RIVERPLACE
· CAPITAL ·
1301 Riverplace Boulevard, Suite 2130
Jacksonville, Florida 32207
904-346-3460

the Lonely Bull

July 2015 · *a market **perspective** by Riverplace Capital* · Number 68

SECOND QUARTER SUMMARY

A Greek default right at the end of the quarter sent shock waves through markets worldwide.

What was a decent stock market return evaporated and the long awaited correction may now be happening. The Greek crisis tells us little about future business conditions. We believe the response is overblown, but brings back visceral memories of the 2008 crisis so emotions rule the day.

Until this latest crisis erupted the stock market was making progress. It was characterized by two steps forward, one backward. Frustrating to be sure and on a day to day basis market action sometime appeared to be bizarre. Why stocks would be bought with enthusiasm one day to be sold the next. Explanations just didn't seem credible. Perhaps it was all a function of computer algorithms and high frequency traders. Surely, there has been an unusual mix of signals from the economy. Whatever the reasons, responding to every zig and zag would have only chewed-up and destroyed capital.

Looked at over time, progress was made, but largely erased at the end of June. The returns were not dramatic, but mostly positive, nevertheless. Since the financial crisis, stock markets around the world have recovered and risen to new highs.

This recovery and subsequent rise has been one of the best bull markets ever. It is not over yet. Bull markets do not die of old age, but due to excesses that build up. So far progress has been tempered by fear and valuations still look to be reasonable. **Once the current crisis over Greece's financial position dissipates, we expect most stock markets to recover and go on to higher valuations.**

The one area of probable excess is in the fixed income arena. Interest rates have been held down by central bankers around the world. These rates are too low for present economic conditions and may be contributing to increasing inflation. Investors loaning money at these low rates will not have happy outcomes. They will either suffer losses on these investments, not receive a rate of return commensurate with the risks and inflation, or both.

In spite of the complex geopolitical backdrop, business conditions remained good. Although another severe winter in the mid-west and northeast slowed progress, growth resumed as soon as the weather improved.

Economic growth remains subdued, but steady; the best combination for sustainability. We believe that this growth can continue for some time yet.

International stock markets, along with ours, were impacted by concerns about how the Greek crisis in Europe will be resolved. In spite of this, international stock market returns have been quite good. Investors are looking through the current crisis, believing it to be manageable and seeing improving business prospects in many of Europe's most important economies.

So after a volatile period with subdued returns, what can we expect for the second half of 2015?

> "Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas."
> *– Paul Samuelson*

TALK WITH US

Just buy an index fund; that's the advice heard by many investors.

The implication is that most investors do not have the background or skills to beat index returns. Indeed, many professional investors do not consistently add incremental value over that from a relevant index.

However, the question gets more complicated when you ask, "which index?" Should an investor only have a domestic equity index or should international ones also be included; if so, in what proportion? Should that proportion change given the outlook for currencies? Relative currency value changes can have dramatic influence on returns from international holdings.

Even a simple domestic equity index may not be so simple. Should one only focus on large companies or also include smaller ones with excellent potential. There are also indices that focus on mid-size companies. Some have a focus on stocks selected according to value parameters and others that select according to growth potential.
To answer these questions, one must not only have a good grasp as to current business trends, but forecast future ones as well.

At Riverplace Capital, we build a model of indices that take in all of the above factors plus a few more. Then shifts are made to account for changes in the environment. (This is just one of the many strategies we can employ.)

So what seems like a simple proposition really isn't. **There is no one decision, then forget it model for investing** in this world of ever faster and constant change. It takes work and vigilance, ***Talk with Us***.

