Polaris Wealth Advisers, LLC

Polaris Educational Series

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2013 Year in Review & What to Look for in 2014

Wow, what a year! The S&P 500 shrugged off a series of challenging events – the Fiscal Cliff to start 2013, sequestration in the spring, and a government shutdown in October - to post the strongest year in the market since 1997, and the 11th best market since 1926.

2013 Highlights

- The S&P 500 was up 29.6%, its best performance since 1997.
- The S&P 500 only experienced one correction greater than 5%. 2013 was the least volatile year since 1995.
- The U.S. was the 5th best performing country, out of a total of 45 worldwide indexes.
- Bonds posted their worst loss in 19 years. The Barclays Long-Term Bond Index posted a loss of -12.66% and the Barclays Aggregate Bond Index lost -2.02%.
- The S&P 500 TR outperformed Barclays LT Bond Index by 45.05%, the widest spread since 1958.
- The Russell 2000 outperformed the Russell 1000 (small vs. large) by 5.71%.
- Growth outperformed Value in every assets class (Large, Mid, and Small). On a long-term trend, growth has been outperforming value for 5.75 years, the second longest time period recorded.
- The best performing sectors of the S&P 500 were:
  - Consumer Discretionary +40.96%
  - Health Care +38.74%
  - Industrials +37.63%
  - Financials +33.21%
- The worst performing sectors of the S&P 500 were:
  - Utilities +08.75%
  - Telecommunications +06.49%
- Gold lost its investors -28.30%.
- Overall, the world's markets had a great year in 2013. Regional performance was as follows:
  - Japan +51.86%
  - U.S. +29.60%
  - Europe ex-U.K. +20.14%
  - United Kingdom +14.06%
  - Pacific Rim ex-Japan +11.94%
  - Emerging Markets +00.92%

