Plimoth Investment Advisors®

INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

SECOND QUARTER – SUMMER 2015

INVESTMENT SPOTLIGHT

"Doubt is an uneasy and dissatisfied state from which we struggle to free ourselves and pass into the state of belief; while the latter is a calm and satisfactory state which we do not wish to avoid, or to change to a belief in anything else." *– Charles Sanders Pierce*

An "uneasy and dissatisfied state" appropriately describes the sentiment of investors during the course of the second quarter. After witnessing yet another first quarter slowdown, investors were hoping for what has become a familiar second quarter bounce back, reviving their hopes for future growth and improving markets. Unfortunately, as additional economic data was released throughout the quarter, no solace was given. Instead data across multiple sectors of the economy including consumption and manufacturing remained relatively subdued, reducing investors' spirits and giving rise to further doubt.

Despite the fact that the weaker data increased investor skepticism and market volatility, U.S. equity markets traded within a very narrow range throughout the quarter, and for that matter, thus far the entire year. The S&P 500 index began the year at 2,059, then traded down to 1,993 by mid-January. After trading back and forth through the next four months, the index peaked at 2,131 on May 21. After falling slightly through the first half of June, markets reacted quickly to Greek uncertainty by falling 3.07% in the last week of the quarter, with the S&P 500 closing at 2,063. The peak to trough difference of 6.69% during the period represents one of the tightest 6-month trading ranges on record. After all of the volatility, the year-to-date return for the index is a modest 1.23%.

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We have mentioned our belief that equity markets are trading at the high-end of fair value in prior newsletters, making them vulnerable during periods of weak data releases. In this environment, traders sell equity as it approaches peak levels, pushing prices down. At the bottom of the range, investors begin looking for opportunities, pushing prices back up. This is the current state of equity markets. U.S. economic uncertainty, U.S interest rate policy uncertainty, and headlines emerging from Europe (both economic and political) have come together in an environment of fair value to create the current trading range. How the range is broken, whether on the high side or low side, will be dependent upon the course of the global economy and the policy decisions made in the coming months. ■

Economic Review & Outlook

As mentioned above, manufacturing activity remained subdued for most of the second quarter. Both regional and national data pointed to expansion, but the pace of growth remained unconvincing, particularly after the weakness in the second quarter. After a slow first quarter, many expected business and consumer spending the post sharp rebounds. Neither provided the bounce. We were more surprised by the weak consumer spending given the lower energy prices and firm employment market. Despite the weakness in these areas, there were some reasons for optimism in the data.

The biggest positive surprise came from the housing sector. After posting modest growth numbers since the summer of 2013, housing activity trended higher over the course of the quarter. New Home Sales, Housing Starts, Building Permits, Existing Home Sales and Median Home prices all trended higher. The catalyst for the surge is difficult to determine as none of the factors that impact housing activity changed demonstrably. Nonetheless, the increased activity is a welcome sign, as incremental housing activity generally bodes well for consumer spending on durable goods and other items associated with homeownership, not to mention the positive impact on job creation.

While employment activity was not necessarily surprising, it was a continued source of economic strength during the quarter. After 2014 posted the largest employment gains since 1999, early 2015 data was a little softer. However, after a weaker than expected report in March, April and May data rebounded nicely, curbing any concerns that job creation may continue to struggle in 2015. The unemployment rate for May closed at 5.5%, which is only slightly above the recent low of 5.4%. This was not a concern as more people identified themselves as seeking employment, causing a rise in the labor participation rate. This is a healthy sign, and must continue as the labor participation rate remains near a 35-year low. While job growth and the unemployment rate point to a positive employment market, the underemployment rate remains grudgingly high, and real wages continue to be held down by available labor.

While the U.S. economy struggled during the first half of the year, Europe appeared to be showing signs of life. After barely avoiding a third recession in the past 8 years during 2014, European GDP rose to 1.4% during the first quarter and continued to show signs of improvement into the second quarter. Many feared European deflation earlier in the year, but fears abated after some strong export numbers fueled aggregate activity. After watching the U.S. Federal reserve successfully implement stimulative policies, the European Central Bank embarked on their own Quantitative Easing program in an effort to spur growth, which appears to have gotten some traction.

Also overseas, Japan's GDP surged to 3.9% in the first quarter on increased capital spending. It marked the second quarter of expansion after the implementation of a consumption tax caused a brief recession in the middle quarters of 2014. Despite the positive news, private consumption which accounts for roughly 60% of Japanese GDP rose a modest 0.4%, casting doubt on the prospects for the second quarter. In Asia, China's first quarter GDP came in at 7% which was in line with expectations. Still, this is the slowest growth rate in 25 years, which Chinese officials deem necessary to reduce the economy's reliance on credit-fueled growth and induce Chinese consumers to spend more of their savings. By the end of the quarter, volatility came roaring back as China's authoritarian government was accused of interfering with the country's natural economic order.

