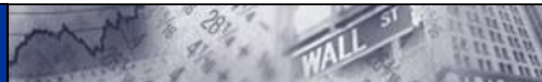


DMS Economic Outlook for next 12 months

- GDP growth will continue to grow modestly. Personal consumption has improved, settling at a growth rate above 2.5%, which is positive for GDP growth.
- A stronger dollar will continue to have an impact on the rate of earnings growth in large multinational domestic companies. The slowdown in the rate of earnings growth will ultimately impact the upside potential of domestic large cap stocks.
- The yield on the ten year Treasury opened the quarter at 2.17% and ended at 1.93%. Lower interest rates are the result of a “flight to quality” as capital flowed into the US to take advantage of higher interest rates. Nominal interest rates became negative in developed European countries such as Switzerland and Germany.
- Both the European Central Bank and the Bank of Japan will move forward with quantitative easing to spur growth. The trend of the stronger US dollar will persist due to the removal of Fed stimulus and modest, but firm, economic data.
- Growth in emerging markets will be higher than developed markets, even with slowing GDP growth in China. Lower energy prices will be a longer term benefit to energy importing developing economies.

Economic Outlook

Discretionary Management Services, LLC

Economic growth is influenced by the ability of consumers to take on debt to fund consumption. Credit expansion has begun to pick up speed in the past several months and should impact GDP growth positively .

FRED — Total Revolving Credit Owned and Securitized, Outstanding

(Percent Change from Year Ago)

15
10
5
0
-5
-10

2006 2008 2010 2012 2014

Source: Board of Governors of the Federal Reserve System (US)

Shaded areas indicate US recessions - 2015 research.stlouisfed.org

Economic Outlook

Discretionary Management Services, LLC

The dollar is at its strongest point relative to the euro in years. A stronger dollar makes imports more price competitive relative to domestic goods and keeps inflation in check. A stronger dollar also slows the earnings growth of domestic multinational companies.

FRED

U.S. / Euro Foreign Exchange Rate

(U.S. Dollars to One Euro)

1.5
1.4
1.3
1.2
1.1
1.0

2011-01-01 2012-01-01 2013-01-01 2014-01-01 2015-01-01

Source: Board of Governors of the Federal Reserve System (US)

Shaded areas indicate US recessions - 2015 research.stlouisfed.org

DMS Strategic Outlook and Tactical Positions

Strategic Outlook – Fixed Income: A trend toward higher interest rates is expected as the Fed is removing monetary stimulus. There will be times that macro economic events will spur a “flight to quality” and capital will flow into US Treasuries and push yields downward.

Tactical positions:

