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Mid-Quarter Commentary as of February 18, 2015

By John M. Silvis, CFA
Chief Investment Officer

After getting off to a rough start with the month of January registering negative returns, the equity markets have returned to positive territory as we reach the midpoint in the first quarter of 2015. The S&P 500 Index registered another all-time high recently closing above 2,100, returning 2.3% so far year-to-date. And the MSCI ACWI Index, a global measurement of equity performance, has climbed 2.89% since New Year's Day and is within 2% of its all-time high which it reached back in July of 2014.

The S&P 500 Index recorded its third year in a row of double digit returns in 2014, the first time that has happened since 1990, with the index returning 13.7% (it registered 16% in 2012 and 32.4% in 2013). It has outpaced the broader MSCI All-Country World Index by over 18% and the Russell 2,000 Index, a broad indicator of small cap performance, by over 5% during the same three year time frame. So it begs the question, is it worth being diversified? A truly diversified portfolio consisting of multiple asset classes (the S&P 500 Index only represents domestic large cap stocks) would have returned much less in 2014. But having all your assets in one part of the global equity market is, in fact, a much riskier proposition. While capital markets and their correlations change over time, there are still major risk/reward benefits to being diversified over the long term (we would use 10 years to define long term).

Ned Davis Research (NDR) has done several studies using 10 year rolling time periods, based on Markowitz's efficient-set theorem, to define what offers the maximum return for varying levels of risk. NDR, using a time period spanning from 1980 through the end of 2014, has shown that introducing international equities represented by the MSCI EAFE Index to a portfolio of large cap stocks (represented by the S&P 500 Index) can reduce the standard deviation or volatility of a portfolio. Their research has shown during the time period that investing 30% in international equities can maximize the reward/risk outcome within the portfolio. A similar study using an even longer time period stretching back to 1935 using small cap stocks to diversify a portfolio of large cap stocks (again represented by the S&P 500 Index) gave similar results. A portfolio with an allocation of 40-60% in small cap stocks over that time frame would see lower volatility and an optimal reward/risk profile.

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As we review the chart below covering the last 10 years of asset class returns, it is important to point out that large cap stocks, as represented by the S&P 500 Index (green square), have never been the best performing asset class during the time period. While they have done well versus the international equities markets, represented by both the international developed markets (brown square) and the international emerging markets (light purple square), over the last few years that has not always been the case. Half the time (2005, 2006, 2007, 2009 and 2012), large cap domestic equities have trailed their international counterparts. The S&P 500 Index has lagged the Russell 2000 Index (representing domestic small cap stocks) for six of the last ten years as well as on a cumulative basis over the last ten years.

Chasing the previous year's best performing asset class has never been a sound investment philosophy. Developing a diversified asset allocation that meets specific risk and reward characteristics is the foundation of what we do and will continue to be our driving principle going forward. We would recommend staying the course.

