FPS
FINANCIAL, INC.

919 Old Highway 8 NW, Suite 400
New Brighton, MN 55112
651.633.2689 • FAX 651.633.2847
www.fpsfinancial.net

July 1, 2013

SECOND QUARTER 2013:
More volatility, but not unexpected

Dear Investor,

After a period of relative calm, volatility has returned to the stock market in recent weeks. Over the first five months of 2013, the S&P 500 Index[1] experienced a move of 1% or more on just 15 trading days, or just 15% of the time. Since hitting an all-time high on May 21, however, the S&P 500 moved 1% or more on 40% of the trading days since the end of May.

The bond market has also become a bit jumpy in recent weeks, with prices tumbling and yields rising. The yield on the benchmark 10-year U.S. Treasury bond[2] spiked from 1.61% on May 1 to 2.67% on June 25, before closing the quarter at 2.49%

What's behind this sudden resurgence in volatility? In short, fears about the impact of rising interest rates. At its most recent policy meeting, the Federal Open Market Committee signaled that it might start to curtail its "quantitative easing" bond buying program, which has helped keep interest rates at extremely low levels. In its statement, the Fed indicated that such a tapering would occur only "if the incoming data support the view that the economy is able to sustain a reasonable cruising speed." Any move to raise short-term interest rates "is still far in the future."

The Fed's careful parsing of its words did little to calm traders. Stocks immediately sold off on the news, with the S&P 500 experiencing its steepest one-day decline since November 2011. This type of increased volatility can be unnerving, but it's not unexpected or unusual. Over the one-year period ended June 30, the S&P 500 has rallied 20.60%. That's a solid gain, so a bit of profit taking is no immediate cause for concern, in my view.

In regards to the potential for higher interest rates, I believe it's unrealistic to expect the abnormally low interest rates that we have experienced since the financial crisis of 2008-09 to persist forever. In fact, I view a return to historical interest rate levels as a positive sign that the economy has moved from intensive care to a more stable condition. While home and auto loans will become more expensive if rates continue to rise, investors who rely on income-oriented securities to generate income will see a welcome increase in their monthly revenues.

Higher interest rates are not the only sign of a strengthening U.S. economy. The housing market recovery is moving full steam ahead, and consumer confidence is at its highest level in nearly six years. Higher home prices (along with higher stock prices) tend to have a "wealth effect" that loosens consumers' purse strings. Consumer spending drives about 70% of our economy, so if consumers are feeling flush, that's typically good news for the overall economy. A strong economy generally helps drive corporate profits higher, which may in turn propel stock prices.

As I look ahead to the second half of the year, I won't be surprised if we see continued volatility in the stock and bond markets. If you find yourself getting unnerved, I encourage you to turn off the TV or computer, put down the newspaper, go for a walk, or simply give me a call to discuss your portfolio and your long-term goals.

Hope you had a safe and fun 4th of July holiday!

Sincerely,

Mike Ovshak
CFP®

[1] All indices are unmanaged and investors cannot invest directly into an index. Past performance is not indicative of future results. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. Diversification does not assure a profit or protect against a loss in declining markets.

[2] Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest, and, if held to maturity, they offer a fixed rate of return and fixed principal value. U.S. Treasury bills do not eliminate market risk. The purchase of bonds is subject to availability and market conditions. There is an inverse relationship between the price of bonds and the yield: when price goes up, yield goes down, and vice versa. Market risk is a consideration if sold or redeemed prior to maturity. Some bonds have call features that may affect income.