HBK Wealth Management

Haire · Bohmer · Kilcoyne

WEEKLY MARKET COMMENTARY

A Candid Look into the Current State of the Markets

April 2014

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

David Haire
HBK Wealth Management
President
9075 Centre Pointe Dr.
Suite 100
West Chester, OH 45069
513-942-9700
Fax: 513-942-9701
d.haire@hbkwealthmanagement.com
www.hbkwealthmanagement.com

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Highlights

This has been the weakest earnings cycle in 55 years. Earnings growth needs to improve to support valuations and drive the stock market higher. Fortunately, growth may be set to improve in the coming quarters.

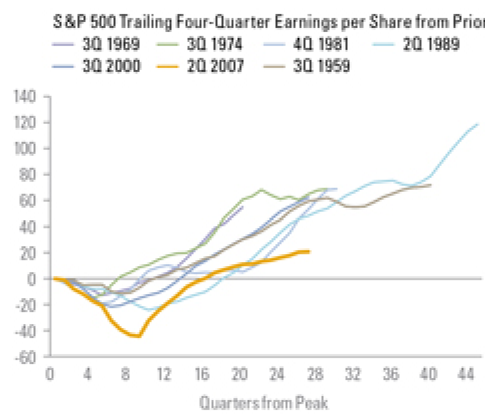
The Weakest Earnings Cycle in 55 Years

This has been the weakest earnings cycle in 55 years. Every earnings cycle over the past 55 years has generated about a 7% annualized earnings per share (EPS) growth rate, when measured from peak to peak or from trough to trough. The best multi-year earnings cycle measured from prior peak to the next peak was an annualized 9.1% and the worst 5.6%, with most clustered tightly around the average of 7.3% [Figure 1]. This is notable given the differing levels of inflation, interest rates, and economic growth that companies had to adapt to in each cycle. However, the current cycle -- while not yet over -- has been much weaker than the average, generating only a 2.8% annualized growth rate from the prior cycle peak in the second quarter of 2007 through the first quarter of 2014.

Most prior earnings cycles had already climbed 50-70% above their prior peak at this point in the cycle. However, the current cycle has only exceeded the prior peak by about 20%, which can be attributed to two factors:

- First, the trough in earnings was much deeper, magnified by the severity of the recession. Financial companies wrote off many years of gains in just a few quarters.
- Second, the momentum of the earnings recovery over the past few years has been subpar -- tracing a much flatter line than in prior cycles.

1 The Weakest Earnings Cycle in 55 Years



Prior Peak	Annualized Growth Rate
3Q 1959	5.6%
3Q 1969	9.1%
3Q 1974	7.5%
4Q 1981	7.2%
2Q 1989	7.2%
3Q 2000	7.4%
Average	7.3%
2Q 2007	2.8%

Source: LPL Financial Research, Thomson Financial 04/14/14

Past performance is no guarantee of future results.

Earnings growth for the first quarter of 2014 does not seem to be improving, with growth appearing to stall on a year-over-year basis. The Thomson Financial-tracked consensus of Wall Street analysts expects growth to be just 1%.

Earnings growth needs to improve to support valuations and drive the U.S. stock market higher. The increase in the price-to-earnings ratio over the past year -- with stock prices rising faster than corporate earnings -- has been a focus of investors lately. Worries among market participants that this type of growth is unsustainable have led to sharp declines among some "bubbly" stocks in certain industries.

Earnings growth is critically important to generating and sustaining gains in the stock market over the long term. For example, from the prior peak in the earnings cycle, 27 quarters ago (June 30, 2007), S&P 500 earnings per share are up 21%, while the S&P 500 Index is up a similar 21% over the same period, as of 04/11/14.

Fortunately, growth may be set to improve in the coming quarters. Earnings growth in the first quarter of 2014 was likely dragged down by extreme weather conditions affecting sales, production, and supply chains. This is not a surprise, so rather than counting how many companies cite weather as a factor, or "excuse," in their earnings discussions, the market may be watching closely for how many businesses cite an improving trend emerging toward the end of the first quarter as weather began to normalize. Typically in any weather-related disruption, 25-35% of the economic activity is lost, but the majority of it is just deferred. The pent-up demand should boost second quarter results. We are already seeing it in rebounding shipping traffic and new orders. Most notably, the widely followed Institute for Supply Management (ISM) Purchasing Managers' Index has a solid track record forecasting earnings growth in coming quarters [Figure 2]. While the ISM slid in the first quarter -- largely tied to the impact of the extreme weather -- this indicator points to a 5-10% earnings-per-share growth rate on a year-over-year basis in the coming quarters as the economy thaws from the first quarter deep freeze.

