Access Investment Advisors Inc.
4400 Calumet Avenue, Suite 201
PO Box 697
Manitowoc, WI
54221-0697

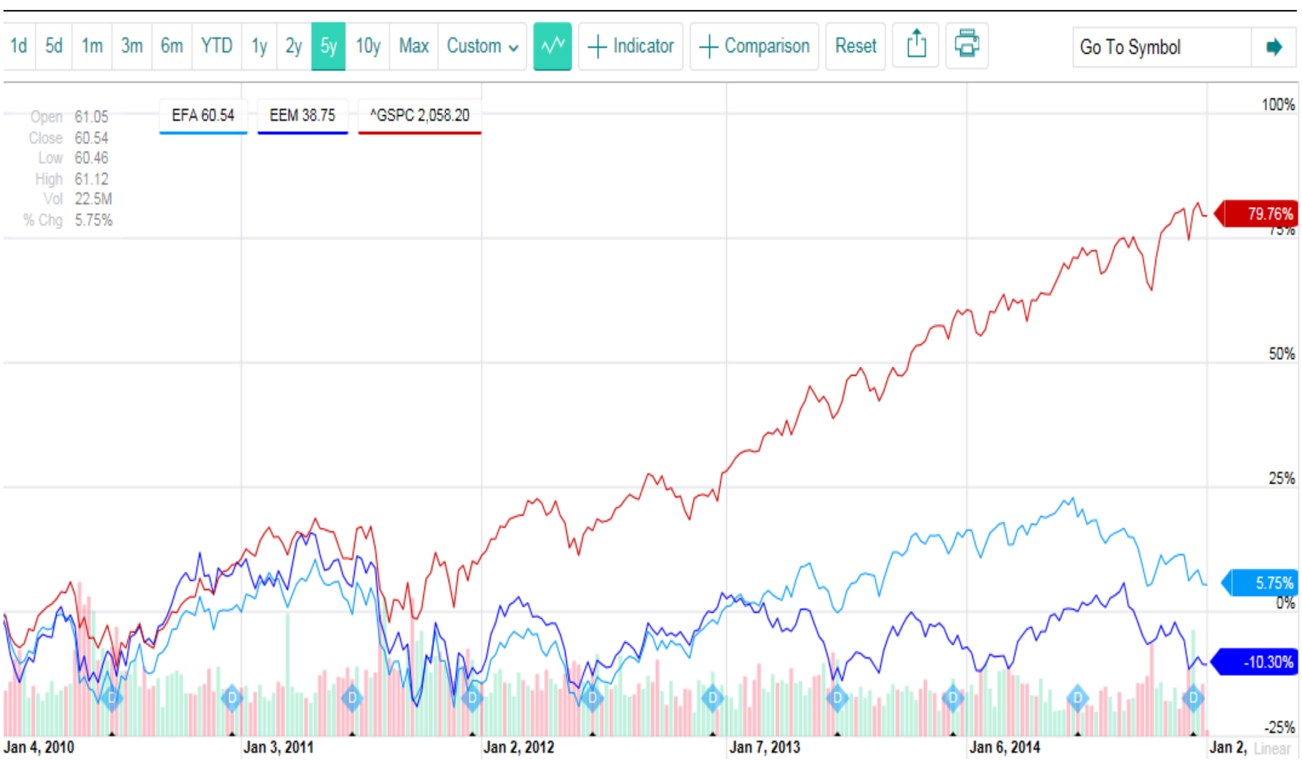
920.683.9901
FAX: 262.364.2147
www.accessinvestmentadvisors.com