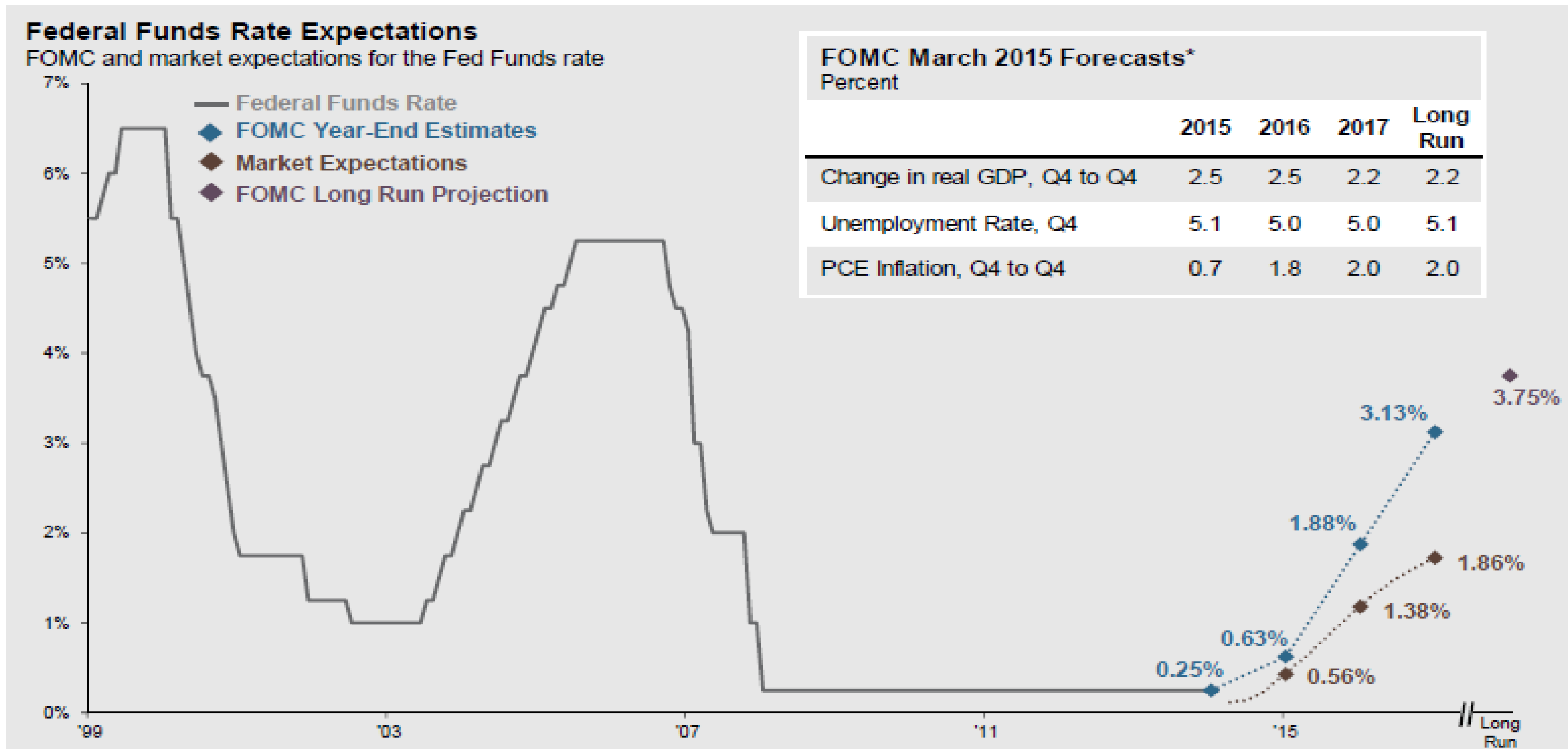
- High yield should outperform in a rising rate environment. Lower oil prices have impacted energy company debt and credit spreads have widened, presenting a buying opportunity. Credit is weighted more heavily than Treasuries and duration is tilted shorter than benchmarks.
- Commercial real estate is viewed as an attractive yield alternative to bonds, however, queues can delay additions to positions and an increase in interest rates could dampen valuation improvements.
- International bonds yields have been pushed lower due to quantitative easing in Europe. The stronger dollar is negative for US holders of international bonds. Emerging market debt denominated in US dollars provides diversification and yield potential.
- Hedge funds with a non-directional (or absolute return focus) are viewed as an attractive uncorrelated option.

Market Outlook

Discretionary Management Services, LLC

Interest rates remain near long term lows. As economic fundamentals continue to show modest growth, interest rates should trend upward to normalized levels. Higher interest rates will also negatively impact the upward potential of stocks.

The Treasury curve signals that the market is anticipating tighter Fed monetary policy. However, the market (the black line) expects rates to rise more slowly than the Fed has forecasted (the blue line).



FOMC March 2015 Forecasts*
Percent

	2015	2016	2017	Long Run
Change in real GDP, Q4 to Q4	2.5	2.5	2.2	2.2
Unemployment Rate, Q4	5.1	5.0	5.0	5.1
PCE Inflation, Q4 to Q4	0.7	1.8	2.0	2.0

Source: Federal Reserve, FactSet, J.P. Morgan Asset Management.

DMS Strategic Outlook and Tactical Positions.

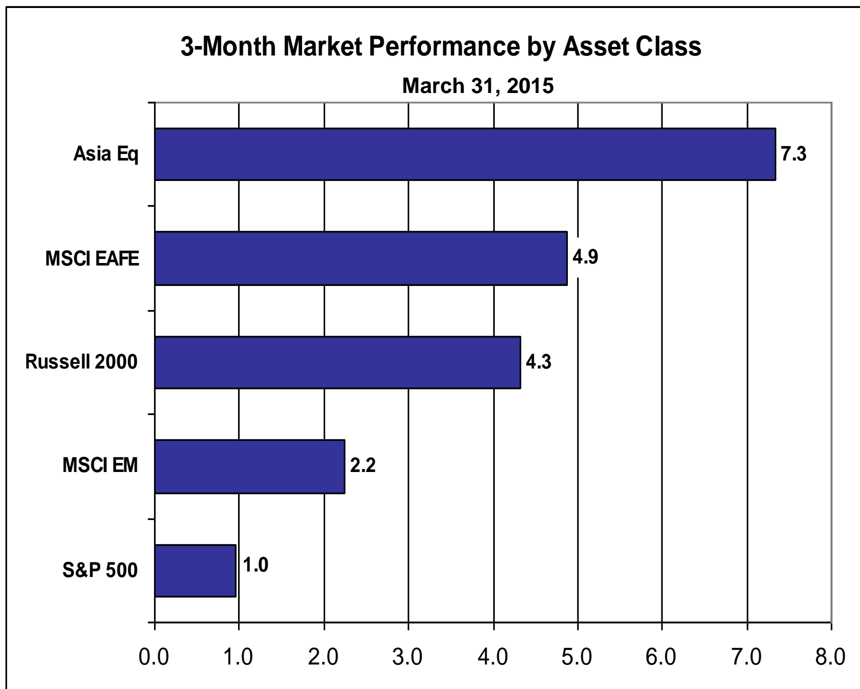
Strategic Outlook - Equities: The domestic stock market appears to be fully valued as earnings growth slows. A stronger dollar is having an impact on domestic firms with global earnings. We expect more volatility in domestic equity markets due to the slowing earnings momentum. The European Central Bank's quantitative easing project should bolster equity returns despite slow economic growth. Emerging market stocks are viewed favorably due to stronger economic growth and attractive valuations relative to developed nations.

