarter, signs of life emerged in Europe with several countries registering stronger than expected economic activity. The Eurozone accounts for just over 20% of global economic activity. Since the end of the 2008 recession, Europe has had a second recession, and growth exceeded 2% in only one year, 2010. Should growth continue to accelerate in any meaningful way, equity investors may be rewarded in an environment of expanding global output and activity, supported by an improving European economy that has not exceeded 3% since 2007.

As always, we will continue to monitor economic and market conditions to ensure timely and appropriate investment action. If we can be of assistance, please do not hesitate to call us at the numbers provided. ■

If you are interested in receiving this quarterly newsletter electronically, please contact Thom Miller at tmiller@pliadv.com. We will be happy to take you off the mailing list and add you to the e-mail list.