

# JMG

## Vantage Point October 2014

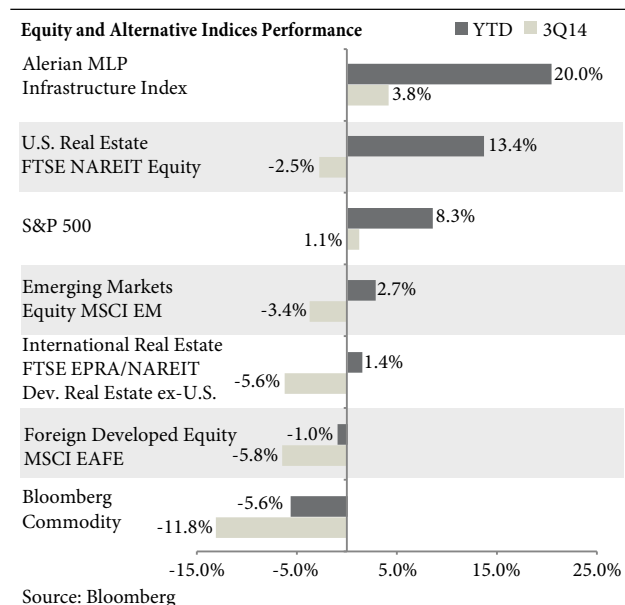
### Market Observations

JMG Investment Committee

- After showing strength in the first half of the year, stocks and bonds paused with mixed results due to higher valuations and increased geopolitical tensions
- The U.S. dollar rapidly strengthened, particularly in September, as the Federal Reserve nears an end to quantitative easing.
- The U.S. economy continues its slow growth trajectory, but weaker economies in Europe and Japan are having difficulty in finding traction.

**3rd Quarter Recap** Domestic equities had mixed results during the quarter. The S&P 500 rose +1.1% but finished the quarter off its September 18th all-time high. In contrast, mid-cap and small-cap U.S. stocks fell by -1.7% and -7.4%, respectively. Year-to-date, the S&P 500 has gained +8.3%. Energy infrastructure (MLP) companies continued strong quarterly performance earning +3.8% helped, in part, by a reorganization of Kinder Morgan, Inc., a major oil and gas pipeline company. U.S. real estate investment trusts (REITs) fell by -2.5% in the quarter, but remain positive for the year with a total return of +13.4%.

International developed country and emerging market equities fell during the quarter by -5.8% and -3.4%, respectively. Negative performance was directly related to the strength of the U.S. dollar which rose +7.7%, mostly in September. In local currencies, international and emerging markets actually had positive total returns. The dollar has not had a quarterly gain of this magnitude in six



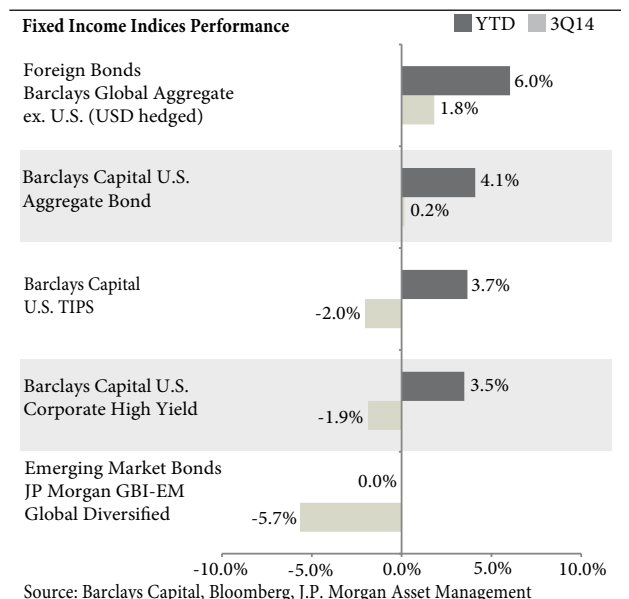
years. Its effects impacted U.S. investor returns from international sources. Notably, the euro-to-dollar exchange rate moved from \$1.369 to \$1.262 over the quarter.