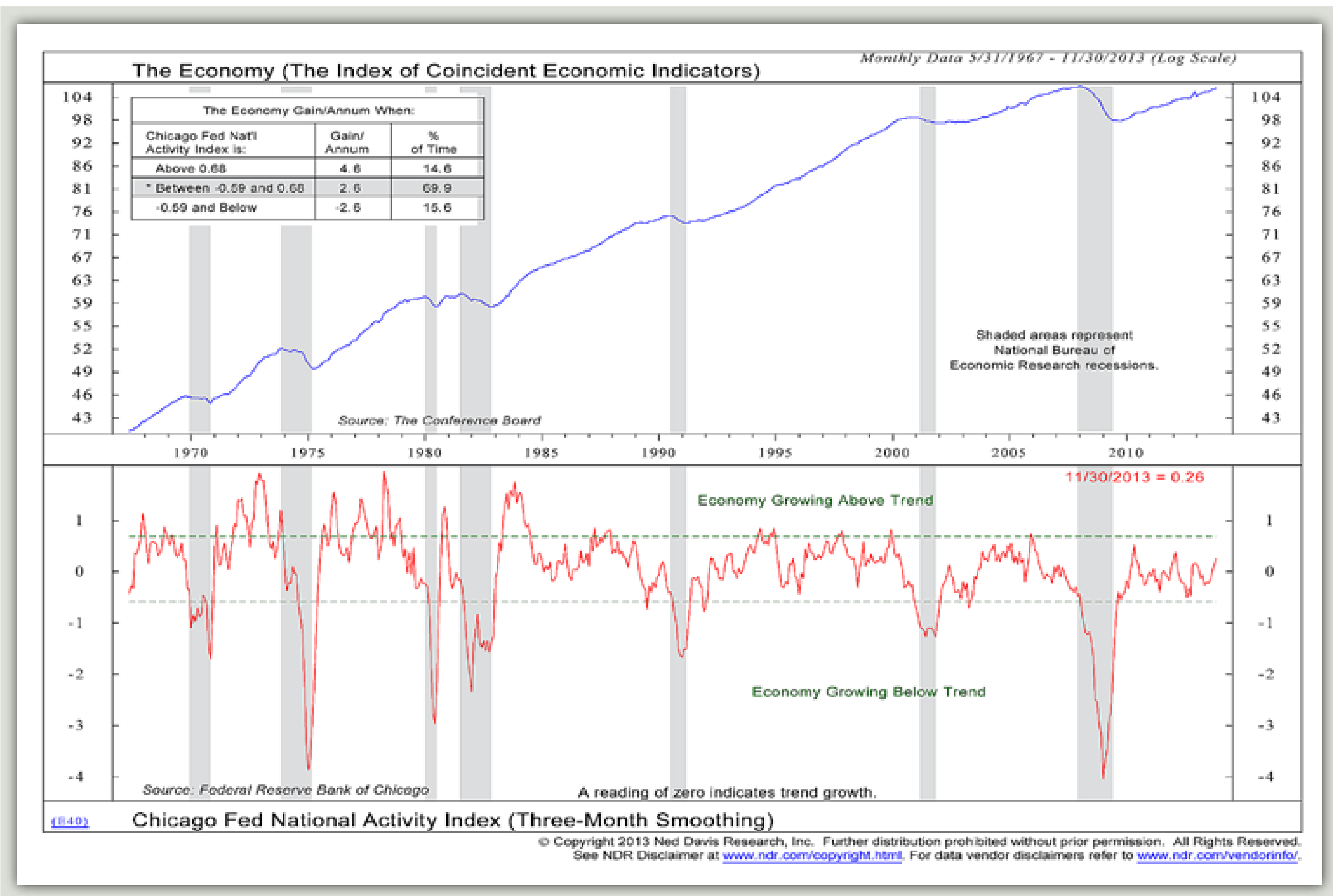
My 2014 Outlook

As you all know, I hate drawing a line in the sand and predicting what might be coming in our future. Those who do are simply trying to make a name for themselves. As I like to say, a broken clock is correct twice a day. So if you keep predicting, you'll eventually be correct. But while talking to many clients at the end of the year, I was continuously asked what I thought would happen next year. So rather than predicting anything, I'll tell you what I like about our current market environment and what keeps me up at night.

What do I like about our current market?

The current technical trend of the S&P 500 is strong. The index is significantly above its 50-day moving average (a good sign), and the 50-day moving average is above the 200-day moving average.

