Argent
Wealth Management, LLC

Investment Outlook

WINTER 2015

First Quarter 2015 Investment Outlook | 2014 Review

It Was All About the Dollar

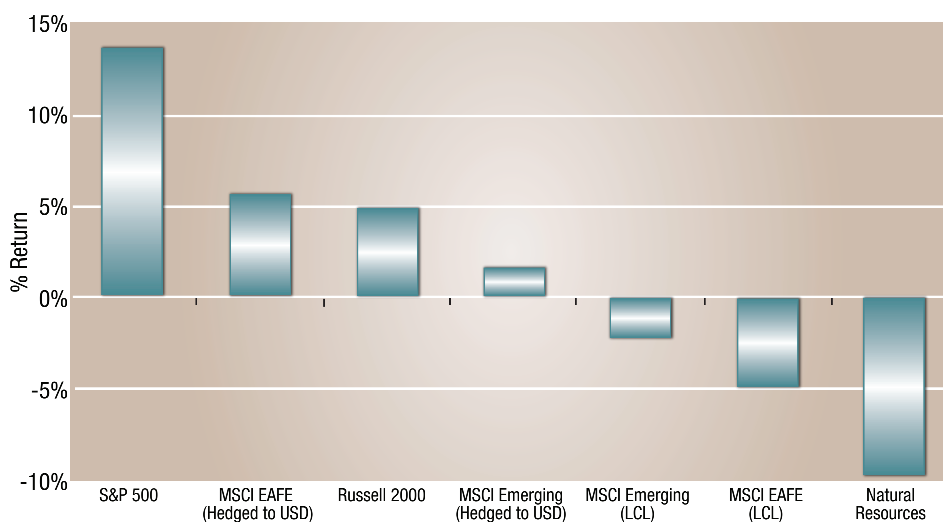
Rarely does a singular factor such as the strength of the U.S. dollar dominate all other market forces, as it did in 2014. Yes, there were many other more minor market factors. Even in these other market stories, the overwhelming dollar strength played a significant contributing role.

The most obvious and visible impact of dollar strength was the huge excess performance of both U.S. Equities and U.S. Fixed Income versus Non-U.S. equivalent markets. The U.S. Equity market averages surged to new record highs and posted yet another year of double digit gains. However, these gains were concentrated in the largest capitalization equities. While the "cap weighted" S&P 500 posted an extremely impressive 13.69% total return, the Russell 2000 (Small Capitalization Index) was way behind at just a 4.89% return.

By comparison, non-U.S. Equity returns were mostly negative with the EAFE index posting a negative 4.90% return and the Emerging Market Index slightly better at a negative 2.19%. What may not be obvious at all, is that many of these markets experienced earnings growth and market appreciation roughly in line with U.S. markets, when hedged to the U.S. dollar.

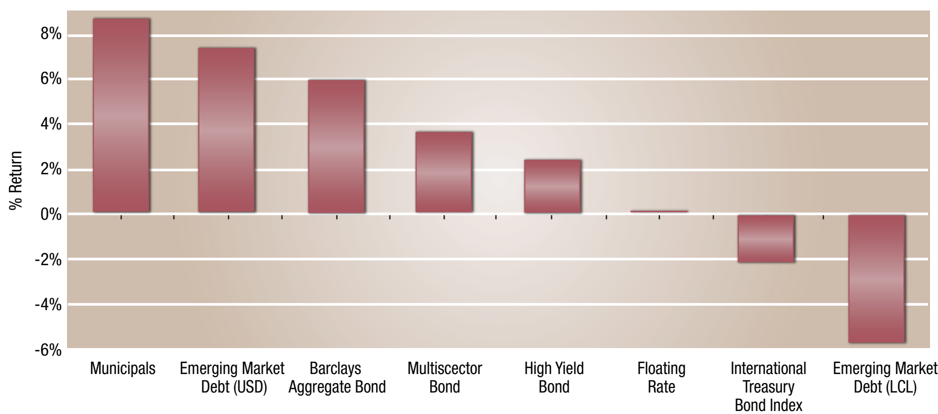
Fixed income markets showed a similar pattern with the U.S. Barclay's Aggregate Index gaining 5.97% while the Index of non-U.S. Fixed Income fell 2.12%. Commodity oriented investments were perhaps the most negatively affected of all categories posting an average negative 9.77% return. Clearly there were significant other contributing forces to declining commodity prices, such as a glut of supply in many areas coupled with faltering demand.

