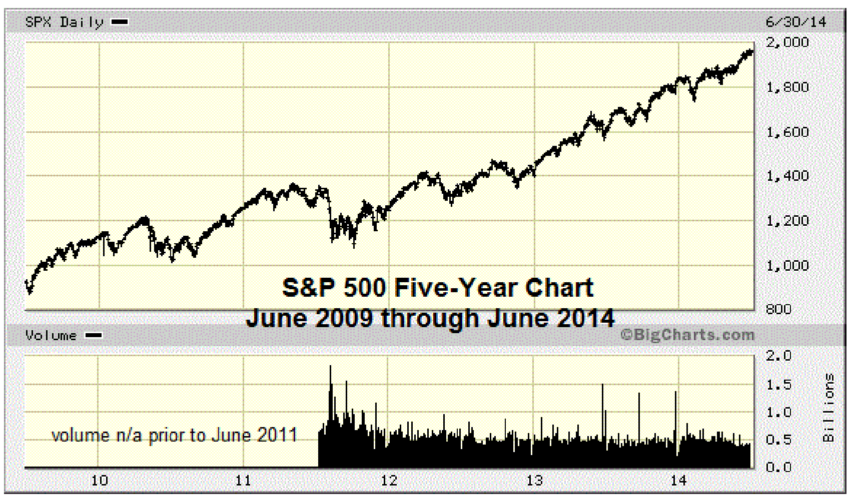
American Heritage Financial

July Update July 1, 2014

Bated Breath!

The old phrase ***bated breath**** aptly describes investors' approach to the 2014 stock market. After record gains in 2013, investors have spent the first six months of 2014 in great anticipation – and indecision. It's as if everyone is holding their breath anxiously waiting for something dramatic to follow last year's big gains. Specifically, investors are waiting for the ***"long overdue correction"*** – after all the market hasn't had a significant pull back (greater than 10%) since mid-2011. Many investors are still sitting on cash that they are dying to invest "when the market corrects." Others are sufficiently invested in the market and enjoyed great gains over recent years but are now anxious that a big correction could wipe out some of those gains.

Investor indecision is highlighted by the long, steady slide in **volume**. Typically, volume – or the total number of shares traded in the market – grows consistently and growth is especially pronounced as a bull market ages and more investors want to participate. In contrast, there has been a consistent decline in volume over the five years of this bull market. According to Standard & Poor's, average monthly volume for the first six months of 2014 is 47% below volume in the first half of 2009 and 9% below volume in the first six months of last year.



Another indicator flashing unusual signals is the **volatility index**, or the VIX. The average investor is not familiar with the VIX, but professionals watch it closely because it measures ***expectations*** of market volatility over the next 30 days. VIX values above 30 imply expectations of high volatility as a result of investor fear or uncertainty. VIX values below 20 are associated with less stressful, even complacent times in the market. In the depths of the financial crisis and bear market the VIX hit a high of 89.5. Over the long term, the VIX has averaged close to 20. However, during 2014, the VIX has traded over 20 on just one day (Feb 3rd) and has been consistently hitting record lows over the past two months. For June, the VIX averaged a reading of only 11.5.

A low reading on the VIX is normally taken as a sign of excessive investor complacency and excess complacency is associated with market tops. (Just as the opposite – excessive fear – is prevalent at market bottoms.) Low volume is also atypical of a market that is consistently hitting new all-time highs. Considering these two signals, along with the length of time since a real market correction, and it is understandable that investors await with "bated breath."

In spite of these and other more typical worries like the economy and politics, this boring and resilient market keeps marching ever higher. The S&P 500 has scored 22 record closing highs in the first half of 2014 and it has climbed by 6% for the first six months (although the Dow gained only 1.5%). If the market remains dead flat for the rest of the year, 2014 would close out a three-year total gain of nearly 60%, the best three year period since the bubble days of 1997 through 1999.

The consistent and record setting market gains have persisted in spite of the unusual trends in volatility and volume, cautious investors and the wobbly economy. The take-away for investors is that trends, even extended trends, can continue for unusually long periods of time. Rather than trying to anticipate a change in trend, it is much better to go with the flow and adjust – if one must adjust – after a trend has definitely turned.

A big news item this past month was the downward revision in first quarter 2014 GDP – marking a significant decline in the U.S. economy. Growth, as measured by GDP, had been 2.5% or higher over each of the last three quarters of 2013 but due to weather and other pressures growth in the first three months of 2014 was expected to be near zero. Thus, it was a real shock when the final GDP report on June 25 came in at negative 2.9%; the biggest decline since early 2009. Undoubtedly, such a dramatic decline was due to more than bad weather. A look under the hood revealed two large one time occurrences which are not expected to be repeated. One was a decline in healthcare spending relating to the change-over to Obamacare, and the other was due to a large swing in exports and imports.

