July 2014

regent atlantic

Investment Outlook Report

The 2014 3rd Quarter Outlook: Lessons Following World Cup Fever

World Cup fever gripped the world in June and July 2014. That comes as no surprise, since soccer is the most popular sport in the world. What is a surprise, though, is how much attention the event received in the United States. The group stage game between the United States and Portugal was the second-most-watched sporting event of the year, after the Super Bowl.

The World Cup can teach us about more than just sports, though. It can also teach us about investing. Investing, like soccer, is a global phenomenon. Investors and fans alike should not overlook major global contenders. Soccer's leading teams come from all corners of the globe, just as the biggest corporations are not based only in the United States, but also in Europe, Japan and in developing economies. This year's World Cup also taught us to expect the unexpected, with Brazil's surprise defeat by Germany, conceding a record seven goals. Similarly, investing is as much about forecasting and analyzing as it is about preparing for the unexpected and knowing what to do when it happens. Finally, the World Cup taught us that developing countries are not to be overlooked. Many of soccer's powerhouses, such as England, Italy, Spain and Portugal, were sent home early. At the same time, teams representing developing nations advanced. We believe that developing nations should not be overlooked in investing either, as we find that they offer some of the most attractive valuations in the world right now.

As the excitement of the World Cup fades, however, investors may also begin to recall some of their long-term financial worries. In the economy, the most pressing concerns include unemployment and the prospect for higher inflation going forward. In the markets—with U.S. stocks trading near their all-time highs—investors are faced with concerns about values and how to handle built-up cash. Does it pay to wait on financial decisions when markets are near their highs?

Unemployment and Inflation

Inflation is a big concern for investors, and one that they have worried about quite a lot in recent years. The overall level of slack in the economy has helped keep consumer prices in check, with the Consumer Price Index (CPI) rising just 2.1% since last year. By most measures, inflation has not been a concern since the Great Recession. A weak economy, driven by low asset values, helped keep commodity costs in check. Most important, high unemployment has kept a lid on rising wages.

With unemployment falling to levels not seen since early 2008, many experts are rightly concerned that inflation may come back in a big way. June's 6.1% unemployment rate masks a disconnect in the economy between the skill sets employers require and the experience unemployed workers have to offer. One statistic that can help measure this concept is the unemployment rate for college-educated adults, which is just 3.9%. Rates are much higher for the rest of the labor force.

We believe that inflation will remain contained, at least in the short term, from an offsetting phenomenon in the labor market. While the headline unemployment rate is just 6.1%, a separate measure known as U6 is much higher – over 12%! This measure includes the general unemployed, but also factors in workers who currently work part-time but desire full-time employment, as well as people who would be looking for work in a stronger economy. This measure is still well above normal levels and suggests that there is hidden slack in our labor market.