January 2015

The Grand Divergence

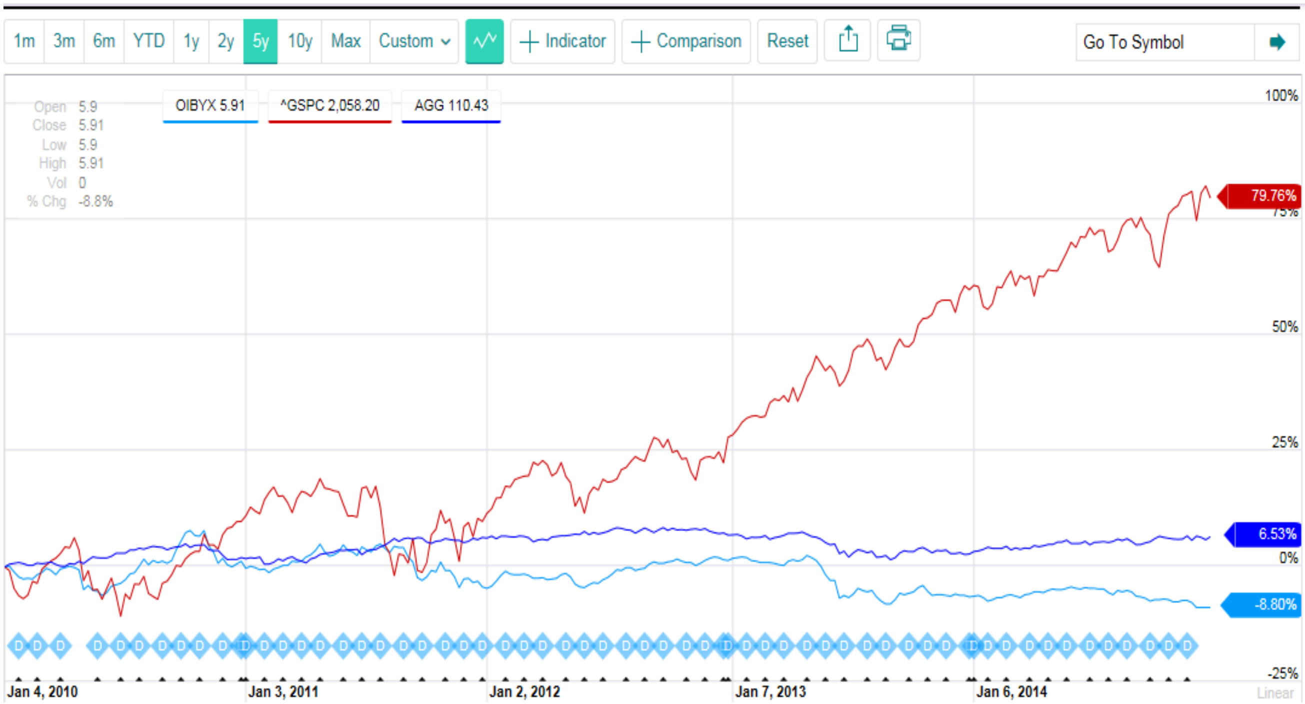
"Different roads sometimes lead to the same castle" – George R.R. Martin, A Game of Thrones

2014 certainly marked one of the most challenging years of my career. The US stock market (as measured by the Standard and Poors 500) continued to gain ground against the backdrop of a sluggish US and world economy. While the S&P 500 (^GSPC) gained over 11% for the year, most other markets were not so fortunate. The Europe, Asia and Far East index (EFA) lost more than 7% for the year, and the emerging markets of Brazil, Russia, India, China (EEM) combined for a loss of more than 2% in 2014. When you look at the five year performance of these, the divergence is even more dramatic with the US gaining close to 80% against rather anemic performance from the rest of the world.



(Over) →

For the past five years, if you'd been anywhere else but the US stock market you got left behind. This includes holding money in bonds. US bonds (AGG) gained a paltry 6.5% total return for the five years and international bonds (OIBYX) lost over 8% during that time.



Our hedging strategies didn't fare much better last year against the relentless rise of the US stock market. Combined, the strategies returned about 1% in 2014.

All of this certainly begs the question of whether our portfolios are correctly allocated. It is a fair question. It is a question, however, that cannot be answered without trying to answer several others that are equally vexing: Can the US remain a safe "island of growth" in a sea of nations weathering severe economic storms. Does the recent precipitous drop in oil prices portend a boon, or ultimate slowdown in on our, and the world economies? How will Russia respond, militarily or otherwise, to prop up its faltering under-diversified economy now that its oil revenues have been cut in half? How much of a slowdown will China experience in the near term, and what impact will that have on world exports and growth? How will the renewed strength of the US dollar affect our trade balance and economy as US imports get cheaper and exports more expensive (who will buy our stuff)? Will the Japan experiment of massive Quantitative Easing be enough to overcome a rapidly aging population with an entitlement system that is already overburdened, or will it continue to be a drag on world economic growth?

Over the past several years, an internationally diversified portfolio has clearly been for "suckers". After all, to make money, all one need do is put it all on "red seven" on the US stock market roulette wheel. That, of course, is a call best made after the ball drops. True diversification requires investments in multiple assets/markets simultaneously that are not highly correlated to each other. Trying to pick the next hot market sounds alluring, but is decidedly difficult.

That being said, we will be making some tactical shifts in 2015. When we began the process of incorporating the hedging strategies into our portfolios, I made the decision to reduce our equity (stocks), fixed income (bonds) and cash exposure proportionally to make room for them. After having seen them perform in our portfolios, and seen the risk reduction that they offer, we will look for an opportunity to add back some additional equity exposure and reduce our fixed income and cash holdings going forward.

The US bull market for stocks is now 70 months old, placing it in a tie for the 3rd longest bull market in recorded history. Only two bulls have had more staying power. They were the periods 1921-1929 (97 mos.), and 1990-2000 (117 mos.). Unfortunately, both of those ended rather badly. The subsequent bear markets lost 86% and 49% respectively

There is an old saying that markets don't ring a bell at the top. I'm not suggesting that the US stock market won't go higher (I'll leave that kind of hubris to the talking heads on TV), but we have not had a significant correction in over five years. Take another look at the above graphs. It is certainly possible that the divergence that exists will carry on for a very long time. However, different roads do indeed often lead to the same castle.