Bond performance also had mixed results. The September 30th yield on 10-year U.S. Treasuries was 2.52%, virtually unchanged for the quarter. As a result, the Barclays U.S. Aggregate Bond Index gained a fraction at +0.2%. However, real interest rates that impact Treasury Inflation Protected Securities (TIPS) rose resulting in TIPS falling by -2.0% for the quarter. Similarly, high yield U.S. corporate bonds declined by -1.9%. Emerging market bonds fell by -5.7% in line with the currency effect of the dollar. On a positive note, foreign dollar hedged bonds and municipal bonds gained +1.8% and +1.5%, respectively.

Commodities fell by -11.8% in the quarter. After showing strength in the spring, the Bloomberg Commodity Index is down -5.6% year-to-date. Besides strength in the dollar, a strong growing season has sent agricultural commodities lower. Corn and soybeans are now trading at prices below production costs.

**Market Analysis** It seems each quarter has a character of its own and in the present case, the markets either paused or somewhat stepped back.

The surprise of this quarter was the rapid strengthening of the U.S. dollar which negatively impacted foreign investments and inflation protecting real return assets such as real estate, TIPS and commodities. Multiple factors contributed to the dollar effect. The U.S. is in a different stage of economic recovery relative to the Eurozone and Japan. The Federal Reserve is expected to end quantitative



easing as the U.S. economy slowly recovers. In contrast, weaker data in Europe and Japan suggest policymakers will continue or expand hyper-accommodative monetary policies to spur their economies. Therefore, the 10-year U.S. Treasury yield of 2.52% is attractive relative to foreign yields and buoys the dollar.

In addition, geopolitical concerns contributed to more cautious risk-off views. The Israel-Gaza conflict, escalating terrorist actions in the Middle East by ISIL, disputes in the South China Sea, masses of people flocking across an insecure U.S. / Mexico border, and problems in containing the Ebola virus are all formidable problems. Geopolitical risks have risen and may have a greater impact on the investment markets.

Last quarter, we noted investment volatility as measured by the S&P 500 VIX Index has been at low levels. In spite of the geopolitical risks noted above, the VIX remained low for most of the quarter although it did increase in the last week of September. Low volatility

generally is associated with positive investment performance. Additionally, corporate earnings generally remain healthy.

Bond performance is explained by changes in both U.S. Treasury yields and in credit spreads on corporate and high yield bonds. Concerns over default rates often impact credit spreads. Recently, Treasury yields are lower and range bound. In the third quarter, 10-year Treasuries traded between 2.31% and 2.64%. Many expect there will be a trend toward higher rates as was experienced in 2013.

Regarding corporate bonds and credit spreads, default risk remains low as the U.S. economy continues its slow recovery. Yet, high yield bond investors withdrew billions during the quarter. A record \$7.1 billion was withdrawn from high yield in the last week of July in a brief but deep pullback. This was probably due to profit taking and worries about junk bond liquidity as investors remember problems experienced in 2008. By mid-August, however, the Wall Street Journal reported large institutions were again buying high yield bonds on the market dip. In September, investors reversed again with strong selling of high yield bonds. Market gyrations are more common later in the credit cycle but the lower default risk is a positive for long-term corporate bond holders.

On September 26th, Bill Gross, founder of investment giant PIMCO, announced he was leaving PIMCO to manage a newly created bond fund at Janus Capital. This was a significant event in the bond community. Bond funds of PIMCO and elsewhere are experiencing higher than normal investor flows on the news. However, because the bond markets are very large and liquid, the bond markets appear to be trading normally.

**Our View** It is not a surprise the predominant upward U.S. stock market trend paused this quarter. It is normal for stocks and bonds

to move up and down over time. Portions of the U.S. stock market have moved slightly downward, but the longer-term upward trend is more likely to continue because stronger fundamentals remain in place.

