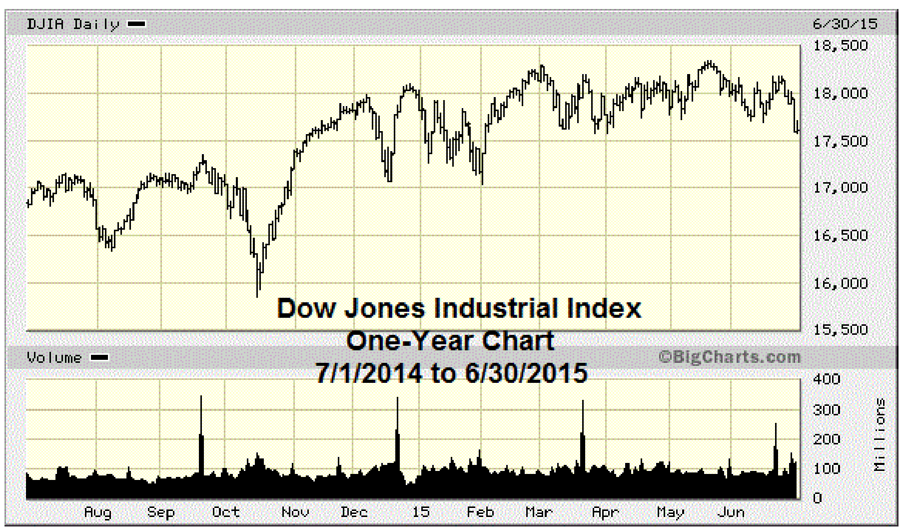
American Heritage Financial

July Update July 2, 2015

Early Fireworks!!!

One of the most unusual characteristics of the market for the past few months has been the benign *lack of volatility in stock prices*. Action since mid-March has been eerily calm as can be seen on our accompanying chart of the Dow. Even more phenomenal, as of Friday June 26th, the S&P 500 had not recorded a weekly change of as much as 1% up or down for nine straight weeks; a streak not matched since August 1993!

Then: **BOOM!** Monday June 29 opened with a barrage of dire headlines and stocks plunged by 350 Dow points (2%), volume spiked and interest rates dropped on a flight to safety. We will take a look at what caused the big decline and our thoughts on where the market might go from here but first, here is a brief wrap-up of the first half.



Even with the recent volatility, the market ended the first half at nearly the same level that it started. For the first six months of 2015, the S&P 500 gained just zero-point-two percent (0.2%) while the Dow declined by 1.1%. That ranks as the worst first half for U.S. stocks in five years. While unchanged returns and the worst period in five years sounds as ominous as another Ohio thunderstorm, the first half was actually a decent period for most investors. Stocks have bounced along near historic market highs and, if you own dividend stocks, dividends for the S&P 500 rose by 4.7% in the first six months of 2015 and are 11.8% higher than twelve months ago, according to S&P.

The bright spots in the first half were healthcare stocks, which gained 8.7% and smaller, more aggressive stocks; as indicated by the 5.3% rise in the NASDAQ Composite Index and the 4.1% gain in the Russell 2000 (although the S&P Information Technology sector was flat at 0.02%). The losers in U.S. markets were defensive sectors: the S&P Utility sector plunged by 12.3% and the S&P U.S. REIT index declined by 6.4%. Those sectors suffered from concerns that interest rates will rise. Rates have been very volatile over the past month but the current 2.4% yield on the 10 year Treasury is about the same as at yearend. However, that 2.4% yield is a big increase from the 10 year Treasury low of 1.7% registered in early February..

The overwhelming focus of the first half was interest rates with everyone wondering when they will rise, how much they will rise and how the rise might affect the economy and markets. Like all other market commentators, we have talked about interest rates constantly in our reports. There is very high expectation in the market that rates will rise but, beyond that simple statement, there is little agreement. The Fed is the ultimate arbiter of short-term rates and they continue to push any increase farther into the future—until they are comfortable that higher rates won't upset the economy. Most of the action this year has been in longer-term rates which have increased more than the short end. Through yearend, long rates may be held in check simply due to supply and demand issues due to heavy quantitative easing (i.e. bond buying) by the EU and Japan; while we may finally see an uptick in short rates based on an expected Fed rate increase in September.

Our sense on interest rates is that any increase will be well anticipated and not dramatic. The Fed won't increase unless it is comfortable the economy can handle it. The increase, when it comes, will cause short-term volatility but should not be a major negative for stocks—at least not in 2015.

The recent fireworks in the market were set-off by three issues which investors have long been concerned about but all went from simmering to exploding at one time: **Greece, China** and **Puerto Rico.** The first two of the issues are well outside of the U.S. markets but have the potential to be disruptive on a global scale, the third, Puerto Rico, is another rotten apple in the municipal bond barrel but unlikely to have a broad impact.

Puerto Rico's financial problems have long been recognized but its governor brought the topic to a head when he warned last weekend that the commonwealth cannot pay its $72 billion in public debt. Just how that crisis will work out is uncertain but PR muni bonds have taken a hit of nearly 25%. One issue is that many investors unknowingly hold PR in bond mutual funds.

If you haven't looked lately, you may be thinking that China was enjoying a wildly exuberant bull market. As of June 12, the Shanghai Index had zoomed ahead by 131% year-to-date for 2015. Following the Isaac Newton's rule of what goes up, must come down, the Chinese market has crashed by 34% in the less than three weeks. Like much of what comes out of China, the decline is as hard to explain as the ascent. What is certain is that growth in the Chinese economy continues to decelerate. Estimates for 2015 growth are now just under 6%. That sounds great to those of us hoping for 3% growth in the U.S. economy, but it is a far cry from the mid-teen growth China enjoyed for years. As the world's second largest economy, slow growth in China has global implications and it is one of the biggest factors keeping pressure on commodity prices.

Of course **Greece is the big headline of the moment.** If you have read this far, you are a person who has kept up with the volatile and ever-changing situation in Greece. It is impossible to know how the drama will end. While it is now at a crisis point, most likely it will continue to unfold for many more months, or even years. The European Union should survive with or without Greece and Greece itself is not large enough to push the world back into economic chaos. But…there are so many uncertainties and such volatile issues (and characters) involved, that the Greek crisis will most likely rock financial markets again like it did on June 29. Investors need to watch the Greek situation but it is doubtful it will evolve into something that requires drastic action on the part of typical U.S. investors.

So there continues to be much to think about and plenty of background noise for the financial markets. Yet, the U.S. economy continues to percolate and stocks continue to look attractive. Bonds carry some risk but even that appears manageable if approached with open eyes and a sound strategy. Overall, we remain optimistic that the last six months of 2015 will provide more positive returns than the first six.

Happy Fourth of July!

Ted Ingraham

EGI Financial, Inc.
American Heritage Securities, Inc.

Questions or comments?
Email us at: **ahs@egifinancial.com** or call 330-535-0881. Visit us at **www.EGIFinancial.com**