Market Review and Outlook—December 3, 2014

With an unsteady start, stocks had a fairly solid three months. Major stock markets peaked in mid-September, fell through mid-October, and have largely recovered since. The table below shows that over the past three months, large US stocks rose 2½%, while small US stocks fell ½% and foreign stocks fell 3½%. The big stories were for natural resources, mostly oil and gold. Natural resource funds fell over 5½% in each of the past three months, while precious metals funds fell over 16% in September and October, but rose 4½% in November.

The US economy continues to chug along, adding momentum as it goes. While the sharp decline in oil prices since August have hurt oil-sector companies, it has a significant beneficial impact on most US industries, and US consumers. We now have the November elections behind us, and while the Senate changed hands, we continue to have a split government, where neither Congress nor the President can get much done without working with the other. The lower oil prices also benefit many foreign countries and industries, although it harms several emerging markets, including Brazil and Russia.

Bonds had a quiet quarter, preparing to end a year with a fairly typical performance of long-term bonds returning 10%, intermediate term bonds up 5%, and short-term bonds up about 1½%. What is atypical is that these returns are coming in 2014, when a year ago analysts expected rates to rise, and 2014 bond returns to be negative. The last result we expected was 'normal bond results.' Surprise!

We continue to find stocks to be compelling. There is solid economic support for US companies, although stock prices appear fair, not underpriced. We are more impressed with foreign stocks. While the economic support is weaker overseas, investor confidence is lower beyond our borders, and this leads to higher potential profits, and lower likely risk than in the US. 2014 has brought a 'flight to quality stocks,' with large US stocks faring the best. It is therefore appropriate to rebalance to seal in some of those profits, and move some dollars to the areas that are less in favor today.

The 'flight to quality' was not restricted to stocks; investors added to their bonds in 2014, and surprisingly have even shown comfort with long-term bonds. We find quality bonds to be more worrisome than a year ago, partly due to 2014's solid results. We therefore find that today's opportunity bonds, which are typically considered higher-risk, to be more attractive than normal. Part of this attraction is that they are far better situated to benefit from an improving US economy than are quality bonds, whose prices are likely to fall as interest rates rise over the coming few years. An aggressive defense is the best play in bonds while rates gradually rise to more normal levels.

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
Fidelity Cash Reserves	+0.00%	+0.01%	+0.01%	+0.02%	+1.63%
Intermediate Term Bond	+0.50%	+4.86%	+3.84%	+4.64%	+4.52%
Intermediate Muni Bond	+0.44%	+6.19%	+3.84%	+4.25%	+3.85%
Large-Cap Stock	+2.49%	+14.02%	+19.38%	+14.49%	+7.41%
Mid-Cap Stock	+0.30%	+10.60%	+18.80%	+15.92%	+8.22%
Small-Cap Stock	-0.51%	+4.03%	+17.37%	+15.86%	+7.70%
Foreign Large-Cap Stock	-3.57%	+0.03%	+10.77%	+6.16%	+5.28%
Real Estate	+5.16%	+26.56%	+16.25%	+17.20%	+7.93%
Natural Resources	-10.11%	-0.61%	+6.51%	+7.61%	+7.38%
Technology	+3.07%	+18.81%	+18.94%	+15.24%	+8.97%
Moderate Allocation (60% stocks)	+0.44%	+8.50%	+12.09%	+9.90%	+6.26%

The data in this table comes from Morningstar and is as of November 30, 2014.
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