The economy continues to grow moderately, with few signs of any economic pull back. While the markets are not directly correlated to the economy, our economy is currently growing faster than historical norms.



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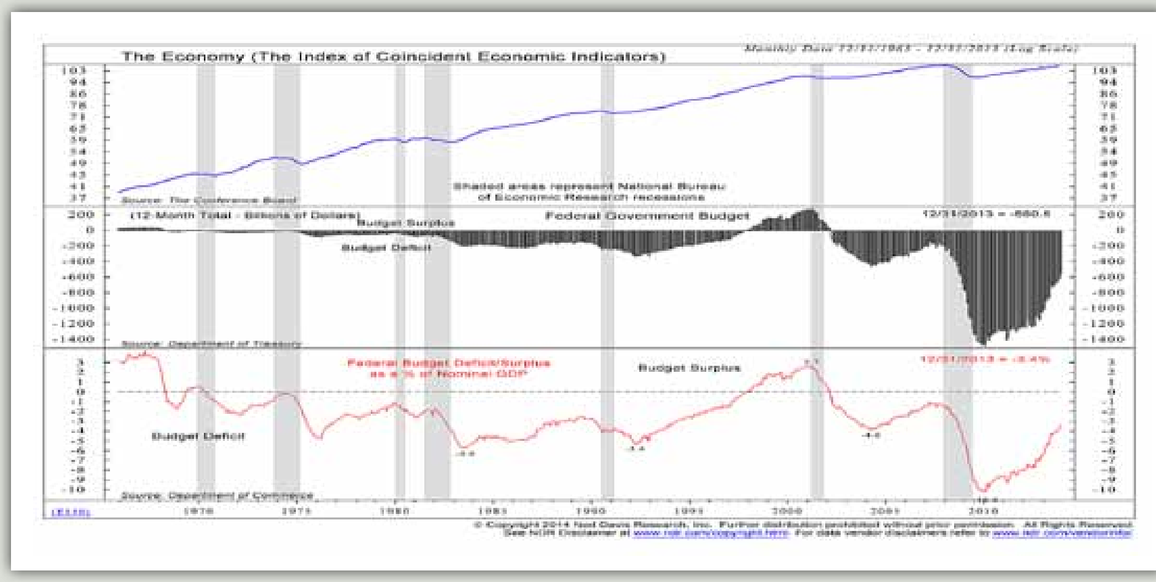
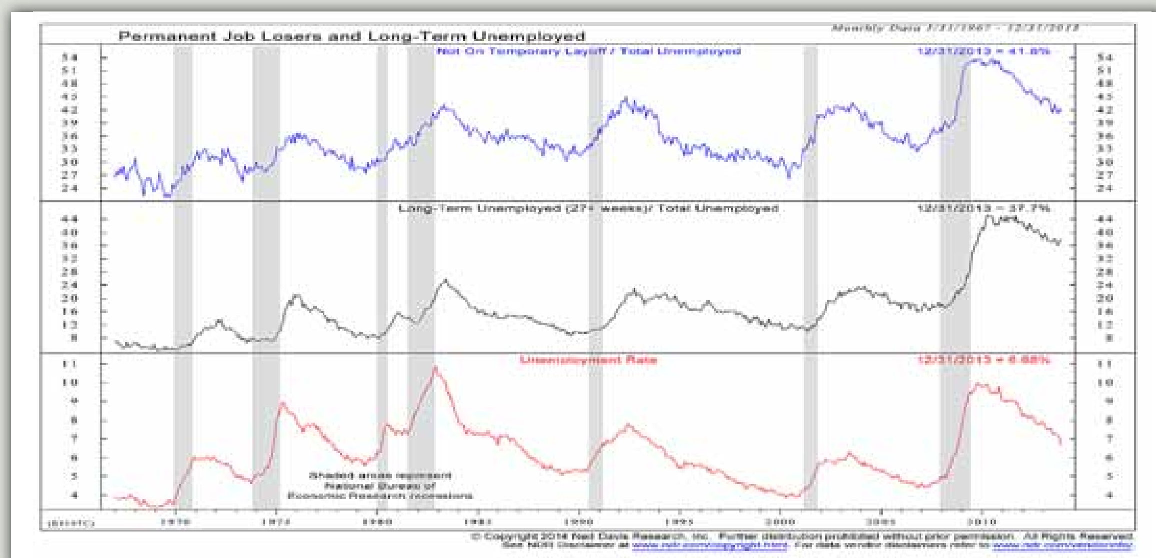
It seems that we are finally getting control of our deficit spending. While we sit on historic levels of debt, our annual deficit has closed to only 3.4% of our GDP. This is a substantial improvement to the 10% deficit-to-GDP levels we experienced during the Great Recession, and lower than where we have historically been under both Bush administrations and the Reagan administration.