											10-yrs. '05 - '14	
2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	4Q14	Cum.	Ann.
MSCI EME 34.5%	REITs 35.1%	MSCI EME 39.8%	Barclays Agg 5.2%	MSCI EME 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Russell 2000 38.8%	REITs 28.0%	REITs 12.9%	MSCI EME 132.0%	MSCI EME 8.8%
Bberg Cmdty 21.4%	MSCI EME 32.6%	Bberg Cmdty 16.2%	Cash 1.8%	MSCI EAFE 32.5%	Russell 2000 26.9%	Barclays Agg 7.8%	MSCI EME 18.6%	S&P 500 32.4%	S&P 500 13.7%	Russell 2000 9.7%	REITs 122.3%	REITs 8.3%
MSCI EAFE 14.0%	MSCI EAFE 26.9%	MSCI EAFE 11.6%	Market Neutral 1.1%	REITs 28.0%	MSCI EME 19.2%	Market Neutral 4.5%	MSCI EAFE 17.9%	MSCI EAFE 23.3%	Barclays Agg 6.0%	S&P 500 4.9%	Russell 2000 111.3%	Russell 2000 7.8%
REITs 12.2%	Russell 2000 18.4%	Market Neutral 9.3%	Asset Alloc. -24.0%	Russell 2000 27.2%	Bberg Cmdty 16.8%	S&P 500 2.1%	Russell 2000 16.3%	Asset Alloc. 15.0%	Asset Alloc. 5.2%	Asset Alloc. 2.0%	S&P 500 109.5%	S&P 500 7.7%
Asset Alloc. 8.3%	S&P 500 15.8%	Asset Alloc. 7.4%	Russell 2000 -33.8%	S&P 500 26.5%	S&P 500 15.1%	Cash 0.1%	S&P 500 16.0%	Market Neutral 9.3%	Russell 2000 4.9%	Barclays Agg 1.8%	Asset Alloc. 91.7%	Asset Alloc. 6.7%
Market Neutral 6.1%	Asset Alloc. 15.2%	Barclays Agg 7.0%	Bberg Cmdty -35.6%	Asset Alloc. 22.2%	Asset Alloc. 12.5%	Asset Alloc. -0.6%	Asset Alloc. 11.3%	REITs 2.9%	Cash 0.0%	Market Neutral 1.0%	MSCI EAFE 61.5%	MSCI EAFE 4.9%
S&P 500 4.9%	Market Neutral 11.2%	S&P 500 5.5%	S&P 500 -37.0%	Bberg Cmdty 18.9%	MSCI EAFE 8.2%	Russell 2000 -4.2%	Barclays Agg 4.2%	Cash 0.0%	Market Neutral -0.5%	Cash 0.0%	Barclays Agg 58.4%	Barclays Agg 4.7%
Russell 2000 4.6%	Cash 4.8%	Cash 4.8%	REITs -37.7%	Barclays Agg 5.9%	Barclays Agg 6.5%	MSCI EAFE -11.7%	Market Neutral 0.9%	Barclays Agg -2.0%	MSCI EME -1.8%	MSCI EAFE -3.5%	Market Neutral 54.0%	Market Neutral 4.4%
Cash 3.0%	Barclays Agg 4.3%	Russell 2000 -1.6%	MSCI EAFE -43.1%	Market Neutral 4.1%	Cash 0.1%	Bberg Cmdty -13.3%	Cash 0.1%	MSCI EME -2.3%	MSCI EAFE -4.5%	MSCI EME -4.4%	Cash 15.7%	Cash 1.5%
Barclays Agg 2.4%	Bberg Cmdty 2.1%	REITs -15.7%	MSCI EME -53.2%	Cash 0.1%	Market Neutral -0.8%	MSCI EME -18.2%	Bberg Cmdty -1.1%	Bberg Cmdty -9.5%	Bberg Cmdty -17.0%	Bberg Cmdty -12.1%	Bberg Cmdty -17.1%	Bberg Cmdty -1.9%

Source: Russell, MSCI, Bloomberg, Standard & Poor's, Credit Suisse, Barclays Capital, NAREIT, FactSet, J.P. Morgan Asset Management.
The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Barclays Capital Aggregate, 5% in the Barclays 1-3m Treasury, 5% in the CS/Tremont Equity Market Neutral Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. All data represents total return for stated period. Past performance is not indicative of future returns. Data are as of 12/31/14, except for the CS/Tremont Equity Market Neutral Index, which reflects data through 11/30/14. "10-yrs" returns represent period of 12/31/04 – 12/31/14 showing both cumulative (Cum.) and annualized (Ann.) over the period. Please see disclosure page at end for index definitions. *Market Neutral returns include estimates found in disclosures.
Guide to the Markets – U.S. Data are as of 12/31/14.

Fixed Income Commentary as of February 20, 2015
By Rick D'Amico, CFA
Manager of Investments

10-year Treasury yields are within a few basis points from where we started in 2015; however, through the first month and a half rates have been anything but predictable. 10-year Treasury rates sunk as low as 1.65% on January 30, 2015, while 30-Year yields touched 2.25%. The sharp, quick drop in rates was primarily attributable to deflationary fears in the Eurozone and increasing concerns over a global economic slowdown. Thus far in February, 10-year yields have rallied strongly all the way back to 2.11%, sparked by a strong January employment report. Attention is again focused on the Federal Reserve regarding both the timing and pace of potential interest rate hikes this year. According to Roberto Perli of Cornerstone Macro Research, the market is pricing in 75% odds of a rate hike by June and 100% odds by July. From that point on, the pace of rate increases expected by the market falls rapidly behind the Fed, potentially leaving the short to intermediate part of the yield curve exposed. If history holds true, the yield curve will likely flatten in 2015 with short-term rates rising and the long end remaining relatively range bound. In our view, there are a number of factors which could keep a ceiling on longer term rates including: (1) a benign inflation environment, (2) modest economic growth and (3) the relative value of U.S. Treasury Yields when compared to other developed market countries (for example, German and Japanese 10-year bonds are currently yielding .36%, and .37%, respectively).

