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After hitting an all-time high in early Q3, after The Dow Jones Industrial Average (DJIA) crossed the 17,000 level for the first time in history, this index ended Q3 at about 17040. The broader equity market indices like the S&P500 were also essentially flat for Q3; broad overseas equity market indices were down, as were indices for real-estate and precious metals. It was a lack-luster quarter.

We acknowledge the new high levels in the U.S. Equity markets and fully expect that we will see a temporary correction. We saw a drop in August and used it to reduce cash levels modestly in client portfolios. We generally prefer to hold a steady course rather than try to time or forecast the market, unless asset classes (or securities) are egregiously mispriced. We do not see such mispricing at this time.

From a world events perspective, Q3 had its share of big news: Ebola, cyber-security, Military actions in the Middle East, and a stand-off with Russia, as examples. Of course these impact financial markets and investments, but we prefer to see (rather than conjecture about) some evidence of their impact on fundamentals before making drastic changes to portfolios.

Therefore, our current investment strategy (asset allocation) continues to favor equities, remain cautious towards bonds, and maintain a neutral-level exposure to real estate and commodities.



QUARTERLY MARKET REVIEW: JULY-SEPTEMBER 2014

The Markets

Volatility returned to equities markets in Q3. A strong August was followed by losses in September, when any rallies began to focus around selected winners rather than benefitting stocks across the board. Investors exhibited a decided preference for large caps; the S&P 500 closed above 2,000 for the first time ever and the Dow industrials also set new all-time highs. The Nasdaq returned to a level it hadn't seen since March 2000 and regained the lead for 2014. However, the Russell 2000, which has struggled for most of the year, fell deeper into negative territory year-to-date, while the Global Dow suffered from political conflicts abroad and concerns about global growth.

Bond investors continued to demonstrate surprising resilience. In early September, the yield on the benchmark 10-year Treasury fell to 2.35%--a level it hadn't seen in more than a year--as prices rose.

Key Dates/Data Releases

10/1: Auto sales, ISM manufacturing report, construction spending

10/2: U.S. factory orders

10/3: Unemployment/payrolls, balance of trade, ISM services report

10/7: JOLTS report

10/8: Federal Open Market Committee minutes

10/15: Retail sales, Empire State manufacturing, wholesale inflation, Fed "beige book" report

10/16: Industrial production, Philadelphia Fed manufacturing, international capital flows

10/17: Housing starts, options expiration

10/21: Existing home sales

10/22: Consumer inflation

10/24: New home sales

10/27: Dallas Fed manufacturing survey

10/28: Durable goods orders, home prices

10/29: Federal Open Market Committee announcement

10/30: Q3 GDP initial estimate

10/31: Personal income/spending

However, as the Federal Reserve continued to taper its economic support and ramped up discussion of how and when to increase rates, demand began to taper off (though geopolitical anxieties and a strengthening dollar kept the decline in check). Gold, which started the quarter at roughly \$1,320, ended below \$1,220. It was hurt in part by a stronger U.S. dollar, which by the end of the quarter had hit its highest level against the euro in almost two years. Dollar strength coupled with weaker global demand also meant lower oil prices; a barrel fell from \$107 a barrel to roughly \$93 during the quarter, a level it hasn't seen since January.

Market/Index	2013 Close	As of 9/30	Month Change	Quarter Change	YTD Change
DJIA	16576.66	17042.90	-.32%	1.29%	2.81%
NASDAQ	4176.59	4493.39	-1.90%	1.93%	7.59%
S&P 500	1848.36	1972.29	-1.55%	.62%	6.70%
Russell 2000	1163.64	1101.68	-6.19%	-7.65%	-5.32%
Global Dow	2484.10	2534.47	-3.22%	-2.73%	2.03%
Fed. Funds	.25%	.25%	.25%	0 bps	0 bps
10-year Treasuries	3.04%	2.52%	17 bps	-1 bps	-52 bps

Chart reflects price changes, not total return. Because it does not include dividends or splits, it should not be used to benchmark performance of specific investments.

Quarterly Economic Perspective

- After contracting 2.1% in Q1, the U.S. economy grew at an annual rate of 4.6% during the second quarter. The Bureau of Economic Analysis said increases in consumer expenditures, exports, business spending on equipment, and spending by both state and local governments were major contributors to the growth. Meanwhile, after-tax corporate profits also rebounded from their Q1 slump, rising 8.6%.
- The Federal Reserve's monetary policy committee continued to unwind its economic support. Its September bond purchases were only \$15 billion, and they are scheduled to end in October. The committee also reaffirmed that the key Fed funds interest rate won't increase for a "considerable time" after that. However, a survey of members showed that most now expect steeper increases than previously estimated, with rates hitting 1.4% by the end of 2015 and 2.9% by December 2016.
- Despite a slight improvement in August's unemployment rate (6.1%), the number of new jobs added in August was a disappointing 142,000, according to the Bureau of Labor Statistics. The continued slack in the labor market is one reason cited by the Federal Reserve for its caution about raising interest rates.
- The housing recovery showed signs of tapering off. New home sales fell in both July and August, and the National Association of Realtors[®] said a shortage of the cash buyers who had helped boost existing home resales in July cut resales the following month. Housing starts and building permits also slowed in August after a strong July, according to the Commerce Department, while the rate of home price increases in

the S&P/Case-Shiller 20-City Composite Index began to taper off.

- After a strong July, manufacturing gains began to taper off. The Commerce Department said durable goods orders rose and fell based on orders for commercial aircraft, which hit a record high in July and plummeted a month later; aside from transportation, durable goods orders rose 0.7% in August. Auto production also saw a strong July and weaker August, and after six straight months of gains, the Fed's gauge of industrial production edged downward in August.
- By quarter's end, the Bureau of Labor Statistics said falling energy costs had helped cut consumer inflation by 0.2%. That left the annual inflation rate for the previous 12 months at 1.7%, down from Q1's 2.1%. The 1.8% annual inflation rate for final-state wholesale prices also was lower than Q1's 2%. The Bureau of Economic Analysis said both personal income and consumer spending saw gains throughout the quarter.
- Conflicts over Ukraine continued to raise concerns about how Russian retaliation for Western sanctions might affect the fragile European economy. A eurozone GDP that essentially flatlined in Q2 and weakness in both Germany and Italy led the European Central Bank to promise more aggressive stimulus measures.
- The Chinese economy continued to show signs of slowing in some key areas. By August, growth in industrial production was almost 7% instead of the previous month's 9%, housing sales were down nearly 11% from the beginning of 2014, and HSBC Corp.'s Purchasing Managers' Index remained at 50.2--barely above the level that would represent contraction.

Eye on the Month Ahead

With October's Fed bond purchases expected to be the last, next month's monetary policy committee announcement will be watched to see if a rate hike is still a "considerable time" away. Global investors will assess whether additional expected support from the European Central Bank is likely to help jumpstart the economy there.

Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services).

Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Past performance is no guarantee of future results. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful.

The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks. The Global Dow is an

equally weighted index of 150 widely traded blue-chip common stocks worldwide. Market indices listed are unmanaged and are not available for direct investment.

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