The Gruchala Wojtal Group Newsletter

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Market Outlook – January 2014

Coming off a strong year around the world in 2013 it is important to look ahead to see what we think 2014 will bring. In this market letter we will primarily focus on what is happening in the US and our outlook for it, given its impact on Canadian and Global markets I think investors need to get a grasp on what is happening in the US before making decisions on their overall portfolio.

From an overall asset mix perspective we continue to overweight the US versus Canada. In the US we continue to like value biased equities they continue to have lower earnings multiples compared to higher growth (companies as they should). We feel these low multiples will be justified by strong earnings growth in these companies.

Fund flows continue to be positive into equities, given that the majority of bond investors lost money for the first time in 10 years; we continue to see this as a positive catalyst for equities in 2014. Furthermore the 30 plus year bond bull market looks like it has come to an end which will put additional pressure on bond investors patience and inability to fathom increased price erosion in the bond market. We continue to position fixed income allocations in portfolios to high-grade corporate bonds with no government exposure, duration continues to be less than 5 years.

Equity allocations continue to be historically low which could add to the velocity of asset mix shifts adding an additional velocity to the mass bond exodus.

One of the biggest question marks in our view will be how the new head of the Federal Reserve Janet Yellen will deal with the Feds accommodative monetary policy. (Given that Ben Bernanke instituted these policies when he was the head of the Federal Reserve.) The Fed has publicly stated that they will be as accommodative for as long as possible in order to stimulate economic growth. In December tapering began, the Fed has trimmed their monthly bond buying purchases from $85b to $75b mainly due to an improving job outlook. The big question mark remains, will equities continue to perform as overall QE is reduced. So far economic momentum continues to accelerate.

The US housing recovery should continue to improve as the fiscal tightening eases in Washington. Overall US growth is forecasted to be in around the 2.5% range. Jobless claims continue to trend in the right direction. They are very close to pre financial crisis levels. This could be one reason the 2.5% growth number could be higher.

Valuations are slightly above average but not over stretched. We are optimistic but remain cautious. One metric we will be watching closely for is solid earnings growth not based on cost cutting, but on solid year over year growth (as I write this we have just begun earnings season). If this does happen you should see upward revisions by the second half of the year. Historically strong market performance has lead to solid earnings growth in the subsequent year.

Bottom line, we think volatility in North American equity markets will be increased due to some of the reasons aforementioned. The biggest uncertainty will be how aggressive the Federal Reserve will be with tapering and how the equity markets will react. As a result volatility looks to pick up in the second half of the year. Investor complacency as measured by the VIX (Volatility Index) is quietly approaching levels of inflection points. No market goes up in a straight line and an over complacent market is one good measure of judging overbought conditions. Preparing for an overall market pullback would be the prudent thing to do. It is up to the Gruchala Wojtal Group to navigate clients through these uncertainties, and along the way revisiting clearly defined asset mixes, and making tactical asset allocation decisions along the way.

If you require further clarification on terms, reasoning's or rationale please do not hesitate to ask Radek or myself.

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