We have also seen unemployment continuing to drop, although not necessarily in the best possible ways. Unemployment has dropped from 10% down to 6.68% in the most recent figures. While this is a substantial improvement, there are still a historically high percentage of those unemployed who have been unemployed for a substantial amount of time.



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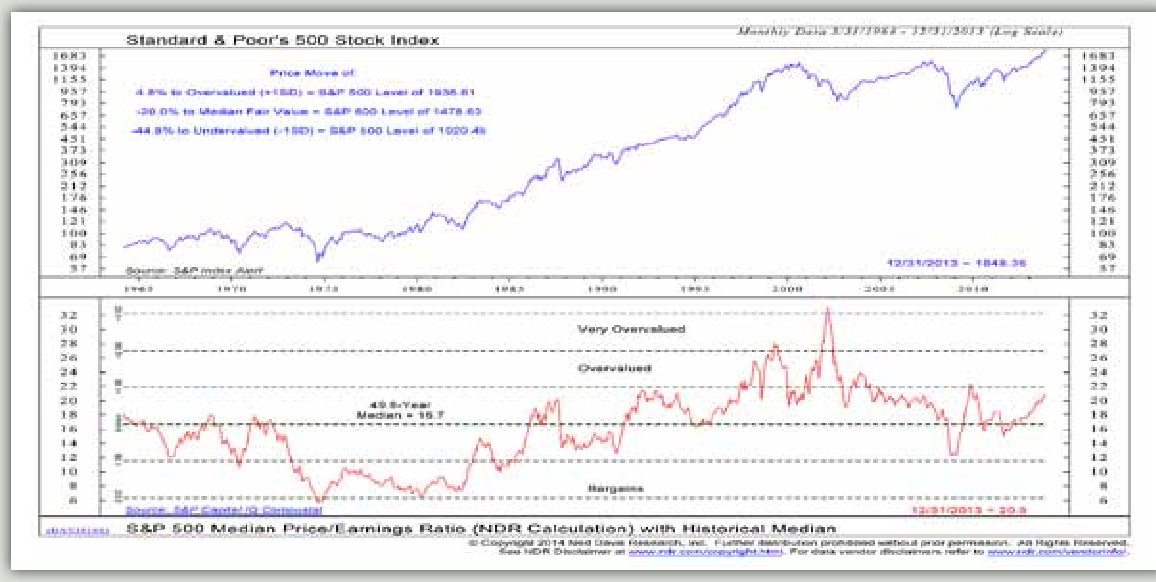
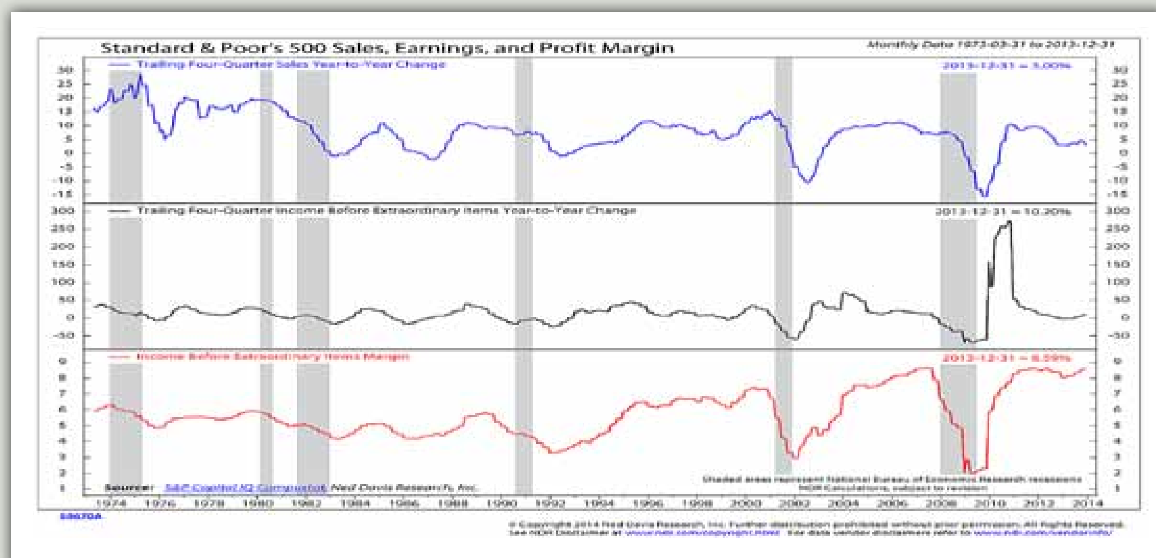
What is keeping me up at night?

Current S&P 500 P/E pricing multiples in the S&P 500 are almost a standard deviation above where they have been historically. This simply means that the markets are currently expensive. Continued strong earnings could bring these multiples down or (and what worries me) this could lead to a correction in the markets to bring them down to their historical norms.



Corporate margins are near record highs. They are just below the record highs we experienced in 2007. On the surface this sounds good. These rates came as a result of falling interest rates, tax carryovers, and historically high unemployment. It seems unlikely that they will be maintained or improved in the years to come.



