



## 2015 - The Year Ahead: December 29, 2014

As I write this letter, markets have now closed above 18,000 on the DOW three consecutive days in a row! Yes, there is a Jolly Old Saint Nick in a guise of Janet Yellen, who delivered our Santa Clause rally that was delayed by the Grinch, played by the dramatic selloff in Oil. What a year it has been!

Looking into the New Year, we expect the global economic recovery to broaden in 2015. We also believe the US should remain strong with an above-trend 3% GDP growth pace. There are several key themes that shape our outlook for 2015: most notably our ongoing geopolitical pressures, the initial steps in the normalization of monetary policy, the impact of a sustained decline in energy prices, and of course the wild card that is our good friends in Washington, D.C.

As we close out 2014, it comes as no surprise that geopolitical tensions are still present. Although turmoil in Russia, Ukraine and Middle East bears watching in 2015, in our view the majority of geopolitical hotspots are regionally contained and of limited broader economic consequence.

Despite global growth, we feel inflation will likely be contained due to economic slack and weak commodity prices. Our main concern is the economic weakness in Europe and China. Our monetary view is that global policy should remain loose, the Federal Reserve and Bank of England should begin tightening this year, while the Euro area will likely see sovereign quantitative easing (QE).

The Fed completed its Large-Scale Asset Purchase program (QE3) in 2014. The million dollar question is when will policymakers start raising short-term interest rates? As they say, "Don't Fight the Fed." We do not think investors should fear the inevitable first rate hike, which should be viewed as a positive sign of an improving economy. Monetary policy will remain loose and accommodative for some time given that the Fed will tighten policy gradually once they begin. In addition, it will take ten-plus years for the Fed to shrink its balance sheet after they stop reinvesting mortgage principal payments and Treasury securities in its portfolio.

In energy, plummeting oil prices have certainly been grabbing headlines and keeping a few Texans shaking in their boots. The dramatic selloff in oil is partly due to lower demand, but also reflects OPEC's strategy to starve out higher-cost producers. Crude closed out 2013 at \$98.42, was ~\$91 at the end of September, and now is hovering around ~\$56. We are pleased with our October 14<sup>th</sup> call to remove our energy overweight, as we think that oil will remain low in 2015 due to the fact that it could take twelve to eighteen months to re-establish market equilibrium.

Entering 2015, here is our asset class investment outlook that will drive our Texas Capitol Group Portfolios.

### **Overweight Domestic Equity - Go USA!**

US Equities are primed to edge higher in 2015 as above trend US growth supports mid-single digit total return in line with profit growth. We are more bullish on domestic equity versus international equity markets.

### **International Rebound**

We feel that developed international and emerging markets could be poised for a rebound. Japan and Europe might surprise to the upside given attractive valuations, and we see attractive earnings yield in Emerging Markets due to positive momentum and supportive macroeconomic conditions. Despite this, broad-based outperformance relative to domestic markets seems unlikely.

## **Overweight Value**

Last year we had more of a growth tilt in our portfolios. During 4Q14 we started establishing a value bias with some dividend focused strategies. Currently, markets have positive sentiment for value equities. We believe a value tilt will help dampen volatility as we enter the seventh year of our bull market, especially if market conviction begins to wane.

Although there are a number of issues to watch out for in early 2015, we feel the U.S. economy is in very good shape and will likely benefit from economic weakness abroad. As we make these adjustments in our portfolios to better position ourselves for 2015, we would like to take the time to wish you all a happy, healthy and prosperous 2015!

Warmest regards,

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