2 Reliable Earnings Indicator Pointing to 5 – 10% EPS Growth

Source: LPL Financial Research, Thomson Financial, Bloomberg data 04/14/14

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Positive forward guidance from corporate leaders may boost confidence in future earnings growth and help to lift stocks in the coming weeks. In general, earnings season tends to be a good period for stock market performance. Stocks posted gains during the six-week period that runs from two weeks before to four weeks after Alcoa reports since the bull market began around the start of the second quarter of 2009. In fact, since the end of 2009, 94% of the gain in the index came during those quarterly periods, leaving nothing, on average, but volatility during the other seven weeks of every quarter.

It is hard to draw conclusions from the handful of earnings results for the first quarter reported so far given the impact of very company-specific factors. For example, Alcoa's earnings were hurt by a decline in aluminum prices. However, this week over 10% of the S&P 500 companies report their first quarter results and offer guidance on the second quarter and beyond. These include plenty of bellwethers that reflect broad business trends such as IBM, Coca-Cola, and Union Pacific. By the end of this week, market participants should have a good sense of whether earnings are likely to re-accelerate and support the stock market.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock and mutual fund investing involves risk including loss of principal.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

The P/E ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher P/E ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower P/E ratio.

The company names mentioned herein was for educational purposes only and was not a recommendation to buy or sell that company nor an endorsement for their product or service.

INDEX DESCRIPTIONS

The Institute for Supply Management (ISM) index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

This research material has been prepared by LPL Financial.

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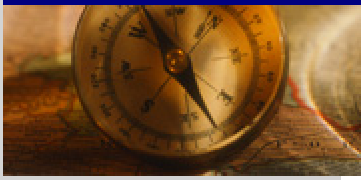


Weekly Economic Commentary | Week of April 14, 2014

Highlights

- The stabilization in growth forecasts for both 2014 and 2015 is a sign that perhaps the market is more confident now that the global economy is in the middle innings of an expansion.
- While the forecasts for GDP growth for 2014 and 2015 have generally moved higher for developed economies over the past 18 months, growth estimates for emerging market economies have generally moved lower.
- We do not expect a "hard landing" in China over the next few years; however, we believe investors who expect China to return to the 10%-plus growth rate of the early to mid-2000s will likely continue to be disappointed.
- Accelerating growth in the Eurozone would be a big boost for global growth, but thus far, the best the Eurozone has managed is stability.

Gauging Global Growth in 2014 & 2015

Developed Markets Grow, While Emerging Markets Slow

The outlook for global growth is important to investors, since it defines the ultimate pace of activity that creates value for countries, companies, and consumers. This week, we will look at how estimates for economic growth for 2014 and 2015 in the United States and across the globe have evolved over the past few years.

The International Monetary Fund (IMF) released the spring edition of its semi-annual global economic outlook early last week. Although the release garnered plenty of headlines in the media, for the most part, financial market participants took little notice of the report. Why? Because consensus forecasts for global gross domestic product (GDP) growth are available monthly from sources like Bloomberg News, and because markets react to changes in projected paths of economic growth every day amid the daily, weekly, and monthly drumbeat of economic data and events from around the globe.

Why Global GDP Growth Matters

Although prospects for U.S. economic growth have generated the most headlines, in recent years, markets have focused more on the prospects for global GDP growth. Why does global GDP growth matter? As we have noted in prior *Weekly Economic Commentaries*, financial markets -- especially equity markets -- focus intently on earnings. Broadly speaking, earnings growth is driven by "top-line" growth, or revenue growth, less the costs incurred earning that revenue, with labor accounting for more than two-thirds of total costs. A good proxy for global revenue growth is global GDP growth plus inflation. Thus, the pace of growth in the global economy is a key driver of global earnings growth, and ultimately, the performance of global equity markets [Figure 1].