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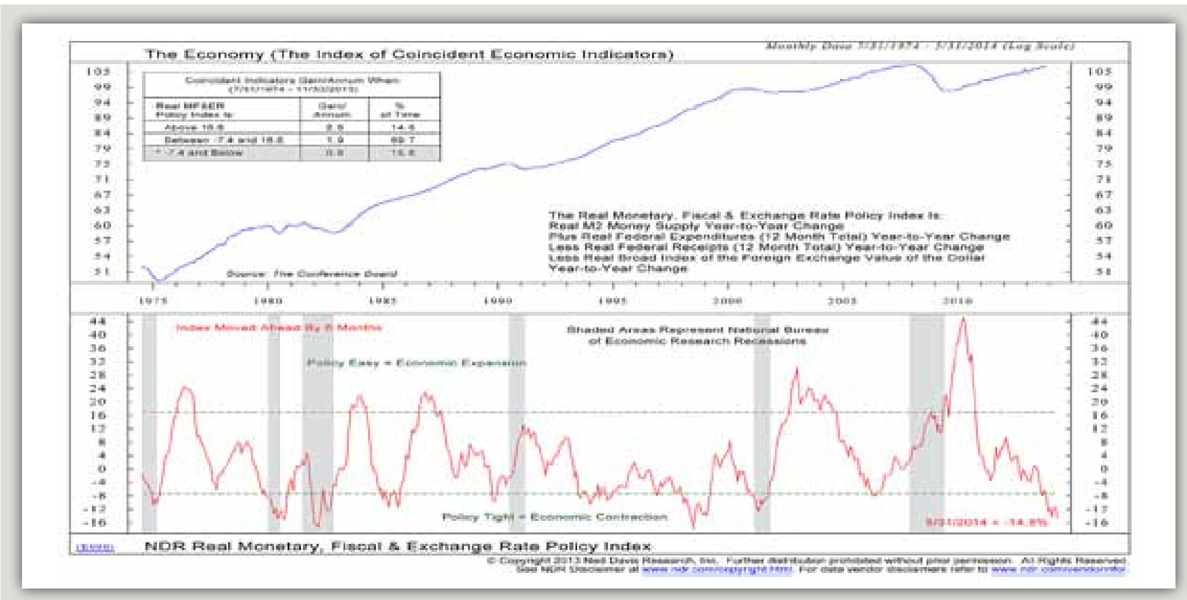
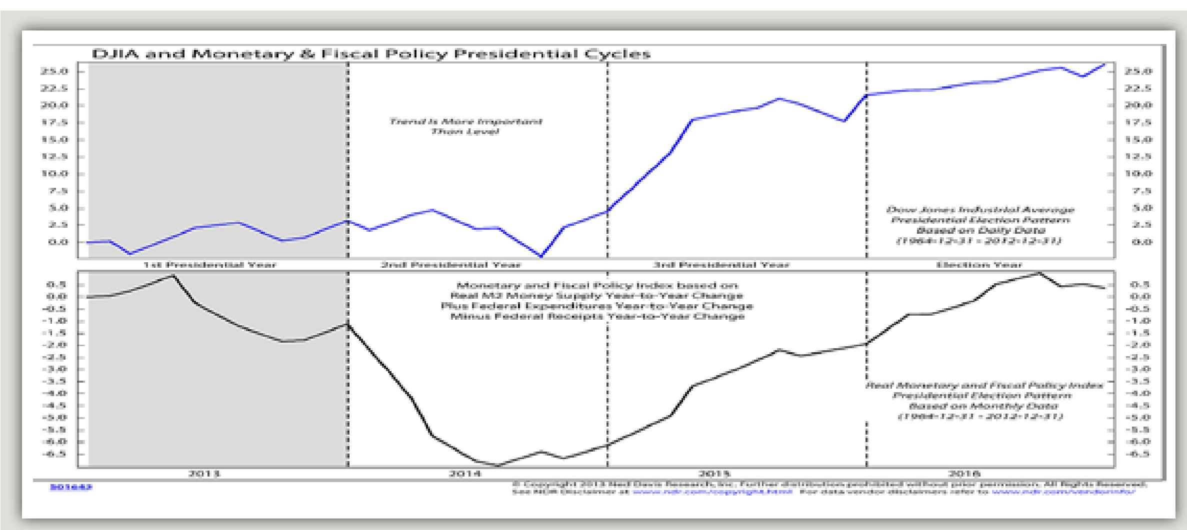
The Federal Government's monetary and fiscal policies are tightening. The government began tapering its purchasing of U.S. Treasuries. This coupled with the sequestration that was passed last year (and kept in place due to the negotiations that occurred when the government shut down) will put in place the most restrictive monetary and fiscal policy since the Great Recession. This means that the days of truly cheap money are over. This can affect personal consumption, corporate profits, and economic growth.



You all know that I am a big believer in studying history. While I don't believe that history repeats itself exactly, I do believe that you can learn from other's mistakes. You can often find trends in historical data. Historically, the second year of a President's term is the weakest and most volatile. This does not mean that history is set to repeat itself but it is something to keep an eye on.



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Conclusion

If someone were to force me to predict the year, I'd say that my best guess is that we will have a much more volatile year than last year. We will have a strong stock market during the first quarter due to the earnings momentum of 2013.

I think that sequestration and fiscal policy will slow the economy and corporate growth. This will most likely be felt for the first time in the second quarter. We will most likely see a correction of 10% or greater in the stock market during the year. If I were to take my best guess it will happen sometime between May and September. The stock market should finish the year on a strong note, single digits above where we began the year. The bond market will experience a second year of negative returns.

As always I welcome your questions and comments.

Sincerely,

Jeff