WILSON CAPITAL
INVESTMENT ADVISORY

As an investment advisor, we feel investors should have an information outlet for the financial markets that is thorough, but does not require a prerequisite degree in economics. Thus we have included a glossary of terms at the end of this commentary. Each term with an asterisk has a corresponding definition in the glossary. We hope this makes our commentary informative and educational for all levels of investors.

Quarter in Review

The beginning of a new year kicks off with a rough start for many people and in 2014 the stock market followed suit. While champagne is typically the culprit for revelers, an exuberant year of returns in 2013 laid the groundwork for stocks to reverse course in January.

After turning in the best year of returns since 1997, the S&P 500 returned -3.5% in January, the worst monthly performance since May of 2012. While significant, the downturn was short-lived, as stocks reversed course during February and March to turn in a positive return (+1.8%) for the S&P 500 for the quarter. The Federal Reserve* (Fed) has continued it's "tapering"* program, furthering its efforts to wean the U.S. off record low interest rates. Despite this program and increased hints to raising interest rates in 2014-2015, the yield on U.S. treasury bonds defied logic by declining during the quarter. This move was justified by political unrest in Ukraine and weakening growth prospects in emerging markets. As a result, "safe haven" investments such as bonds† (+1.8%) and gold † (+7.2%), both showed gains for the quarter.

Turning to economic growth in the U.S., corporate earnings for the 4th quarter of 2013 showed continued strength, with approximately 70% of companies in the S&P 500 exceeding analyst estimates. Revenue growth still lags earnings growth indicating lower "earnings-quality" based on cost-cutting and share buy-backs* rather than increased sales growth.

Outlook

With the stock market posting record high gains nearly every week, the talk of whether the U.S. stock market is approaching overvalued levels or even a bubble has also gained momentum.

Despite the pullback in the stock market in January, the rebound through March brought U.S. markets back to reaching new all-time highs. This performance had led many market observers to question whether the stock market is approaching bubble territory. While we are not astrologers, we believe that the stock market has more room to run based primarily on these two reasons:

1. **Stocks aren't overvalued relative to history**

   The price-to-earnings ratio* is among the most popular metrics used to determine market value. It has been well noted that over the past 5 years the stock market, as judged by the S&P 500, has achieved annualized returns of 21%, far exceeding the long-term average of approximately 10%. What is less noted is that during that same time period, the underlying earnings of the index has kept pace with the performance of the stocks, with operating earnings for the S&P 500 rising by 20% for that same period. The tandem rising of both prices and earnings has left the market price-to-earnings ratio at 17.5, which is still below the average of the last 50 years of 18.9 (source: Standard & Poors). To be sure, there is no mechanism that requires the market to become overvalued before it drops, but current valuations do not beg for a correction.

2. **Stocks are still the best house on the block**

   Compared to other investment options, the stock market still looks attractive. In the simplest terms, tradeable investments can be broken down into three categories: cash (savings or money market accounts), bonds and stocks. Interest rates that affect both savings accounts and bonds are still near all-time lows. While both cash and bonds have historically been much less volatile investments compared to stocks, at current interest rates, investors are sacrificing a significant amount of yield for safety.

Trying to gauge the direction of the stock market makes us think about the small print on most financial products, which states, “past performance is no guarantee of future results”. Such disclosure is important for all investors to heed, however, it should also be recognized that past performance does not *require* a reversal of such performance in the future.

Glossary

Federal Reserve - The United States’ central bank, which is responsible for regulating the banking industry and controlling the money supply through monetary policy.

Tapering – Reduction of the bond purchases by the Federal Reserve with the intention of raising interest rates.

Share Buy-backs – Companies use cash from their earnings to purchase shares of the company. This reduces the number of shares held by the public and spreads the earnings of the company across fewer shares.

Price-to-earnings ratio – a standardized measure of how much investors are paying for each dollar of earnings. An 18x p/e ratio means investors are paying 18 times each dollar of earnings.

† Indices used to represent asset classes:
Bonds – Barclays U.S. Aggregate Bond
Gold – London Fix Gold PM

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