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FORECAST

ECONOMY

The U.S. economy's growth rate looks set to accelerate over the second half of this year. Consumer spending has recently begun to improve, capital goods spending is increasing, and government expenditures are no longer shrinking. **A weaker first half with a stronger second has been the pattern for the last few years.**

Riverplace Capital, along with many other investment professionals and economists, have predicted a step up in the U.S. growth rate from 2%-2.5% to one above 3%. So far that has not happened consistently. It may be that the softer rate of growth is actually better for the longevity of the recovery and expansion. The typical economic distortions that normally occur after an expansion that has lasted as long as this one simply have not happened. **The economy and markets remain reasonably well balanced with small corrections along the way.** ◆

EQUITIES

The U.S. stock market is fairly valued. It is no longer cheap. Gains from here on depend upon earnings growth. Those companies that continue to grow their earnings will become more valuable, those that don't will not.

One reason that the stock market seems to lurch from one quarter to the next is because earnings reports have become the only definitive guide as to whether companies are growing or not. The need to produce earnings gains is pushing more companies to consider mergers or acquisitions, along with business restructurings. That in itself has produced earnings gains for firms in facilitating that business. Identifying the pockets of growth is part of our investment strategy (see the *Investment Strategy* section). ◆

FIXED INCOME

Even though the Federal Reserve has yet to begin raising rates, the bond market has already responded. Short-term rates remain under the Fed's control, but longer-term rates are already increasing. (As interest rates rise, bond prices go down.) As a result many bond funds and longer-term bond indices are showing losses for the year. The higher rates rise, the greater these losses will become.

The process may be irregular, but it seems that interest rates are finally on the rise. They have a long way to go before they reach levels which are historically commensurate with an economy as robust as ours. ◆

INVESTMENT STRATEGY

EQUITIES

Our strategy is all about earnings growth. It is the driver of higher valuations. Earnings growth can come about from a variety of sources, we look at all possibilities. International recovery, sector rebounds, new products, good business execution are all possible drivers.

A recovery in Europe and emerging markets are two particular potential drivers of earnings growth for particular companies that we are analyzing with interest. New products and services is another that is important to many bio-tech and pharmaceutical companies that have our attention.

We are now in the earnings reporting season for the second quarter. We will be analyzing every one of the companies in which we have investment. Inevitably we will have to make decisions based upon these results. ◆

FIXED INCOME

With interest rates now climbing, we are becoming more interested in the fixed income sector. Rates are still not at levels we deem to be investible, but we are getting closer. We will eventually be buying bonds for many of the accounts we manage. Bonds can be sources of consistent income and add stability to portfolios; so they are important. Like every investment, it is a matter of price and rates. We do not buy bonds to lose money.

Bond investments can lose value by not returning a rate in excess of inflation and taxes; as well as losing absolute value because of increasing rates. Then there is always credit risk, the risk that the borrower will not pay the principal back when it is due. ◆

WEALTH MANAGEMENT

The adjustments we have made to our asset allocation models are working well. So far the results exceed the expected benchmarks. We do not see any further changes for the time being. As always, we monitor the investment environment and will make changes as needed. ◆

MAJOR INDICES

as of 06/30/2015

Large Cap Stocks (S&P 500)	0.2%
Dow Jones Industrial Average	-1.1%
Mid Cap Stocks (S&P 400)	3.4%
NASDAQ Composite	5.3%
Small Cap Stocks (Russell 2000)	4.1%
MSCI EAFE	3.8%
Barclay Aggregated Credit Index	-0.8%
Inflation	2.0%

Equity indices are six-month returns excluding dividends.

NOTICES

Check out our updated web site. It offers a lot more information for you including a blog with weekly insights.
www.riverplacecapital.com
We look forward to your feedback.

Riverplace Capital offers our clients free financial planning. We believe strongly in the value of planning as it helps document goals and objectives, and provides a benchmark to measure progress. Planning helps us provide better, more targeted financial service to you. If you are a Riverplace Capital client interested in a financial plan, contact Wendy Hamilton, CFP® at (800) 391-1212.

CONTACT US

1301 Riverplace Boulevard
Suite 2130
Jacksonville, Florida
32207-9030

(904) 346-3460
(904) 346-3434 Fax

info@riverplacecapital.com

 Written by Peter E. Bower, *President*.