Our views from last quarter generally carry over. The U.S. economy continues to grow slowly, but valuations are higher for both stocks and bonds. U.S. stocks have higher valuations and foreign stocks are relatively less expensive. Navigating a low interest rate environment remains difficult. Geopolitical risks are higher and can impact investment performance, especially in the short-run, regardless of fundamentals.

After six years, the Federal Reserve's (Fed) most recent asset purchasing program is ending. This means U.S. monetary policy is moving from highly accommodative to just accommodative. It does not mean Janet Yellen is leading the Fed to a restrictive policy. In contrast, foreign central banks in Europe and Japan are expected to continue their respective asset purchase programs. Uncertainty remains in Europe as to further recession and potential deflation. The European Central Bank (ECB) bank deposit rate is negative at -0.1%. Such policy of negative interest rates is unorthodox but signals ECB concerns of deflation and is necessary because of the structure of the Eurozone. Japan is in the midst of aggressive economic stimulus that is expected to continue.

Because the U.S. is in a different stage of recovery than other countries, it is unclear how soon interest rates or inflation will turn higher. The expectation is U.S. interest rates will move higher. If foreign interest rates remain low, this would mean the U.S. dollar would strengthen further. However, the Fed does not want interest rates to increase too quickly as it could derail the trend of economic growth. The Fed has unemployment and inflation targets of 6.5% and 2.0%, respectively. Such targets are near and it seems the Fed may be late in raising

the fed funds rate if they are being achieved. Possibly, the Fed is considering the structural issues in employment and recognizing there needs to be more hiring strength in spite of the headline unemployment number.

Ben Bernanke recently noted his personal mortgage refinance application was rejected. Housing has continued to slowly recover but housing starts are below average. Yet housing affordability is favorable. The problem is credit standards remain tight and banks are less willing to lend. Bernanke should know that a reason banks are hesitant to lend is a consequence of the low interest rate environment. Thirty-year mortgage rates are at 4.25%. Bank profitability on mortgages is based on the spread between long-term mortgage interest rates homeowners pay to the banks and short-term interest rates banks pay for deposits. While the low 30-year rates are locked in, shorter term rates are more likely to rise. Banks are afraid the long-term and short-term rate spread could narrow making lending at those rates unprofitable. Looking back to the 1970s, the rapidly increasing interest rate environment of the time was problematic and contributed to the savings and loan crisis when about one-third of S&L Associations failed.

The strength of the U.S. dollar has both positives and negatives. A strong dollar lowers import prices, helps foreign exporters, and lowers commodity prices. However, U.S. exporters are disadvantaged by a strong currency. One of the reasons for central bank quantitative easing was to devalue currencies to help exporters. In analyzing strong dollar vs. weak dollar periods since the late 1970s, the S&P 500 has performed about twice as well in strong dollar periods. Quick, sharp movements in the value of the dollar have led to greater stock market volatility and that is the situation we have seen recently.

## Did You Know...

Joseph Menconi, CFP®  
JMG Advisor

### What is Alibaba?

In September Alibaba's IPO became the world's largest ever raising \$25 billion and surpassing the 2010 IPO from the Agricultural Bank of China which raised \$22.1 billion.

Alibaba is an online marketplace, bank, and search engine all in one. Alibaba is China's largest online commerce company. Eighty percent of China's online shopping was done through Alibaba in 2013 with transactions totaling \$248 billion. That value is more than the transactions of eBay and Amazon.com combined.

Alibaba consists of three main sites, Taobao, Tmall, and Alibaba.com. There are over one million merchants and businesses hosted on the sites and hundreds of millions registered users. Alipay, Alibaba's new financial services division,

processes online payments (similar to PayPal in the U.S.), has a smartphone app to pay for purchases such as theater tickets and taxi services, and also offers investments in a money market fund. The money market fund is approaching \$100 billion in assets and was the fourth largest money market fund in the world after the first quarter of 2014.