1 Global GDP Has Been a Good Proxy for Corporate Revenue Growth

Source: LPL Financial Research, Haver Analytics, Standard and Poor's 04/11/14

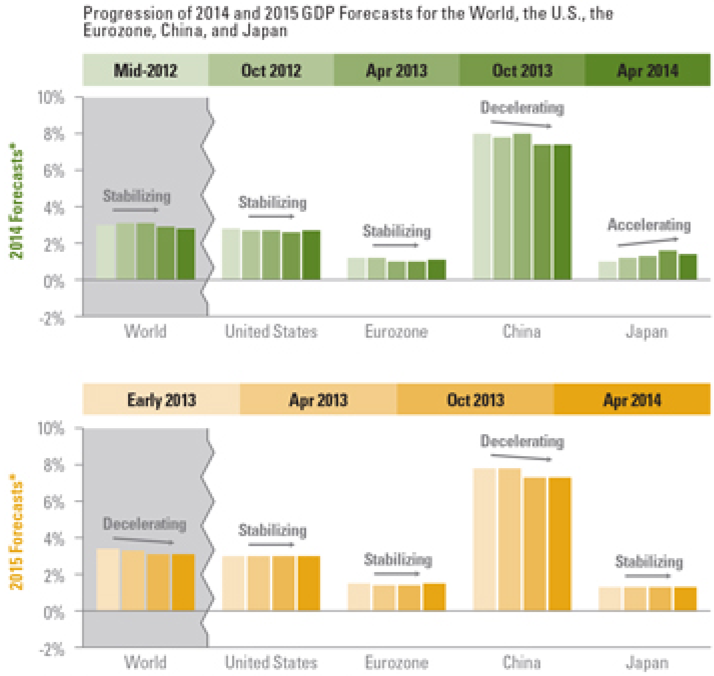
Past performance is no guarantee of future results.

The latest (mid-April 2014) Bloomberg-tracked economist consensus forecast for 2014 global GDP growth stands at 2.8%, little changed from the 2.9% expected for 2014 back in October 2013 and the 3.1% forecast made in April 2013. In mid-2012, when Bloomberg first began tracking consensus estimates for global GDP growth for 2014, the consensus was expecting 3.0% world GDP growth in 2014. For 2015, the consensus now expects 3.1% growth, the same as the forecast made in October 2013. A year ago (April 2013) the consensus was looking for 3.3% growth, and in early 2013, when Bloomberg first began tracking consensus estimates for global GDP growth for 2015, the consensus was looking for a 3.4% gain in global GDP in 2015. On balance, the stabilization in growth forecasts for both 2014 and 2015 is a sign that perhaps the market is more confident now that the global economy is in the middle innings of an expansion, rather than still in, or lurching toward, another recession.

Although global growth forecasts have stabilized in the past 18 months or so, they are still below forecasts made for 2014 and 2015 back in 2012 and early 2013 [Figure 2]. The downgrade to growth expectations for 2014 and 2015 since mid-2012 reflects several factors:

- The ongoing slowdown in China's economy in response to the monetary and fiscal tightening implemented over 2010 and 2011;
- The ongoing transition in China's economy from an export- and infrastructure-led growth profile to a more consumer-oriented growth profile;
- Fears of asset bubbles in China further hampering the transition noted in the bullet above;
- The ongoing uncertainty in Europe surrounding the future of the Eurozone, and the strains those concerns are having on the European financial system and European economy, which remains mired in slow-growth mode; and
- The drag from fiscal policy, and lately, unusually harsh winter weather, in the United States.

2 Stability in Global Growth Forecasts for 2014 and 2015 Is a Positive Sign for Markets



Source: LPL Financial Research, Bloomberg 04/11/14

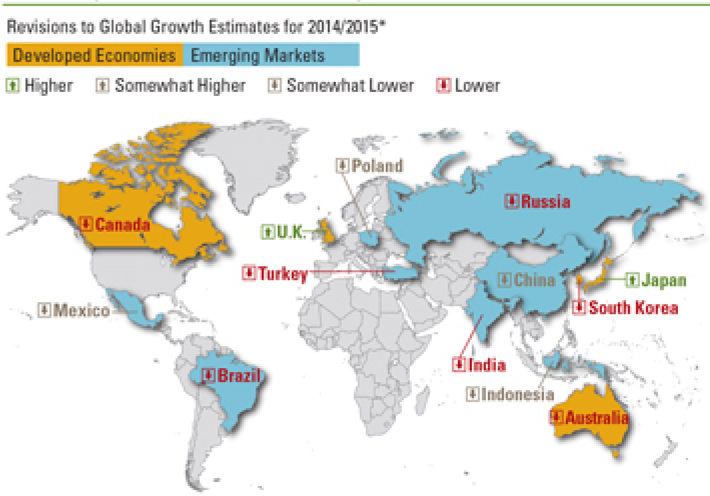
*Forecasts for 2014 and 2015 made in 2013 and 2014