The stock market shrugged off the drop in GDP because most indicators still signal economic improvement. We attached a series of tables to this month’s letter so those of you statistically inclined can see for yourself. You have to look closely, but the tables show that the economic recovery appears to be developing true, sustainable strength, led by small but steady improvements in employment, housing, manufacturing and consumer confidence. From a market standpoint, economic growth should be a continued positive driver; the caveat in future economic strength is that we could actually see too much growth, too fast. Should that occur the risk of higher interest rates, increased inflation and a change in Fed policy could be a real risk to continuing the bull market.

*** In checking usage of “bated breath,”** we found the term originated from shortening the word “abated” which means “to slow down” and originates from an Old French word. “Bated breath” literally means to slow down or hold one’s breath – such as is often done in anticipation. Also, “bated” is no longer commonly used causing people to think the expression is “with baited breath,” but that misspelling is considered by wordsmiths to lead to confusion and strange imagery.

Best regards,

Ted Ingraham

EGI Financial, Inc.
American Heritage Securities, Inc.

2014 First Half Score Card

LABOR

	January	February	March	April	May	June
Unemployment Rate	6.7%	6.6%	6.7%	6.7%	6.3%	6.3%
Nonfarm Payrolls	84,000	144,000	222,000	203,000	282,000	217,000
Private Payrolls	86,000	166,000	201,000	200,000	270,000	216,000
Avg. Hourly Earnings YoY	1.9%	2.0%	2.1%	2.1%	2.0%	2.1%
Initial Jobless Claims 4-week Moving Avg	334,000	337,000	321,000	320,000	310,000	314,000
Labor Force Participation Rate	63.6%	63.3%	63.5%	63.2%	63.2%	62.8%

Source: Bloomberg

MANUFACTURING

	January	February	March	April	May	June
ISM	56.5	51.3	53.2	53.7	54.9	55.4
Philly Fed	9.40	-6.3	9.00	16.6	15.4	17.8
Construction Spending YoY	5.2%	7.1%	9.2%	8.8%	9.5%	8.6%
Chicago PMI	60.8	59.6	59.8	55.9	63.0	65.5
Industrial Production YoY	3.25%	3.01%	3.44%	3.84%	3.76%	4.27%
Capacity Utilization	78.5	78.1%	78.8%	79.3%	78.9%	79.1%

Source: Bloomberg

INFLATION

	January	February	March	April	May	June
CPI	1.5%	1.6%	1.1%	1.5%	2.0%	2.1%
Core CPI	1.7%	1.6%	1.6%	1.7%	1.8%	2.0%

Source: Bloomberg

HOUSING

	December	January	February	March	April	May
S&P/Case- Shiller Home Price YoY	13.7%	13.3%	13.1%	12.8%	12.3%	10.8%
New Home Sales	442,000	457,000	432,000	410,000	425,000	504,000
Existing Home Sales	4.87M	4.62M	4.60M	4.59M	4.66M	4.89M

Housing Starts	1034K	897K	928K	950K	1071K	1001K

Source: Bloomberg

CAPITAL MARKETS

	January 31	February 28	March 31	April 30	May 30	June 27
US 10-Year Yield	2.64%	2.65%	2.72%	2.65%	2.48%	2.52%
US Dollar Index	81.311	79.691	80.10	79.47	80.37	80.10
S&P 500® Index	1782.59	1859.45	1872.34	1883.95	1923.57	1957.22

Source: Bloomberg

OTHER KEY ECONOMIC METRICS

	January	February	March	April	May	June
Consumer Confidence	79.4	78.3	83.8	81.7	82.2	85.2
NFIB Small Business Optimism	93.9	94.1	91.4	93.4	95.2	96.6
Auto Sales	15.25M	15.82M	15.21M	15.30M	16.33M	16.70M
ISM Services	53.0	54.0	51.6	53.1	55.2	56.3
Trade Balance	$-36.97B	$-36.55B	$-42.26B	$-37.39B	$-44.18B	$-47.2B
Retail Sales MoM	-0.1%	0.9%	0.9%	1.5%	0.5%	0.3%
Federal Budget Deficit as % of GDP	-3.8%	-3.6%	-3.3%	-3.3%	-3.3%	-2.9%
Conference Board LEI	0.1%	-0.1%	0.5%	1.0%	0.3%	0.5%

- See more at:
https://www.virtus.com/blogs/details?story=10695&section=265&year=2014#sthash.ReU2vInS.dpuf