### Crowdfunding: Part 1

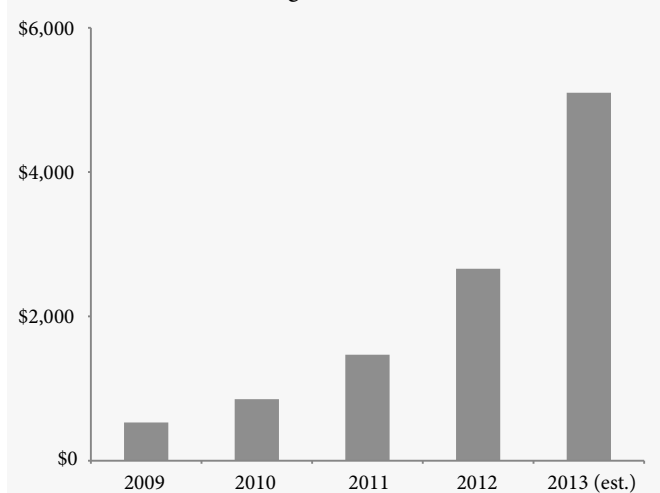
Crowdfunding has two main types: peer-to-peer lending and donation-based giving. This quarter's Vantage Point will focus on the latter.

Kickstarter, Indiegogo, and GoFundMe are three of the prominent online venues in the crowdfunding space today. They give artists, inventors, entrepreneurs, and governments access to funds for new projects or business ideas. Kickstarter projects alone have raised over \$1.2 billion dollars since the site's 2009 inception. Some of the most popular categories for projects include film and video production, publishing, art, and theater. The average success rate for a proposed project is just over 43%.

How does it work? A person or group posts an idea, project, or service that needs funding. Then solicitations are sent to family, friends, and the community at large to review the proposal and donate to the cause. If the funding goal is reached the pledged dollars are delivered. If the funding goal is not met the donors are relieved of their pledge obligations.

Does this really work? In 2012 eighty-eight residents of Athens, Georgia raised \$3,015 for the

Worldwide Crowdfunding Volumes (\$M)



Source: Bruegel.org

construction of a municipal bus stop. In 2011 an 18-year old video game designer raised \$2.4 million in thirty days using Kickstarter for the creation of a prototype virtual reality system. Less than three years later he sold the resulting technology and company for \$2 billion dollars.

Next quarter, peer-to-peer lending. The future of lending...no banks required.



Joe Menconi  
JMG Advisor

Joe has been with JMG since 1996

# JMG Technology Perspective

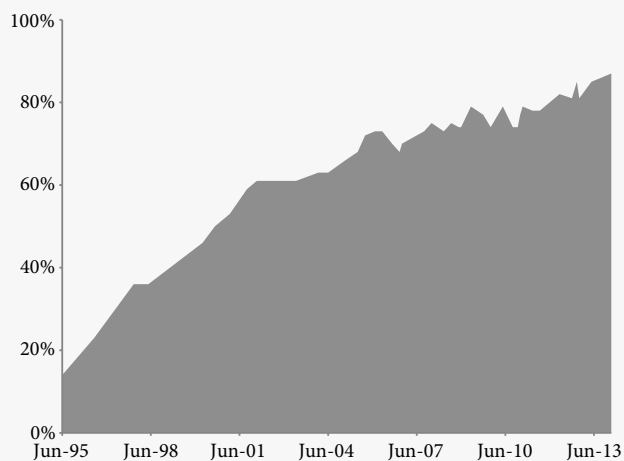
## Cybersecurity Awareness

Edward Raffenetti  
JMG Senior Information Technology Associate

October is National Cyber Security Awareness Month, and cybersecurity is a hot topic in the financial industry. Hackers, hacktivists and cyber-warriors are exploiting insecure software, and stealing data including, but not limited to, passwords, credit cards, and photos. With high profile exploits and attacks on the rise, everyone wants to know what to do to stay safe online. While volumes could be written about best practices in hundreds of different situations, we are addressing some recent issues, buzzwords, and trends.