Forecasts for Developed Market Economies Stabilizing, While Forecasts for Emerging Market Economies Still Moving Lower

Beneath the surface of a relatively stable outlook for global growth, a somewhat unfamiliar pattern is emerging. While the forecasts for GDP growth for 2014 and 2015 have generally moved higher for developed economies over the past 18 months or so, growth estimates for emerging market economies have generally moved lower. This is the exact opposite of what occurred between 2001 and 2007 and in the early years of the current economic expansion that began globally in early 2009.

There are exceptions in both camps, however [Figure 3]. In the developed world, the United Kingdom -- despite its strong economic ties to the Eurozone -- has seen its GDP growth estimates for 2014 more than double over the past year (from around 1.5% in early 2013 to 2.8% today) while the estimates for 2015 have moved from around 2.0% to 2.5% today. Japan--thanks to aggressive monetary and fiscal stimulus -- has seen its GDP growth estimate for 2014 move substantially higher (from 0.8% in early 2012 to around 1.5% today).

3 Looking Beneath the Surface of the Changes to Global Growth Estimates



Source: LPL Financial Research, Bloomberg 04/14/14

*Forecasts for 2014 and 2015 made in 2013 and 2014

On the other hand, developed economies like South Korea, Canada, and Australia -- all of which have strong ties to emerging market economies -- have seen their growth estimates for both 2014 and 2015 cut substantially over the past 18 months. For example, in mid-2012 the consensus estimate for GDP growth in

South Korea for 2014 was 3.8%. Today, the consensus expects just 2.1% growth in South Korea this year and just 2.5% in 2015.

Within the emerging markets, the eight largest economies (China, Brail, Russia, India, Mexico, Indonesia Turkey, and Poland) have all seen their growth estimates for both 2014 and 2015 revised lower over the last 18 months. China, Mexico, and Poland have seen their growth estimates revised down the least for 2014, while 2014 GDP growth estimates for Brazil, Russia, India, and Turkey have been cut by more than half in the past 18 months. Many emerging market economies continue to struggle with high inflation and big movements in their current account balances (importing more goods, services, and capital than they export), driven in part by the Federal Reserve's (Fed) moves to begin to slow -- and eventually end -- its quantitative easing program.

Looking at 2015 estimates, Mexico, with its strong ties to the U.S. economy, and Poland, with its strong ties to the relative stability of the Eurozone, have seen their GDP estimates remain stable over the past several quarters. Russia has had its GDP estimate for 2015 cut in half over the past several quarters, and the longer the unrest involving Ukraine persists, the more the estimates are likely to be cut. Brazil's GDP estimates for 2015 continue to be cut, despite the likely boost to economic growth from the upcoming World Cup (2014) and Summer Olympics (2016). Estimates for GDP growth for 2015 in India and Indonesia appear to have stabilized in recent months.

Impact of China on Global Growth

China, which boasted 10-12% real GDP growth between 2001 and 2007, has been a global growth engine since the early 2000s. China's economy was one of the first to turn around after the global financial market meltdown in 2008, and its economy grew 11% in 2009, reviving hopes that China's decade -- long run of 10% GDP growth would resume. Chinese authorities, however, who were worried about a spike in inflation--especially food inflation -- began to ratchet up reserve requirements and interest rates in early 2010 and continued to tighten monetary policy until mid-2011.

Since then, investors waiting for a re-acceleration in Chinese economic growth to the 10%-plus pace seen in the early to mid-2000s have been disappointed, and market participants continue to mark down their 2014 and 2015 GDP growth outlooks for China. The consensus GDP growth estimate for 2014 now stands at 7.4%, the same as the 7.4% forecast made back in October 2013, but well below the 8.0% forecast made in mid-2012. Looking out to 2015, the consensus now expects the Chinese economy to decelerate to 7.3%, down 0.5% from the forecast made a year ago, in April 2013.

