IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

In the second half of 2013 bond returns have made progress, but they may very well record negative returns for 2013. The market is still trying to anticipate when or if the Federal Reserve will taper its bond purchase program and how interest rates will react. Despite investor's fears and the Federal Reserve's expanding balance sheet, inflation has yet to materialize. Recent comments from Janet Yellen indicate that we may see more of the same from the Federal Reserve in 2014.

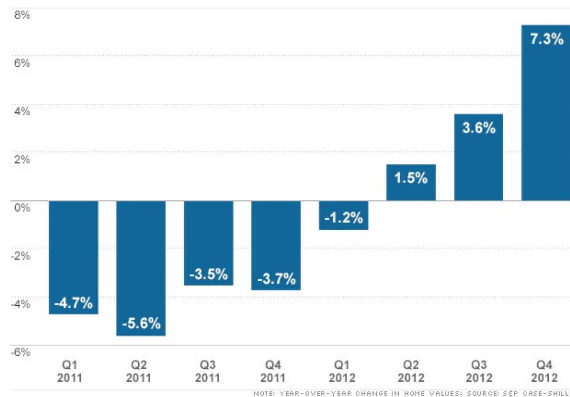
Bonds

Bonds have had a rough 2013. Aggregate total return figures are negative year-to-date, largely due to speculation that the Federal Reserve was going to taper its current quantitative easing program that sent bond yields and interest rates soaring. However, the Federal Reserve did not taper. In September the Federal Reserve elected to leave their quantitative easing program unchanged, surprising markets. Since that time, interest rates have stabilized and bond returns have crept closer to positive territory. It is widely expected that at some point either this year or next, the Federal Reserve will see enough economic data to support a tapering of their quantitative easing program which may cause rates to rise again. That being said, there is reason to believe that future rising rates may not be as dramatic as they were earlier in 2013. A sluggish economy and persistent low levels of inflation could dampen future rising interest rates. Another argument against quickly rising interest rates is that the economy is simply not strong enough to support a sharp rise in interest rates this year or early in 2014.

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.

Currently, the market is anticipating the Federal Reserve to taper its quantitative easing program either in December of this year or March of next. However, unless economic indicators improve, it is plausible for the Federal Reserve to continue its purchase program at its current rate of $85 billion a month. Tapering the current quantitative easing program could have a potential impact on the recovering housing market which is a point of concern for the Federal Reserve. If the Federal Reserve does taper, it could cause mortgage interest rates to increase further making financing potential home purchases more expensive. The housing market has been making gains year-over-year; however, already higher mortgage interest rates and higher housing prices have slowed the housing market's pace.



Housing Recovery Gains
Source: CNN Money

Inflation

Investors have worried that the Federal Reserve's massive quantitative easing program will stoke inflation. Persistent high inflation is dangerous because it lowers the value of a country's currency. Currently, despite all of the Federal Reserve's recent monetary expansion, inflation pressures have persistently remained low. The latest consumer price indicators (CPI) year-over-year figures, a measure of growing inflation, are the smallest gains witnessed in the past four years. Even Richmond Federal Reserve President, Jeffrey Lacker, one of the Federal Reserve's biggest inflation fighters admitted in a speech given November 22nd that he is surprised that given the amount of new money the Federal Reserve has pumped into the economy that inflation and inflation expectations remain low. He stated *"I have been surprised by the stability of inflation and inflation expectations. Given the expansion of our balance sheet, if you told me we were heading to a $4 trillion balance sheet, $4 trillion of outside money in the system, and that inflation expectations have remained stable, and apparently as a result of inflation itself has remained remarkably stable, I wouldn't have put 99% probability on that. I would have put much less probability on that."* Mr. Lacker dissented against expansionary decisions at monetary-policy meetings in 2012 when he was a voting member of the Federal Reserve's Federal Open Market Committee.

As a result of inflation not rising, Treasury Inflation-Protected Securities (TIPS) became very popular a few years ago on speculation that the Federal Reserve's programs would cause inflation. Not only has this not come to fruition, but TIPS securities are down 7% year-to-date, which is on pace to post their largest loss since TIPS were introduced by the Treasury in 1997. Current break-even yields, an indicator of the market's expected inflation levels in the future, remain benign not showing signs of inflation on the horizon.

Germans citizens during a period of hyperinflation from 1921 to 1924 disposing of German Marks (German's then currency)

Janet Yellen's Nomination

On Thursday, November 21st the Senate Banking Committee approved Janet Yellen's nomination to be become the Federal Reserve's first Chairwomen. In what was speculated to be a difficult confirmation, it was a quick session only taking a few minutes confirming her nomination with a 14-8 vote of approval. Next, Janet Yellen's nomination will go before the full senate where it is expected that she will be easily confirmed. The current economic environment and the state of the economy at the last Federal Reserve Chair nomination reflects how much progress the economy has made. Four years ago, at Benjamin Bernanke's nomination confirmation hearing for his second term, the economic recovery was in its infancy and the unemployment rate was 9.8%.

Janet Yellen has already made a few dovish statements, meaning she supports current expansionary or easy money policy. These statements and her previous involvement in the Federal Reserve's work mean that we may not see a lot of changes in the Federal Reserve's policies under her tenure next year. On November 14th, she stated that she'll ensure that monetary stimulus isn't removed too soon for the economy. In a November 18th letter sent to Senator David Vitter, she stated *"By putting downward pressure on longer-term interest rates and helping to make financial conditions more accommodative, the Federal Reserve's asset purchases have supported a stronger economic recovery, improved labor market conditions, and helped keep inflation closer to its 2 percent objective."* These statements further support her views as dovish and in favor of current monetary policies.

Conclusion

Bond's had a tough 2013 but stocks have had a wonderful year with the S&P 500 returning 30% year-to-date. We may not see major changes within the Federal Reserve's monetary policies in the near future even as Benjamin Bernanke steps down and Janet Yellen takes his place showing the Federal Reserve's determination to stimulate the economy.

S&P 500 Index

3 Month	11.16%
Year-to-Date	29.11%
1 Year	30.28%
3 Year	17.70%
5 Year	17.56%

MSCI EAFE Net Index

3 Month	11.97%
Year-to-Date	21.74%
1 Year	25.65%
3 Year	11.19%
5 Year	14.16%

Barclays Aggregate Bond Index

3 Month	1.38%
Year-to-Date	-1.47%
1 Year	-1.61%
3 Year	3.09%
5 Year	5.32%

As of 11.30.2013

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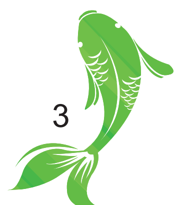

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