With Central Banks across the globe maintaining stimulative growth policies, we continue to expect the global economy to grow in a manner consistent with recent years. This includes the U.S. where we now anticipate year-end GDP to fall very closely to the 2.4% level of 2014. ■

S & P 500 Sector Performance

	Q2-2015	YTD-2015
Consumer Disc.	1.92%	6.81%
Consumer Staples	-1.74%	-0.77%
Energy	-1.88%	-4.68%
Financial	1.72%	-0.37%
Healthcare	2.84%	9.56%
Industrial	-2.23%	-3.06%
Info. Technology	0.19%	0.76%
Materials	-0.48%	0.50%
Telecommunications	1.59%	3.15%
Utilities	-5.80%	-10.67%

Bond Market Review & Outlook

After beginning the year at 2.25%, Ten-Year U.S. Treasury yields cratered through the month of January, falling to a low of 1.67%. The reason for the decline was two-fold. Weaker than anticipated U.S. data called into question the timing of Federal Reserve rate hikes. More impactful though was the interest rate environment across Europe. At the beginning of the first quarter, investors were concerned about the prospects of European deflation. These concerns combined with the European Central Bank's bond purchasing program pushed interest rates across Europe down. At one point, the German 10-Year Bund was trading with a yield of .05%. In an environment of falling yields across Europe, the yield advantage of U.S. Treasuries, along with their relative safety, drove global investors to the U.S., pushing interest rates down commensurately. As the European economy began to improve, bond yields rose along with the yields here in the U.S.

Bond investors are now once again more focused on the policy of our Federal Reserve, specifically the timing of a Federal Funds rate hike. At the beginning of the year, the majority of investors believed the Fed would start raising rates in June. Fed Chairperson Yellen has always maintained the move was dependent on continuing positive economic data. Given the weak data, expectations have been pushed out to later in 2015 or perhaps 2016. We have maintained our belief from the beginning of the year that Federal Reserve policy action is not set on a specific time table. Strong data that suggests positive sustainable economic activity will prompt the Fed to act. Anything below that threshold will result in further delay of policy changes. Rampant inflation represents the biggest concern when maintaining an accommodative monetary policy. At this point, there is no data to suggest the Federal Reserve should be concerned with it, giving them considerable latitude to maintain existing policy positions for an extended time period.

Given the state of the U.S and global economy, and the current stance of Central Banks across the globe, we believe interest rates on the 10-year Treasury will remain range-bound through the end of 2014, trading between 2.00% and 2.75%. Short-term interest rates which are more sensitive to Federal Reserve decisions already reflect the expectation of a rate hike prior to the end of the year. Therefore, we do not see much variability in rates on the short-end of the curve prior to year-end. ■

	Q2-2015	YTD-2015
Cash:		
T-Bill Index	0.00%	0.01%
Taxable Fixed Income:		
Barclay's US Agg. Bond	-1.68%	-0.10%
Barclay's Govt./Credit Int.	-0.62%	0.82%
Barclay's Govt./Credit Long	-7.57%	-4.47%
BofAML High Yield Index	-0.05%	2.49%
Tax Exempt Fixed Income:		
Barclay's Muni. 5 Yr.	-0.17%	0.59%
Barclay's Muni. 7 Yr.	-0.77%	0.31%
Barclay's Muni. TR	0.89%	0.11%

Stock Market Review & Outlook

As referenced in the opening comments, stocks have traded in a very tight trading range through the first half of the year. We attributed the tight trading range to two broad themes. First and foremost from a valuation perspective, equity markets are trading in a range of fair value. As measured by standard valuation measures that consider the price of the stock relative to the earnings and sales it produces, it is fair to say that in general stocks are trading in a range of normalcy. No longer do they appear cheap, as has been the case during most of the recovery, but they also do not appear to be significantly over-valued.

This brings us to the second theme, which is expectation for the future. When investors have a strong opinion concerning the direction of the economy, whether positive or negative, they will buy or sell accordingly, driving more consistent directional trade up or down. What is very clear in this environment of fair valuation is that investors are less certain about the upcoming months. There is reasonable justification for this uncertainty. Uncertain global economic trends, aggressive Central Bank policy, various geopolitical risks and global politics all combine to provide a backdrop which give legitimate reason for doubt.

	Q2-2015	YTD-2015
DJIA Index	-0.29%	0.03%
S&P 500 Index	0.28%	1.23%
Russell 2000 Index	0.42%	4.75%
EAFE Index	0.84%	5.88%

Despite the back and forth trade, the S&P 500 index managed to end the quarter closer to the high end of the trading range than the low end, resulting in a year-to-date gain of 1.23%. European markets, which lagged in the prior year, posted even stronger returns with many individual country indices posting double digit returns. Asian markets also finished with strong gains despite the end of quarter dip in Chinese markets.

Despite the volatility and uncertainty, particularly related to the recent events in Greece, we continue to believe U.S. stocks will provide respectable returns for the remainder of the year. At the beginning of the year, we believed stocks would provide returns consistent with earnings growth in the mid-single digits. We continue to believe this to be the case. ■

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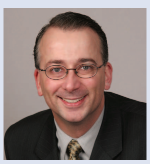

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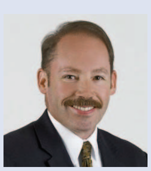

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Closing Thoughts

Thus far in 2015 we have been surprised by the relative economic weakness here at home. The adverse impacts from declining oil prices, a strengthening dollar and cautious consumers have pulled down activity more that we had anticipated. Severe weather conditions could also have contributed to some of the slowdown. However, we do believe the longer-term impacts of lower energy prices will ultimately translate into stronger consumer spending. We also believe the sudden uptick in housing could provide some aggregate relief to areas that will likely continue to be challenged, namely exports. In aggregate, we believe 2015 is shaping up to be similar in many ways to 2014, which while not exceptional, is also not problematic.

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.

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