**The Cloud** is a term you are hearing more and more. Cloud technology can be defined as services and data that are accessed with a device that is connected to the Internet. High speed Internet connections have made more data and services easily accessible through the Internet, or in the cloud. As a result, the number of individuals using the internet has increased dramatically over the last 20 years (see chart). There are cloud based free email services like Gmail, Yahoo Mail,

American Adults Internet Usage Over Time



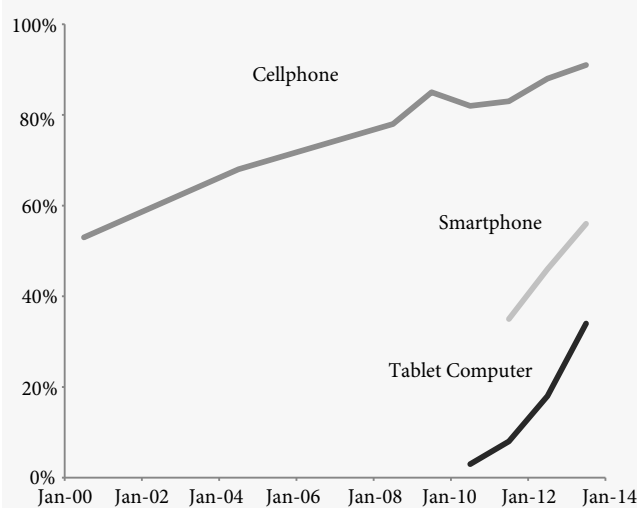
Source: Pew Research

and Outlook.com. There are cloud file storage services like Dropbox, Google Drive, and iCloud. There are cloud services that will back up your photos and videos from your cell phone and tablets. Also, there are cloud services that host software, data, and infrastructure for businesses. If you are looking to use one of these services, there are a few things to consider. Even with all of the advantages of cloud storage, you might find that keeping backups with an external USB hard drive, and storing it in a safe in your home or safe deposit box at the bank is still a great option. Cloud services that encode the data so that it can be read only by the sender and the intended recipient are the best choices. This encoding, or

encryption, should be used during storage, and during transit. Another option is to encrypt your data on your personal computer or mobile device before sending it to the cloud. Lastly, cloud services are a big target for hackers, so do not store anything that is potentially sensitive in the cloud.

**Mobile Devices** are constantly evolving, and so are their security needs. Device ownership has significantly increased over the last several years (see chart). Mobile devices including your cell phone, tablet, or notebook computer can be protected easily with a password or pin. This is a simple security step that a lot of people skip, but is very important in keeping your data safe. An additional security measure is properly encrypting your device to ensure that the most skillful hackers cannot recover data from a device if it is lost or stolen. When installing applications, or

Devices Ownership Over Time



Source: Pew Research

“apps” on your device, stick to well-known apps or app vendors. Before installation, check if the app might have access to data on your phone like pictures, contacts, and calendar. A good habit to practice is once a month, go through your mobile device and remove any apps you are not using. Many charging stations are appearing at coffee shops, airports, and kiosks that could not only charge your device, but also secretly access your data. Data theft while charging or “Juice Jacking” is easily preventable by carrying your own charger, spare battery, or a portable charging pack. When giving up or disposing of your unused mobile devices, perform a factory reset or “hard reset.” This process should remove all the data, or “wipe” your device. Recovering data is sometimes still possible with wiped devices, so fill the device’s storage with benign data to ensure any remaining personal data is overwritten, then wipe it again.

**Desktop Computers** are being used less and less in favor of mobile devices; however, they still pose some major security concerns. In 2014, Microsoft officially stopped supporting the Windows XP operating system, meaning they will no longer provide future security updates. Because of this, we suggest upgrading or replacing any computers with Windows XP or an older operating system. Keep your operating system, browser, and other critical software optimized by automating the installation of updates. Continue to run antivirus and antimalware software. Lastly, do not use public computers (e.g., Library or coffee shop) for sensitive transactions.

