

BULL & BEAR BULLETIN



Volume 5, Issue 8

December 2014

Market Trends: 2014

2014 has been another positive year for stock and bond investors, making it the fifth time in six years that both markets have been up in the same year. Investors may have become accustomed to the positive returns regardless of their choice between stocks and bonds, but this year's returns were not what most expected heading into the year.

One of the most popular themes heading into 2014 was an expectation for higher interest rates. Bond investors were convinced that former Federal Reserve Chairman Ben Bernanke's May 2013 reference to a tapering of the Fed's \$80 billion monthly asset purchases marked the bottom in U.S. interest rates. To reduce their risk to higher interest rates, investors pulled over \$250 million, or 7%, from bond funds in the last eight months of 2013, according to Investment Company Institute's data.

While investors may have been correct in calling the bottom in interest rates, expectations were partially misguided as interest rates across most maturity timeframes are now lower than the end of 2013 (Chart 1). Investors started to buy back bonds in the first quarter after a 2% contraction in the U.S. economy erased expectations that the Fed would quickly taper its stimulus measures. More recently, interest rates have been subjected to additional bond buying due to global economic fears. Investors have collectively added \$200 million back into bond funds this year, nearly replacing the significant outflow in the second half of 2013.

While the U.S. stock market fell over 3% in the first month of the year and was relatively unchanged through the first four months of the year, stock prices eventually started a three month period of continual gains on the realization that the first quarter economic weakness was a one-off event. As the summer concluded and the Federal Reserve ended its monthly stimulus measures, we experienced a near 10% correction and recovery that many investors had long anticipated. The S&P 500 Index has since continued to rally higher, experiencing only ten down days in the past 37 trading sessions.

While market volatility has been relatively low in 2014 versus the past few years, the broad market's strength has masked many surprising moves within the market. One surprise has been the divergence in returns across small and large sized companies. Generally, in positive market years, small company stocks tend to outperform large company stocks. This year, U.S. large cap stocks, in particular the largest of the large, have been the best performing stocks, while small cap stocks have underperformed their larger brethren by nearly 9%.

Another significant surprise was the relative performance of two particular sectors (Chart 2). The utilities sector was the second best performing sector this year, with a return that is currently above 25%. Utilities are generally shunned by investors as an income based investment that lacks potential for above average returns. Even after its 25% gain this year, the utilities sector still makes up less than 5% of the S&P 500 Index. Given the perpetual underweighting by investors in utilities and minimal contributions to the broad market, few likely benefitted from this rare outperformance.

Conversely, the energy sector quickly became the worst performing sector this year. Despite leading the market in total return through the mid part of July, the sector has experienced one of the largest sector declines in recent memory. Weak global economic conditions and a stronger U.S. dollar have coupled with higher U.S. oil production and unwillingness by OPEC (Organization of the Petroleum Exporting Countries) to cut production levels creating a headwind to oil prices and energy stocks. While we outlined the likelihood of weak oil prices back in October, the recent selloff has more than outpaced the speed and magnitude we expected. Oil prices are now down more than 40% from their July high and more than 20% in the past five weeks. While cheaper oil will benefit the global economy, at current levels we would anticipate a

Cultivating Relationships

30 Years

1984 - 2014



VALICENTI ADVISORY SERVICES, INC.

400 East Water Street
Elmira, NY 14901-3411
607-734-2665
Fax: 607-734-6845

350 West Church Street
Elmira, NY 14901-2637
607-733-9022
Fax: 607-734-6157

24 West Market Street
Corning, NY 14830-2617
607-936-1203
Fax: 607-936-0213

www.valicenti.com

Asset management
as individual as you

2014
TOP
100
FEE-ONLY
WEALTH
MANAGERS



An on-line publication by
The Investment Committee

pullback in global production and an increase in global demand to help create some stability around the \$60 level.

In the end, 2014 may prove to be the year that defied expectations and caught many investors off guard. With January just around the corner, we still anticipate modest economic strength in the U.S. and additional monetary stimulus by foreign central banks. As these two dynamics evolve, the corresponding impact on the U.S. dollar will likely dictate the performance and direction of all other investments. Any further strengthening of the U.S. dollar is likely to act as a headwind to U.S. exports, interest rates, oil prices, precious metals and emerging market economies, while likely benefitting the economies and markets of our largest trading partners, the U.S. consumer and the bond market.