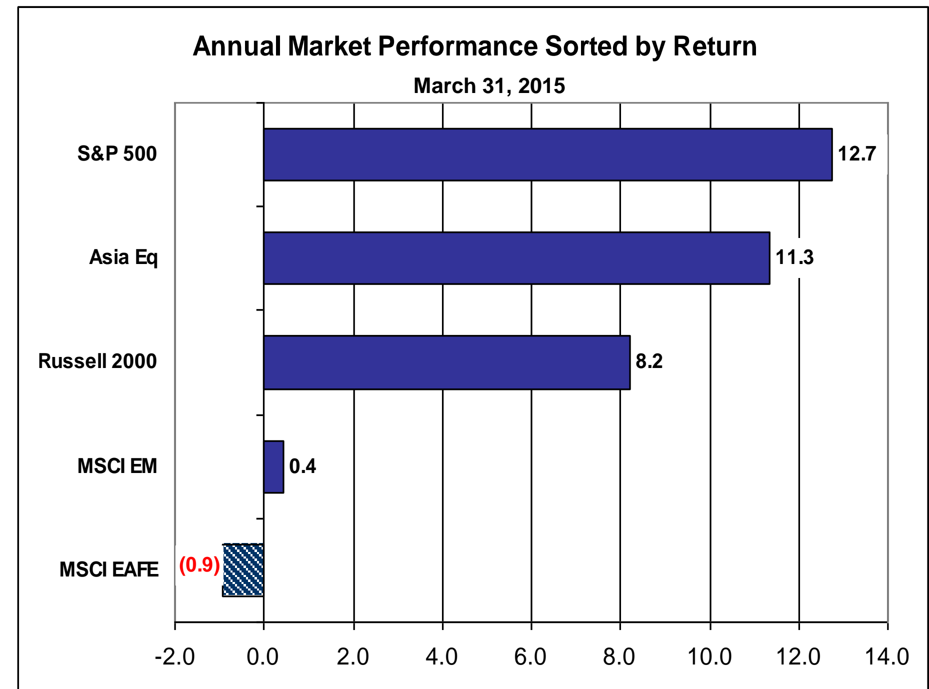
Tactical positions:

- Small cap stocks are weighted less than large cap stocks due to above average P/E multiples, however small companies' earnings growth should not be impacted as negatively as large companies' earnings. Equities are tilted toward lower beta, higher dividend stocks to reduce volatility and to generate income. We are looking for corrections in the market as points to "buy in" and bolster small cap positions.
- Stock allocations in developed markets lean toward high quality stocks as they appear to offer relative safety. The relative attractiveness of international stocks takes into account the lackluster economic growth in Europe and Japan. The European Central Bank and the Bank of Japan will continue their quantitative easing programs.
- Within international equities, emerging markets stocks, comparatively attractive due to their low relative P/E multiples, are equally weighted to target. Unfavorable economic news has been priced into valuations.

Equity Returns by Tactical Strategy

- Added to U.S. Small Cap positions upon sell off as risk/reward tradeoff now looks more favorable. Still below target weights in accounts. Still looking to bolster small cap positions.
- Added slightly to International Equity positions, taking advantage of low relative P/E multiples. Positions are slightly underweight to target.
- Added to Emerging Markets equities during quarter to take advantage of relative undervaluation.





Fixed Income Returns by Tactical Strategy

- High-yield corporate bonds are still viewed favorably given a mildly improving economic outlook and continuing low default rates. Added to positions upon modest spread widening in the quarter.
- Continued the overweight in investment grade credit as yield is attractive relative to U.S. Treasuries.
- Continue to maintain a shorter duration of portfolios versus the benchmark in anticipation of increasing interest rates.