IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

2013 was a great year for stocks. Even in a historical context, the stock market performed well. This has many investors asking what 2014 will be like after such a run-up in the stock market. The year has started off with stock valuations looking expensive and unless corporate earnings come in stronger than expected, stocks could pull back in early 2014.

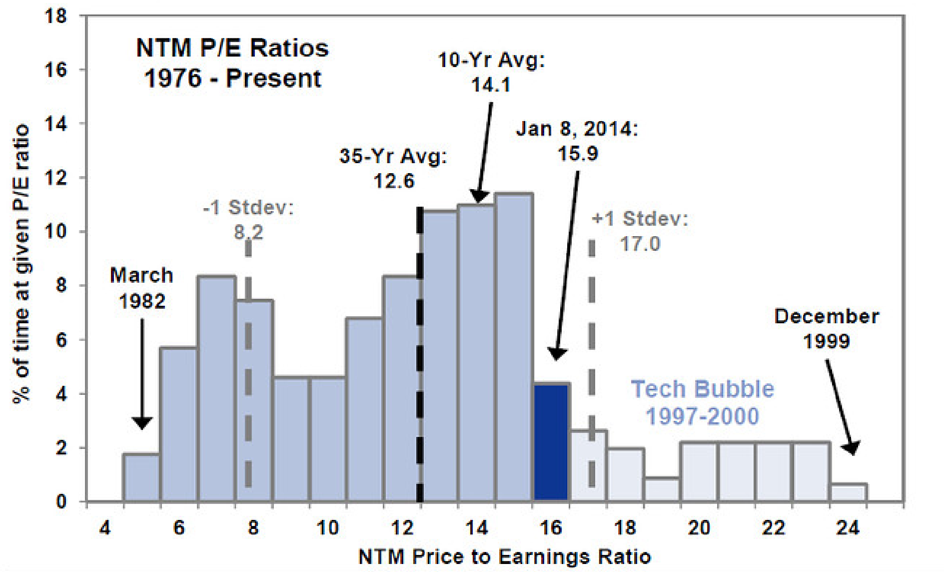
Stock Valuations

2013's stock market rally was not only fueled by better corporate earnings but mostly because of the Federal Reserve's stimulus programs and investors' optimism for future corporate earnings. In a historical context, stocks appear expensive now that investors have increased the price of stocks due to their future expectations. There are several valuation measures that measure the relative attractiveness of stock prices. A common measure is the price-to-earnings ratio, or P/E ratio. The P/E ratio measures the price of a stock against the relative share of that company's earnings. For example, a P/E ratio of 15 means that investors are willing to pay a price 15 times higher than the relative share of earnings of that stock. Historically, the S&P 500 trades at a P/E ratio of 12.6 times earnings. Last year, the S&P 500, a broad measure of stock performance, returned 32.36%. Historically it has typically returned 11.54% per year since 1976. In fact, investors are now willing to pay for P/E Ratios of 16.4 times earnings compared to 12.7 times earnings from a year earlier. There have only been two times in the last 35 years that the S&P 500's P/E ratio has been this high, during the tech bubble, 1997 through 2000, and for a period in 2003 and 2004 (see following graphic).

Idaho Trust Bank offers total wealth solutions including its LifeNeeds™ investing process. The LifeNeeds™ investment process utilizes proven strategies and techniques delivered by a highly trained staff of wealth management professionals.

LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.

Exhibit 2: S&P 500 P/E historically high, only lower than tech bubble levels
as of January 9, 2014



