THE BUTTONWOOD

On May 17, 1792, twenty-four merchants gathered under a buttonwood tree at 68 Wall Street. There they signed the Buttonwood Agreement, creating the first investment community, which later evolved into the New York Stock Exchange.

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SECOND QUARTER 2014

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This Market Gets No Respect

After the first 6 months of 2014, the stock market might be feeling a bit like Rodney Dangerfield in that it doesn't seem to get any respect. The major US indices that we follow closely all posted 6 month gains, with the S&P 500 leading the way by gaining 6.1%. During the second quarter of 2014 the Dow Jones Industrial Average made new highs 11 times and the S&P recorded 16 new highs.

Despite these positives, there has not been much in the way of "stock market noise" thus far in 2014. In our opinion, the reason for this is that the relatively modest gains the Dow Jones and S&P have made equate to low volatility, and low volatility rarely makes headlines. To some extent this lack of attention can also be attributed to the big year the US markets had in 2013.

In addition, we are further encouraged by the Federal Reserve's benign interest rate stance, reasonable earnings expectations, favorable capital expenditure projections for the second half of 2014, and a fairly valued stock market from a price to earnings perspective.

For many people there were two mild surprises in the first half of 2014. The first surprise was the trend in interest rates. The yield on the 10 year US Treasury note fell from nearly 3% in early January to 2.5% at its low point this year. The Barclays 3-15 year blended municipal index posted a gain of 4.54% and the Barclays US aggregate bond index weighed in with a gain of 3.86%. Most analysts had expected bonds to be down year-to-date as interest rates were expected to rise.

In our opinion, the Federal Reserve will continue with its easy monetary policy. Despite tapering its bond buying thus far in 2014, the Fed has stated that long-term unemployment remains a concern. In addition Federal Reserve commentary remains quite dovish and suggests that rates will remain low for quite some time.

The second surprise was that there was not a broad market correction. This despite the fact that the market had good reason to correct given the tensions in the Middle East and the Ukraine, a spike in oil prices, and the harsh winter's effect on the economy, etc.

In our opinion, reasonable stock valuations certainly have contributed to the absence of a correction. When stock prices reflect fair value and inflation remains benign, stocks typically don't go down.

Nonetheless we too are a bit surprised that we've not seen some sort of broad correction since October of 2011. As measured by the S&P 500, this marks the fifth longest run since 1945 without a 10%+ correction.

Longest Periods for S&P 500 without a 10% Correction - 1945 to present

Rally Start	Rally End	Length in Days	% Gain
10/11/1990	10/7/1997	2,553	232.7%
3/11/2003	9/22/2006	1,291	64.2%
10/23/1962	2/9/1966	1,205	78.8%
7/24/1984	8/25/1987	1,127	127.8%
10/3/2011	TBD	1,001	78.4%

Source: RBC Dominion Securities Inc., Bloomberg

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How Corrections Play Out Since 1945

As we have been saying for quite some time, we know there will be a correction, we just don't know when. A better exercise might be to examine some historical data regarding mild vs. intermediate corrections. As the chart below shows, mild corrections are typically brief, lasting on average one month. Market recovery is also brief, averaging two months.

Intermediate corrections are more severe and usually grab headlines. Interestingly, an intermediate correction is also quick, typically going from peak to trough in four months. This data supports the old Wall Street adage that corrections in a bull market are usually quick and can be severe.

Corrections Since 1945

Type =>	Mild 5 - 10%	Intermediate 10-20%
Occurrences	56	19
Avg. Decline	-7%	-14%
Peak to trough	1 month	4 months
Recovery	2 months	4 months

Source: RBC Dominion Securities Inc., Bloomberg

What about a bear market? The data tells us that all bear markets since 1945 have been associated with a recession. The duration of a bear market is much longer than those corrections scenarios mentioned above. We don't see any bear market warnings on the horizon. These warnings include meaningful declines in corporate earnings, declining investor confidence, and most importantly a tightening of monetary policy. Today's low rates will, at some point, give way in rising rates. But it will be critical to keep in mind that rates will be returning to normal levels from long term historic lows.

As we alluded to earlier, we think the Fed will raise rates slowly, and in so doing, keep rates low for some time to come on a relative basis. Therefore, we don't see a recession or a bear market anywhere on the horizon.

Another interesting point to make is that the market has, in fact, gone through somewhat of a rotating correction. Liz Ann Sonders (Charles Schwab Sr. Vice President, Chief Investment Strategist) wrote recently ***"the first quarter brought an internal correction where many high-flying names sold off, potentially alleviating the need for an overall market correction"*** that many investors had been looking for. The recent steep price decline in the bio tech area was another example of a correction in an overvalued segment of the market and further evidence of a rotating market correction scenario.

As we've said many times, you cannot time the market. You will never be "all in" at a market bottom or "all out" at a market top. Since, as the evidence suggests, mild and intermediate market corrections are quick by nature, any attempt at timing them is even more difficult.

We continue to believe that we made a generational market low in March of 2009 and that the odds of a repeat anytime soon are extremely long. The Federal Reserve will likely keep rates low for a longer period of time than most had forecast. The US economy continues its slow recovery and good quality US stocks are the place to be for the foreseeable future. If you don't panic when the market corrects, you'll be able to ***Get Rich Slow.***

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