Despite the slowdown in its pace of growth, China's economy remains the second largest in the world. While we do not expect a "hard landing" (a sharp deceleration to 5-6% GDP growth) in China over the next few years, our view remains that investors who expect China to return to the 10%-plus growth rate of the early to mid-2000s will likely continue to be disappointed. China will report its first quarter 2014 GDP figure later this week. China is experiencing more bad loans and some defaults on bonds and trust products, and more are likely coming. But China's "shadow banking" system (money lent out by non-banking institutions) accounts for no more than 15% of its GDP, and the debt is not leveraged or securitized. Therefore, unlike in the West, failures among these loans do not have the same power to generate a systemic financial crisis as we saw among U.S. financial institutions in 2008-09.

Growth Estimates Have Stabilized in the Eurozone

As we have noted in several recent *Weekly Economic* and *Weekly Market Commentaries*, the Eurozone's economy has stopped getting worse. However, our view remains that the Eurozone is unlikely to improve significantly until its leaders can repair the region's broken financial transmission mechanism -- the ability of Europe's banking system to provide much needed credit to Europe's consumers and small and medium sized businesses -- and address the banking, regulatory, and labor issues that are severely hampering growth. After bottoming out at 1.0% in early 2013, the consensus forecast for GDP growth in 2014 has now stabilized at just 1.1%. In early 2012, markets were expecting 2.4% GDP growth in the Eurozone this year. Growth prospects for 2015 have stabilized as well, and currently stand at 1.5%, just above the 1.4% forecast made in October 2013, and the same as the forecast for the Eurozone economy made in early 2013.

The key for markets here is the stability of the recent forecasts. In turn, that stability likely stems from the notion that the odds of a breakup of the Eurozone, while not zero, seem remote given the actions taken by Eurozone officials over the last 12-18 months. Looking ahead, accelerating growth in the Eurozone would be a big boost for global growth, but thus far, the best the Eurozone has managed is stability.

Harsh Winter Weather Hurt GDP Growth in Q1 2014, but We Still Expect GDP Growth in 2014 to Be 3.0%

The consensus for 2014 real U.S. GDP growth now stands at 2.7%, up 0.1% from the 2.6% expected by the consensus back in October 2013, but the same as the forecast made a year ago in April of 2013. When Bloomberg first began tracking consensus estimates for 2014 U.S. GDP growth back in early 2012, the estimate was 2.8%.

Our forecast for U.S. GDP growth in 2014 remains at 3.0%, and we expect that the economy will accelerate in the second quarter of 2014, after a harsh winter likely held down GDP growth to less than 2.0% in the first quarter of 2014. The U.S. government will report first quarter 2014 GDP on April 30, 2014.

The consensus forecast for 2015 for U.S. GDP growth remains at 3.0%, where it has been for the past year. Similar to the recent stability of the consensus forecasts for global growth, the stability of the 2014 and 2015 GDP growth forecasts for the United States over the past year to 18 months is informative. In our view, it is a sign that most market participants are comfortable that the U.S. economy is firmly in the middle part of the economic recovery, with little chance of recession in the next two years. LPL Financial Research will provide an update to our 2014 GDP forecast in our upcoming *Mid-Year Outlook 2014* publication, due out in late June 2014. We will continue to monitor these trends in the global economy and provide regular updates on the pace of global growth.

Women Are Saving Less

One of the findings in Aon Hewitt's *2013 Universe Benchmarks Report* is that women are saving less for retirement than men.

Although men and women participate in their employers' defined contribution plans at the same rate, women are saving less: 6.9% of pay for women versus 7.6% for men. Also, women are contributing below the threshold for the employer match in greater numbers than men.

While women and men receive loans from their retirement savings plans at relatively equal rates, women are more likely than men to default on a loan upon terminating employment. Almost three-quarters (71%) of women defaulted following termination, while only 64% of men defaulted.

Aon Hewitt recommends that women start investing earlier and contribute more, take full advantage of the employer match, and use automatic features, such as automatic contribution increases.

Details of Aon Hewitt's study are at http://tinyurl.com/Aon2013UniverseBenchmarks.

Kmotion, Inc., P.O. Box 1456, Tualatin, OR 97062; 877-306-5055; www.kmotion.com

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