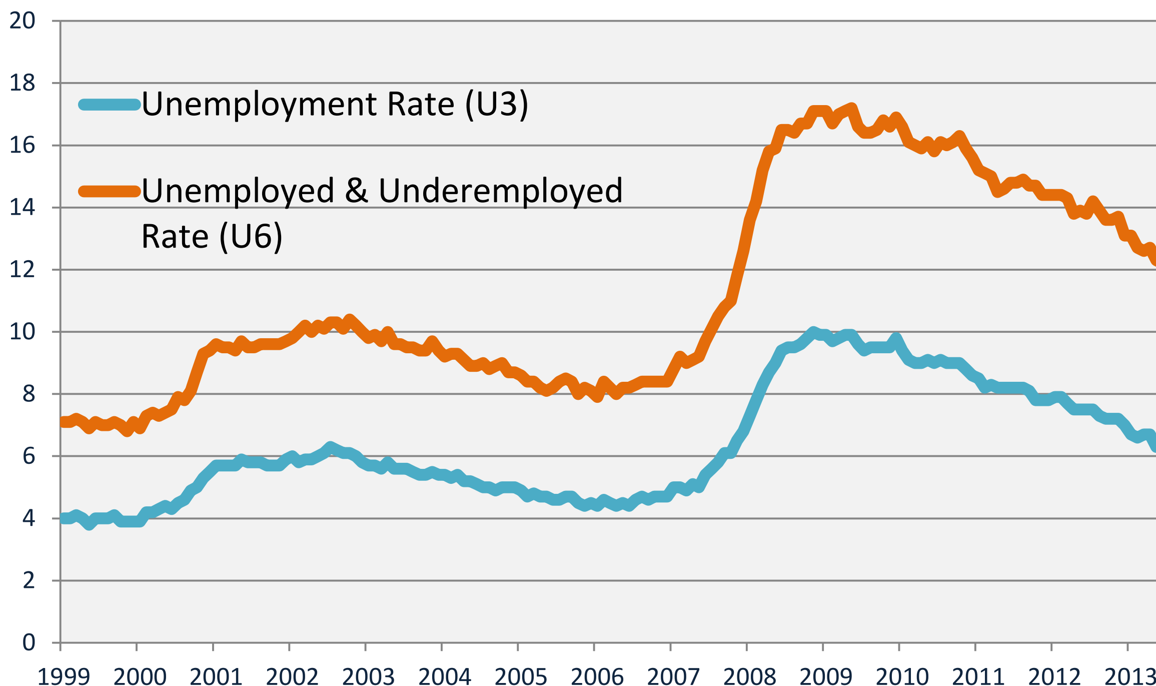

Chart Source: Bloomberg

Buying When the Market is Near its High

Shoppers like nothing more than a good sale. Getting what you want at a big discount off the sticker price can feel like a conquest. It makes shoppers feel like they've outsmarted the retail game. Those feelings can be transferred to investing, too. Many investors like to wait for stocks to decline before they put their money to work. The risk with this strategy, however, can be that the market could get away from the investor by rising significantly without suffering a big decline.

To test this concept, we modeled two investors with different strategies. Each investor began putting money to work in 1980 and had $1,000 in cash each month to invest. The first investor followed a simple strategy: Invest $1,000 per month regardless of what the stock market was doing. The second investor added a wrinkle to this: He invested his $1,000 only when the market was at least 10% below its all-time peak. If it wasn't, the investor held onto his cash and simply earned interest on it.

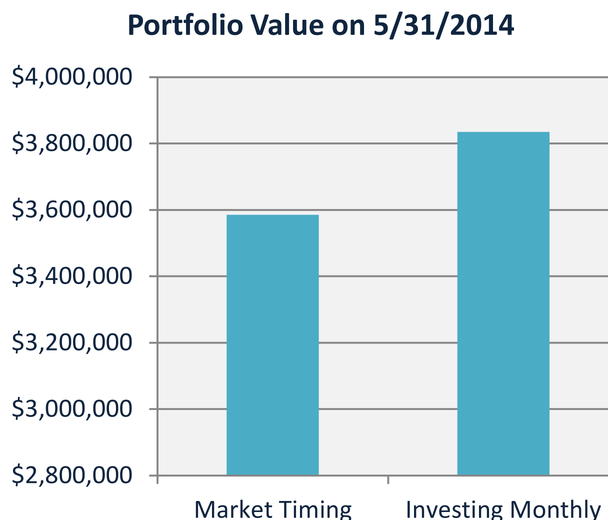

Chart Source: Bloomberg

Following these strategies, both investors were successful in building their wealth over time. However, the investor that "timed" the market declines actually ended with approximately $200,000 less than the consistent investor. And that's the potential cost of waiting for market declines; sometimes the market goes a long time without one and the benefit of the decline can be far offset by the foregone returns.

One more point for globally diversified investors to keep in mind is that while U.S. stocks (as measured by the S&P 500) are trading near all-time highs, a global portfolio will have investments in markets that are still well below peaks hit in 2007. Emerging markets stocks and stocks of companies based in the Eurozone, for example, are at least 20% below the highs they hit in 2007–a relative bargain.