“**The Internet of Things**” is a growing movement of everyday physical objects being connected to the Internet. Devices like smoke detectors, fitness equipment, home security systems, and even refrigerators can be accessed and manipulated online. One big challenge is to keep all your devices updated with the latest features and security patches. Consumers are responsible for updating devices that cannot be updated automatically. Advertisements displayed on these devices may become more widespread over time, thus reducing their functionality. The most significant challenge may be privacy; device providers and manufacturers could collect and sell the consumer’s data without proper notice or consent. Even with all of these challenges addressed at the current time, the future may bring additional changes. Companies that build these devices need to convince consumers that these devices are secure and non-invasive.

**Passwords** are still a popular tool of choice for cybersecurity. Your passwords are susceptible to being leaked or hacked, so here are some tips to help protect yourself. Use passwords made from 8-12 characters, with random numbers, upper and lower-case letters, and, if the system allows, a symbol. Use different passwords for each and every site you access. While this may seem difficult, you could utilize a standard random password, and then work the site’s name into the password. Password Managers are programs or apps that easily store all your unique passwords, but make sure the data is encrypted. Lastly, enable “two-factor authentication” wherever possible. Two-factor authentication is a process which adds a second step to verify you are who you say you are. If you are using online banking, you are probably already familiar with this process by having to authenticate and remember a new mobile device or computer. This is a great way to add a higher level of security. Instead of thinking of this as a nuisance, try to change your mindset, and understand and appreciate this added security. Two-factor authentication is available for many cloud based email providers, social networking sites, and brokerages, but is widely underused.

### ***Passwords are susceptible to being leaked or hacked***

With the recent cybersecurity breaches of many large corporations, there might be a sense that companies, and not individuals, are being targeted. However, everyone has the opportunity to increase awareness of cybersecurity and improve your security for the future. For more information about cybersecurity awareness, visit <http://www.staysafeonline.org>.



Ed Raffenetti  
JMG Senior Information Technology Associate

Ed has been with JMG since 2002

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# JMG

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## Friends of the Firm

**Deborah A. Grisko, RN, President and Executive Director of Almost Home Kids** received the March of Dimes 2014 Jonas Salk Public/Community Health Award. This award honors the achievements of Chicago area maternal and infant health professionals in the public and community health discipline.

**Ken Meyers, a co-founder of Elyssa's Mission** hosted the Race to Save Young Lives Benefit at Arlington Race Track. The funds raised at the event will allow Elyssa's Mission to implement their Signs of Suicide® program, which is a resource to help prevent teen suicide, into ten new schools.

## In the News



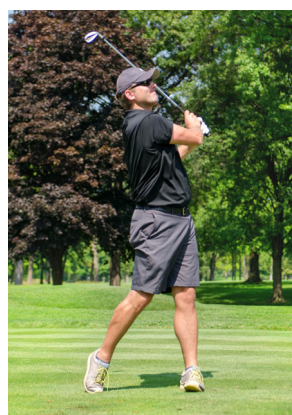
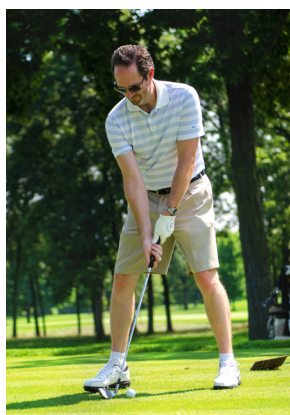
**William G. Waight, Principal**, was appointed to the JMG Officer Group as Senior Vice President. Bill has made numerous contributions to the firm and is an integral member of the JMG Investment Committee. Bill has been with JMG since 1991.

## 2014 Client Appreciation Event

On August 18th, JMG hosted a Client Appreciation event at Sunset Ridge Country Club in Northfield. The weather was picture perfect for those who were able to enjoy 18 holes on the golf course. The day concluded with a buffet dinner that was attended by over 150 guests. It was a great day for everyone who was able to attend.



From left to right: Matt Grubb, Yonhee Gordon, Erik Faust, Joe Gordon, and Cheryl Cassell



Clients enjoyed the beautiful weather



From left to right: Francesco Maranto, Donna Smolich, and John Karavouzis

We welcome your questions, comments or suggestions at [Newsletter@jmgfin.com](mailto:Newsletter@jmgfin.com).

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