After a surprisingly strong year of 5.97% returns for the Barclays U.S. Aggregate Bond Index in 2014, our performance expectations for 2015 are more modest. Finding value in the fixed income market remains a challenge, however, high yield bonds are becoming more relatively attractive after the recent sell-off. There are also pockets of value in the municipal bond sector as well, with the 10-year AAA Muni currently yielding 103% of a comparable treasury.

Five Themes for 2015

Improving U.S. economic expansion. The U.S. economy, which grew at 2.5% in 2014, should continue to pick up steam as we head into 2015. Gross Domestic Product (GDP) should grow between 3 and 3.5% for 2015 as the economy benefits from lower energy prices and a stronger U.S. dollar.

Volatility will likely continue in 2015. It is common during maturing bull markets to see an increase in market volatility. Equity markets continued to grind higher late last year even in the face of frequent pull backs driven by geopolitical uncertainty. Market will continue to “climb the wall of worry” in 2015 creating opportunities along the way. The stronger dollar’s impact on earnings, the escalation in the Ukraine and the political jockeying in Greece are all potential roadblocks in the coming months.

Great year for Main Street. An improving economy, rising consumer confidence and lower energy prices will form a strong tailwind for the average U.S. consumer in 2015. Evercore ISI, a macro economic research firm, predicts the drop in gasoline prices to be a net benefit of $100 billion to the economy. Inflation will remain in check and wages should see some improvement this year. The job market continues to improve with over 1 million jobs created in the last three months.

Globally, easy monetary policy will remain. The Federal Reserve, led by Fed Chair Yellen, will likely raise interest rates around the middle of the year. However, outside the U.S., global monetary policy will remain firmly accommodative. Japan will continue down the path of quantitative easing while the European Central Bank (ECB) will embark on its own plan of purchasing bonds later this year. In an effort to smooth the transition to a consumer driven economy, China has announced it will use targeted stimulus programs, which could total over a trillion dollars, in the coming years to buffer the economy.

Where is the correction? The S&P 500 Index has gone over three years since experiencing a correction of 10% or more, well past the historical average. Trying to predict the next correction is an exercise in futility and not something on which we spend a copious amount of time. A famous investor named Peter Lynch once said "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

Practice Group Spotlight on Family Business Owners
By Andrew R. Connors, CFP®, CEPA
Partner & Business Owner Practice Group Leader

Nearly two-thirds of owners want to transition their business in the next 10 years – but only about a third actually have a plan in place to do so. Learn about other obstacles family businesses face and how to overcome them by checking out our thought paper.

It would be our pleasure to present our family business owner survey findings to your group. Contact Andrew directly about speaking engagements at andrew.connors@fairportasset.com or (216) 431-2754.

Fairport News

Fairport employees frequently present at and attend conferences, educational seminars and informational webinars on new strategies and industry trends relating to the wealth management needs of our clients. From investment management to client service to technology, read more about the conferences we've recently attended.

Emily Drake was a featured panelist at the United Way's Women's Leadership Council's *Women on the Rise: Preparing Yourself for Your Career and Your Future* event earlier this month.

Heather Ettinger was a speaker at the Financial Research Associates *Women & Wealth* conference in New York City in January.

Heather Ettinger met with her study group, the Family Wealth Advisors Council (FWAC), in New Orleans earlier this month. She and fellow FWAC member Eileen O'Connor are co-authoring another white paper on the results of their most recent national survey of over 1000 breadwinner women. Stay tuned for the exciting findings!

Emily Shacklett and **Heather Ettinger** partnered with Ann-Marie Ahern of McCarthy, Lebit, Crystal & Liffman, Co. to present *Lean In on Executive Compensation & Benefits*. The program, created specifically for executive women, was designed to teach participants ways to maximize financial return on their human capital. Due to the event's success and additional demand, we will be reprising the presentation on April 28th. Please email kristen.lucas@fairportasset.com to be included on the invitation.

John Silvis kept current on investment strategies and trends by attending the Inside ETF conference in Florida.

Newsletter Disclosures

This newsletter represents an assessment of the economic and market environment at a specific moment in time and is not intended to be a forecast of future events or any guarantee of future results. It is for informational purposes only and should not be relied upon as research or investment/financial planning/tax advice. It should not be considered as a solicitation or recommendation by Fairport to buy, sell or continue to hold securities or other investments. Past performance is not a guarantee of future results, and is not indicative of any specific investment. It should not be assumed that the investment process and strategy discussed herein has been or will prove to be profitable. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.