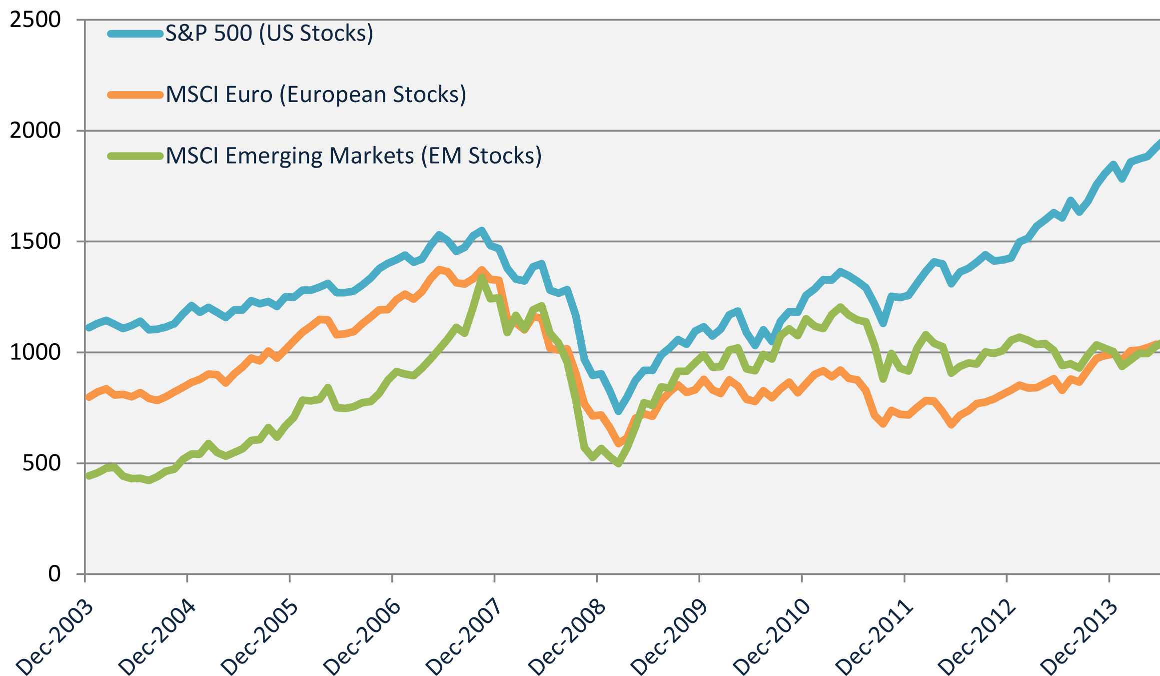

Chart Source: Bloomberg

To reiterate: Lessons learned from the World Cup can clearly apply to the field of investing, too. Among the most important teachings are the global nature of both the game of soccer and the field of investing. Focusing on a globally diversified portfolio, we see great values in markets abroad that are still trading well below their 2007 peaks. In looking at the United States and our economy, we see the prospect for contained inflation in the near-term, with some risks from a mismatch between the skills that employers desire and the skills that the labor force has to offer. Like any loyal soccer fan/ investor, we continue to keep a watchful eye on our own country and its successes. However, we can enjoy seeing (and perhaps benefitting from) other countries' accomplishments, too.

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Important Disclosure Information

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The chart labeled Portfolio Value on 5/31/2014 plots the terminal value on 5/31/2014 of two hypothetical portfolios. The Investing Monthly portfolio invested $1,000 into the S&P 500 index each month starting January 1980 and earned the index's total return with dividends reinvested. The Market Timing portfolio accumulated $1,000 per month and would only invest it into the S&P 500 if the index's

total return was at least 10% below its all-time peak. If the S&P 500's total return was within 10% of its all-time peak, the Market Timing portfolio kept its cash and invested its $1,000 per month into 3 month T-bills, earning a rate of return equal to their yield at the time. Whenever the S&P 500 total return index fell more than 10% below its all-time peak, the Bargain Hunter portfolio took

all accumulated cash and interest earned and invested it into the S&P 500, and earned the index's total return with dividends reinvested.

Please note that these hypothetical portfolios are NOT intended to illustrate the investment results that were actually achieved or could have been achieved by any of our clients. The portfolios do not reflect the deduction of fees and expenses that a client would incur, which would have the effect of reducing the returns of each portfolio. Information regarding RegentAtlantic's wealth management fees is provided in its Form ADV Part 2. These portfolios are intended to show the potential differences in two types of investment approaches.

The index returns shown above show the total return for various investment indices and include the impact of the reinvestment of dividends. A comparison to indices may not be a meaningful comparison. Comparisons to benchmarks have limitations because benchmarks have volatility and other material characteristics that may differ from the performance of a client's portfolio. The investments in a client's portfolio may differ substantially from the securities that comprise each index and are not intended to track the returns of any index. One cannot invest directly in an index, nor is any index representative of any client's portfolio. Actual client accounts will hold different securities than the ones included in each index. The index returns are gross of applicable account transaction, custodial, and investment management fees. The actual investment results would be reduced by such fees and any other expenses incurred as an investor. Please below for definitions of the indexes used.

The S&P 500 is an index consisting of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe. Each constituent in an index is weighted by its market-capitalization, as determined by multiplying its price by the number of shares outstanding after float adjustment. The price return of an index is a measure of the cap-weighted price movement of each constituent within the index.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance in the global emerging markets. The MSCI Emerging Markets Index consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

The MSCI Euro Index (European Economic and Monetary Union) captures large and mid cap representation across the 10 Developed Markets countries in the EMU (European Economic and Monetary Union). The index covers approximately 85% of the free float-adjusted market capitalization of the EMU. Developed market countries in the EMU include Austria, Belgium, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal and Spain.