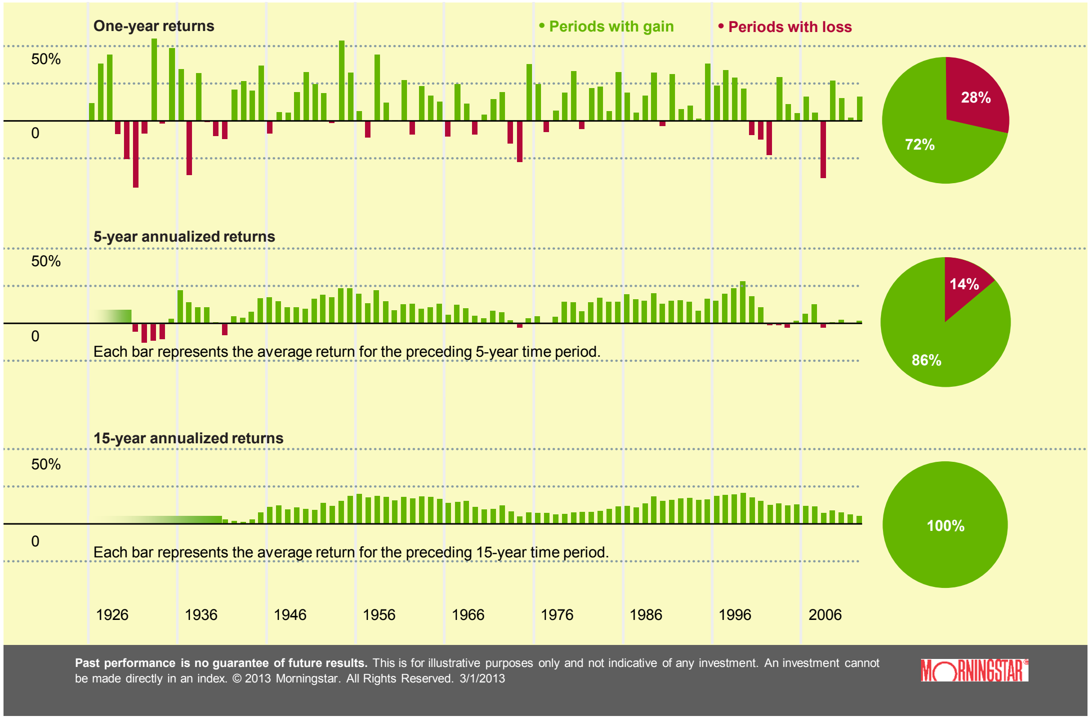
Source: Compustat, I/B/E/S, and Goldman Sachs Global Investment Research.

Earnings Season

Given the abnormally expensive price levels of stocks currently, few expect 2014 to be as good as 2013. However, if corporate earnings do in fact grow as investors expect, then stocks may have a good year. Conversely, if corporate earnings lag expectations this year, there may be little support for their currently high prices and prices may correct. Therefore, investors will be paying close attention to this year's corporate earnings season. Earnings season is when the majority of corporations release their quarterly earnings in January, April, July and October. These periods of time are busy for investors who review the new material for the latest information and revisit their future expectations. Early indications of earnings last January have shown overall tepid earnings growth and slowing revenue growth for the companies that have already reported so far. UnitedHealth, Goldman Sachs, Citigroup and Best Buy have all reported declining earnings. That being said, investors have not seen enough yet and there are still a lot of companies that will be reporting earnings over the next few months. February will be a key month to see if earnings are in fact going to be tepid or if growth has been better than observed.

However, in general, the stock market has consistently returned positive returns (see following graphic) over any extended period of time of investment. As the length of time invested in stocks increases the probability of an investment in stocks to lose money decreases. In fact, the S&P 500 has returned 19.16% annually for the last five years. Therefore, on average, even if 2014 turns out to produce below average returns, stock investors have already experienced above average returns cumulatively.

Risk of Stock Market Loss Over Time
1926–2012



Additional Tapering

Last December the Federal Reserve started to taper their quantitative easing program and the Federal Reserve announced last month that they are going to continue their tapering in February. The Federal Reserve will now only purchase $65 billion a month of purchase down from $85 billion a month last December. This is in line with Chairman Bernanke's suggestion that the Federal Reserve will taper the program by $10 billion at each of its meetings this year.

The latest decision to taper the Federal Reserve's program comes amidst mixed economic data. The Federal Reserve admitted as much, stating that economic growth has picked up in recent quarters but that labor-market indicators are mixed, likely referring to a poor December jobs figure. Despite the poor December jobs indicator, deteriorating economic and currency conditions in developing countries, the voting members of the Federal Reserve Open Market Committee voted unanimously to continue to taper their quantitative easing program showing continuing confidence in the economy.

Conclusion

Given the high valuations from 2013, it is plausible that 2014 may not be a great year for stocks. A lot will depend on how corporate earnings do this year. That being said, if 2014 ends up being relatively flat for stocks, stock investors still would have great average returns for 2013 and 2014 because 2013 was so good. Despite mixed labor indications the Federal Reserve is still confident enough in the Economy's growth to continue to taper its quantitative easing program.

S&P 500 Index

3 Month	1.99%
Year-to-Date	-3.46%
1 Year	21.50%
3 Year	13.89%
5 Year	19.16%

MSCI EAFE Net Index

3 Month	-1.84%
Year-to-Date	-4.03%
1 Year	11.93%
3 Year	5.86%
5 Year	13.83%

Barclays Aggregate Bond Index

3 Month	0.53%
Year-to-Date	1.48%
1 Year	0.12%
3 Year	3.73%
5 Year	4.93%

As of 1.31.2014

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