Chart 1

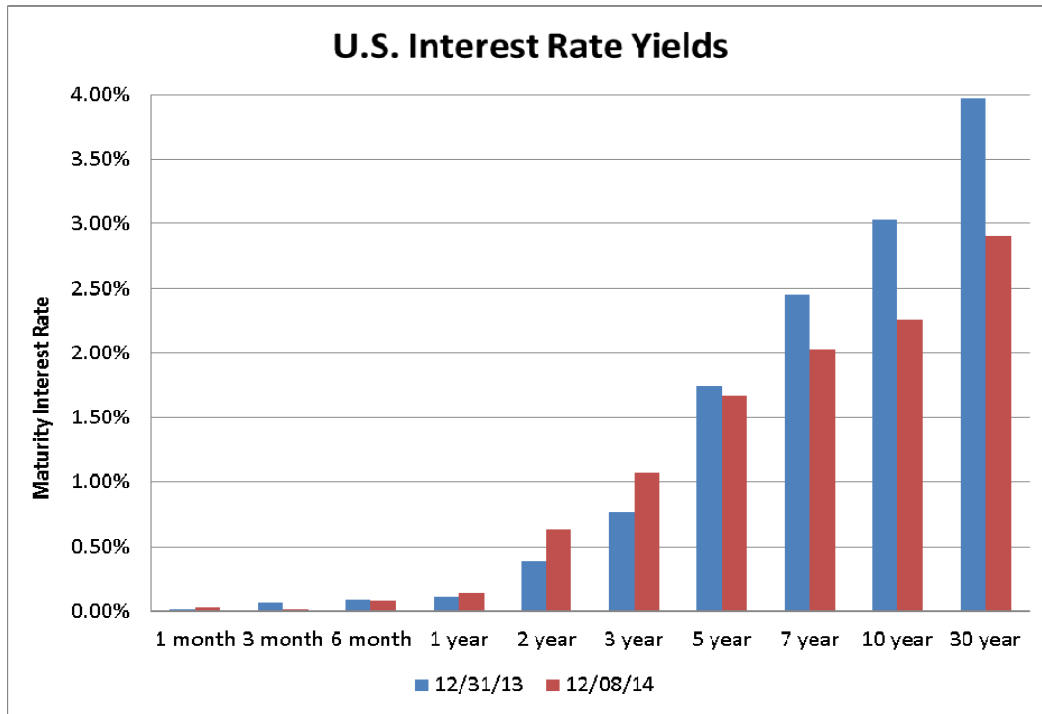
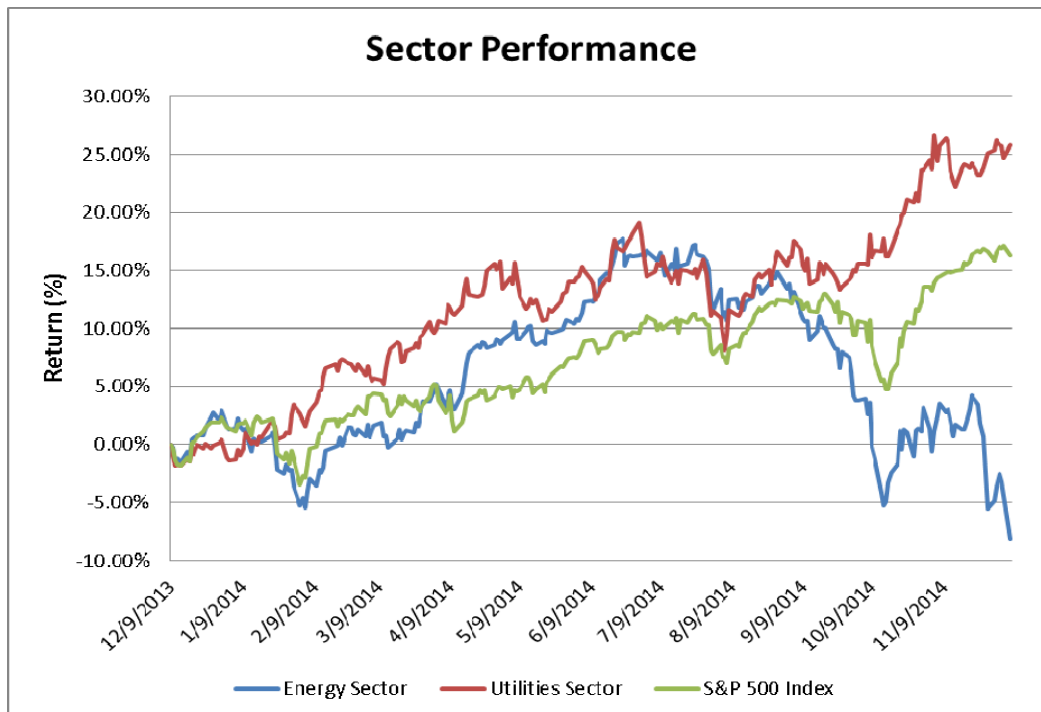


Chart 2



Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Valicenti Advisory Services, Inc.), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Valicenti Advisory Services, Inc. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. Valicenti Advisory Services, Inc. is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of the Valicenti Advisory Services, Inc.'s current written disclosure statement discussing our advisory services and fees is available for review upon request. Please Note: Fee-Based services. The Registrant provides investment advisory services on a fee basis. The Registrant does not receive any transaction/commission-based compensation for its investment advisory services. Rather, its only compensation is derived from fees paid to it by its clients as discussed on Part 2A of its written disclosure statement. However, because the Registrant is now affiliated with Valicenti Insurance, a NY insurance agency that is licensed to offer insurance products on a commission compensation basis, the Registrant cannot hold itself out as a "fee-only" advisory firm.