Equity Returns Year to Date



Data: J.P. Morgan Asset Management, Blackrock Ishares Chart: Argent Wealth Management, LLC © 2015
Data as of 12/31/2014

Fixed Income Returns Year to Date



Data: J.P. Morgan Asset Management, Ishares BlackRock, Morningstar
Chart: Argent Wealth Management, LLC © 2015
Municipals: Muni Bond 10-Year Index Data as of 12/31/14

To be clear, there were fundamental economic factors that supported the surge in the value of the dollar. The U.S. economy posted impressive performance in absolute and relative terms with strong job creation, solid growth, limited inflation and still highly accommodative monetary policy. Conversely, European and many Emerging Market economies were unable to make critical structural reforms and their economies languished in comparison.

Having said this, the dollar surged more than these fundamental market factors would suggest. We believe that all of this "extra" movement in the dollar was due to the other key factor in currency movement: asset flows. Specifically, non-U.S. investors flooded into dollar denominated assets of all kinds. That pushed already elevated Price-to-Earnings multiples on U.S. Equities even higher by historical standards. More surprisingly, yields on higher grade U.S. Bonds fell steadily and sharply for most of the year. The fall in Treasury yields was exactly the opposite of what the overwhelming percentage of market participants were predicting or positioned for.

Can this Dollar-Centric Environment Continue? Unlikely for Very Long

It appears to us that virtually every category of investor, strategist and professional asset manager is highly confident that dollar strength will continue. The most simplistic argument goes something like this: the U.S. economy grows faster than most other economies and the U.S. Fed starts raising rates while the ECB and many other non-U.S. central banks step up the pace of their accommodation.

The consensus would argue that it is obvious that growing interest rate differentials and superior U.S. growth would result in continued dollar appreciation.

We are highly skeptical of such a simplistic and overwhelming view, just as we were last year at this time about the assured rise in U.S. interest rates. It is just much more complicated than that.

A key starting point for any investment decision is to analyze what is already priced-in or "discounted" already by current market expectations. Yes, the ECB is set to begin their version of quantitative easing (QE). Everyone already knows this! Investors of all types have been flooding into dollar denominated assets and fleeing Euro assets. That positioning alone makes additional large moves in the dollar harder to come by.

Secondly, there are numerous complex off-sets to such a large movement in a key currency such as the dollar. U.S. based exporters have been hit with a 15 to 20 percent price increase (based upon dollar appreciation) in many of the markets that they export to. Likewise, non-U.S. exporters may be able to increase their earnings growth and margins based upon dramatically more competitive pricing power.

Finally, it would be a mistake to assume that superior U.S. economic performance lasts forever. Any policy miscalculation here or more effective policy actions elsewhere could challenge that perception.

Our expectation is that the current dollar strength does last somewhat longer, although the pace of appreciation moderates. In the short-run, we think that the consensus of opinion may well be correct. However, at some point that consensus of opinion will inevitably be proved wrong in a dramatic way, although we would not pretend to have the capacity to predict the timing or the catalyst.

Resist a Temptation to Become Dollar Centric/ Build a Global Portfolio Today

We remain absolutely committed to building a global portfolio and utilizing a global opportunity set of investments. Such a portfolio, over a complete market cycle, delivers superior return and, much more importantly, has less risk

than a more concentrated portfolio holding just U.S. Equities and U.S. Fixed Income.

We would also be the first to admit and accept that the recent market pattern has felt intensely frustrating. This has been the second year in a row whereby U.S. Equities have been at the top of the pack. That is highly unusual.

In such a singularly focused market, any actions to build more diversified portfolios and to manage risk prudently do reduce return. Fortunately, these environments don't last forever and the mathematics of diversification undeniably work over any longer periods of time.

Valuations Strongly Support International Equities

Price-to-Earnings ratios (as well as other valuation metrics) more strongly favor many non-U.S. Equity markets. Additionally, many non-U.S. central banks have their short-term interest rates anchored at or near zero for as long as we can currently forecast.

Cyclically-Adjusted Price/Earnings

	Current P/E	Historical Median P/E
United States	23.50	19.50
Emerging Markets	11.70	18.80
Europe	12.70	17.50

Source: Ned Davis Research Group. Table: Argent Wealth Management, LLC © 2015

While the economic performance in developed Europe is certainly nothing to write home about, we strongly believe that the perception is worse than reality. That perception is there is great risk of a full blown deflationary scenario and that both structural reform and monetary accommodation is ineffective. We believe that the reality is that while growth has slipped again to low levels, the probability of either another significant recession or a significant deflationary outcome remain low.

