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Second Quarter 2014 Market Update: Economy and markets heating up with summer's arrival

Dear Investor,

In last quarter's letter, I wrote about the negative impact that this past winter's harsh weather was having on the economy. Sure enough, last week the Commerce Department reduced its final estimate of first quarter Gross Domestic Product activity to reflect a 2.9% *decline*.

You might assume that an economic contraction of this magnitude would result in a stock market selloff. Yet the S&P 500 Index¹ rose 3.96% during the second quarter and is up 7% at the year's mid-point. Meanwhile, a much anticipated bond market selloff has also failed to materialize. In fact, bond prices rallied further during the second quarter, with the yield on the 10-year U.S. Treasury bond declining from 2.70% to 2.52%.

Why did stock and bond values rise as the economy was contracting? Because the markets are forward-looking entities. And, as many investors and traders look to the future, they are seeing strong evidence of an improving economy, notwithstanding the weather-related slowdown during the first quarter. These positive signs include:

- **Renewed Consumer Confidence.** According to the Conference Board's June survey, consumer confidence is at its highest level since January 2008². When people are feeling better about the economy and their own financial situation, they are more likely to spend their money. Consumer spending drives about 70% of all economic activity, so consumer confidence is critical.
- **A Rebound in Housing.** Sales of new homes³ rose nearly 19% in May, representing the biggest one-month jump in 22 years and matching the highest annual level in six years. Sales of existing homes⁴ also rose 4.9% in May to the highest level in seven months. These monthly indicators are highly volatile, but the overall trend appears to be moving in a positive direction.
- **A Strengthening Employment Picture.** The pace of new-job creation has quickened in recent months. U.S. employers added 217,000 new jobs in May and the average over the previous three months was 234,000. The total number of people working is now above the previous peak reached in January 2008⁵.

Of course, we always need to be prepared for an economic downturn or other events that have the potential to upset the apple cart. The recent turmoil in Iraq, Syria and Ukraine underscores how international events can quickly escalate. Similarly, domestic political squabbles, Fed policy changes, and natural disasters here at home are always a threat. So, while I'm optimistic about the near-term outlook for the U.S. economy, I will continue to scan the horizon for approaching storm clouds.

As we celebrate Independence Day, I also encourage you to take a moment to reflect on how blessed we are to live in this great nation. While we all have our differing political views, our challenges and hardships pale in comparison to what people in many other parts of the world have to endure. Thank you for your continued trust.

Sincerely,

A handwritten signature in blue ink that reads "Mike".

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. Percentage values from finance.yahoo.com.

² Source: https://news.fidelity.com/news/news.jhtml?cat=Economy.US&articleid=201406241101MRKTWTCHNEWS_SVC000204&IMG=N

³ Source: https://news.fidelity.com/news/news.jhtml?cat=Economy.US&articleid=201406241532MRKTWTCHNEWS_SVC000343&IMG=N

⁴ Source: https://news.fidelity.com/news/news.jhtml?cat=Economy.US&articleid=201406231509MRKTWTCHNEWS_SVC000216&IMG=N

⁵ Source: <http://blogs.wsj.com/economics/2014/06/06/highlights-from-the-may-jobs-report/?KEYWORDS=employment>