Away from Europe many more countries are increasing the pace of expansion than contracting. The probability of a global recession or deflationary spiral remains relatively low.

Our current positioning is to maintain appropriate exposures to these markets, and we would add exposure if we gained confidence that a rebound in non-U.S. Equity prices was underway.

High Yield Looks Attractive, Again

Wow, what a stunning shift. At mid-year, we had sold much of our exposure here and urged caution given excessive valuation. The High Yield market did correct, as we were expecting from the summer months into the late fall. Then the oil market took a nose dive and took High Yield along for the ride. We now find valuations compelling again and have added exposure.

U.S. High Yield Spreads and Defaults

	Average	Latest
High Yield Spreads	5.90%	5.70%
High Yield Default Rates	4.00%	1.80%

Data: J.P. Morgan Asset Management. Table: Argent Wealth Management, LLC © 2015

About 18% of the High Yield market is in the energy sector and we do expect a rise in defaults in this sector. However, the market already has discounted a near 50% default rate in these bonds. We believe this is a much more dire outlook than is reasonable even if oil stays at $50 for a long period. Fortunately, the prices of all other High Yield bonds have fallen as well and there has not been, nor do we expect, any deterioration in default expectations.

As Treasury yields have plummeted, the spread levels to these non-Energy High Yield bonds have exploded. Our managers are focusing on these sectors and have limited exposure to Energy. We find that attractive.

Commodities

Commodity holdings have certainly been a brutal place to be. We keep the size of these positions quite modest, recognizing the high volatility of the asset class. Despite the considerable discomfort of the asset class lately, commodities play a critical role in a well-constructed, properly diversified portfolio.

That critical role is that commodities tend to move up sharply and violently when there is even the slightest anticipation of inflation. Typically this happens long before actual inflation is detected in the data, so it is important to have some allocation to the sector even when it feels unnecessary. Commodity appreciation typically occurs when equities, fixed income or both sectors holdings are

getting hurt. That feature makes this asset class exceptionally helpful in diversification terms.

Commodities have a well-documented pattern of "over-shooting" on both the upside and the downside. When prices are weak, as they are currently, capital investment is reduced or curtailed entirely. Production from current capacity declines (decay curve) until prices start rising. Because new investment, such as the next oil well, takes a long time to come on line, prices can rise dramatically.

Brent Crude Oil Spot Price

Data: Ned Davis Research Group
Graph: Argent Wealth Management, LLC © 2015

Real Estate

Real estate remains a key and growing allocation for many client portfolios, and it has been performing exceptionally well. These investments, however, may not be appropriate for all investors. The fundamental economic conditions for real estate continue to improve with accelerating employment conditions, stronger growth and rock bottom interest rates. As such, real estate appreciation is broadening by sector, property and region.

Over A Full Market Cycle, a Properly Diversified, Global Portfolio Has Better Return

It is human nature to want to buy more of whatever area of the market is doing the best currently and to discard areas of the market that are doing poorly. In the current market, that would be to become heavily concentrated in U.S. Equities and Higher Grade U.S. Fixed Income. Both of these assets are now highly priced by historical standards and yet that is where most investors are increasing risk.

We understand that it is not easy or comfortable to build properly diversified portfolios. By definition, that requires acceptance that short-term movements in asset prices are impossible to predict with accuracy. Over the longer-term, diversification works as inevitably each asset class takes its turn at the top of the pack.

"It is critical to find asset categories that are both reasonably priced and have appropriate diversification characteristics."

That is not to say we just throw portfolios together. Just being "diversified" does not work either. It is critical to find asset categories that are both reasonably priced and have appropriate diversification characteristics. Reducing weights, but generally not eliminating, expensive asset classes improves the probability of long-term success.

404 Wyman St., Suite 375 | Waltham, MA 02451
T 781-290-4900 | F 781-290-4920
www.argentwm.com | contact@argentwm.com

All of us at Argent thank you for your continued support and confidence. If you know of anyone that might benefit from Argent's services, we would welcome the opportunity to discuss their particular situation with them.

Past performance is no guarantee of future results. Charts presented in this article are not indicative of the past or future performance of any Argent Wealth Management strategy. This article has been distributed for informational purposes only and is not a recommendation or offer of any particular security or investment strategy. Information contained herein has been obtained from sources believed to be reliable. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Argent Wealth Management.

Argent Wealth Management is registered with the Securities and Exchange Commission (SEC) as a Registered Investment Advisor © 2015 Argent Wealth Management, LLC. All rights reserved.