2015 Market & Economic Outlook

MEMBERS® Trust Company

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Equity Market Outlook - Jason Ritzenthaler, CFA, CTFA

The US equity market continued a run of six straight positive years with the S&P 500 gaining 13.68%. In fact, the last three years have seen an increase of 74.6% and over 240% since the March 2009 lows. An improving US economy and record corporate profits contributed to the fundamentals of the equity returns. Utilities led the way with a return of 24.29% after being the worst performing sector of 2013. With the price of oil declining over 50% since June, it should be no surprise that the energy sector was the worst performing for the year at a decline of nearly 10%. Telecom was the only other sector to experience negative returns with a loss of 1.91%.

In a reversal of 2013's out-performance, US small companies (as measured by the S&P 600 index) struggled to keep pace with their larger brethren. US small cap spent the first six months of the year climbing back into positive territory as we saw an early move to more defensive areas of the equity markets, but they finished the year with a gain of 5.74%, about half of that coming in December. The small cap energy space was especially hard hit with a year-over-year decline of 36.2%. 10 of the 35 energy companies in the index lost over 50% of their value [1].

Corporate earnings largely kept pace with stock market price increases for much of the year with earnings per share growing over 18% the first 3 quarters. Expectations for fourth quarter earnings have come down significantly since September 30th, starting at 8.4% growth and now sitting at 1.1%. Most of those decreases came in the energy sector with an expected decline of 19.1%. Despite the bar being lowered by analysts and companies providing negative forward guidance, all-time record corporate profits and profit margins are expected for 2015 [2].

Equity market valuations remain within normal ranges, but have moved towards the higher end in the US. (see chart 1, page 2)

International equity markets struggled with the developed markets MSCI EAFE index declining 4.2% and the MSCI Emerging Markets index down 2.11%. Declines in the developed markets were broad based with MSCI Europe, Japan, and Pacific ex Japan all down 5.55%, 3.37%, and 1.49% respectively. The emerging markets saw more differentiation among equity markets. MSCI India and China led the way within the BRIC countries increasing 23.87% and 8.26% respectively. The ongoing economic effects of sanctions on Russia, the decline in oil, and the Petrobras corruption scandal all played roles in the struggles of Russian and Brazilian equity markets with MSCI Russia down 45.86% and MSCI Brazil declining 13.74%.

International investments last out-paced their US counterparts in 2012. Our investment team believes some of the US out-performance will reverse in 2015 as the landscape changes. The US Fed is no longer actively engaged in Quantitative Easing (QE) with the end of QE3 in October, which is in contrast to what we are seeing in Japan and Europe. Prime Minister Shinzo Abe appears intent to continue QE, securing greater control after recent snap elections in Japan. The ECB also has moved closer to full blown QE after expanding their asset backed security purchasing and a perceived loosening of opposition from Germany. The long-term value of QE is a hotly debated topic but what QE1, QE2, and QE3 showed us here in the US is that asset prices tend to rise. The S&P 500 gained over 40% during QE3. We believe a similar pattern may develop internationally. Longer-term, international developed markets

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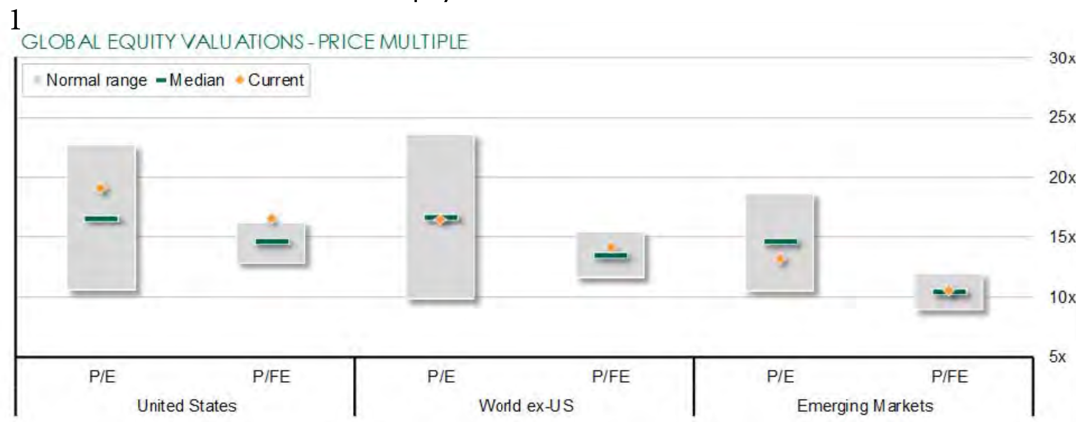
Equity Market Outlook (from page 1)

have out-performed the US in 4 of the last 10 years and emerging markets 5 of the last 10 years. Asset class diversification is a critical component to a diversified portfolio, and international investments play an important role. The chart below highlights the historical tug-of-war between US and international equity markets. (see chart 2)

[1] S&P Indices

[2] FactSet Earnings Insight

1



Source: Northern Trust, MSCI. Monthly data through 12/31/2014. Indices are MSCI US, MSCI World ex-US, and MSCI Emerging Markets; US and World ex-US data begin in 1970, EM data begin in 1995. Normal Range: +/- 1 standard deviation from the median. LT: long-term.

2

S&P 500, MSCI EAFE Take Turns Outperforming

From	To	Outperformer	By
Apr. 30, 1971	Mar. 30, 1973	MSCI EAFE	62.2%
Mar. 30, 1973	Oct. 31, 1976	S&P 500	30.5
Oct. 31, 1976	Oct. 31, 1980	MSCI EAFE	90.0
Oct. 31, 1980	Oct. 31, 1982	S&P 500	34.1
Oct. 31, 1982	Feb. 28, 1989	MSCI EAFE	409.4
Feb. 28, 1989	Aug. 31, 2000	S&P 500	490.6
Aug. 31, 2000	Nov. 30, 2007	MSCI EAFE	60.5
Nov. 30, 2007	Oct. 31, 2014	S&P 500	58.4

Source: Bloomberg as of Oct. 31, 2014

Jason Ritzenthaler CFA, CTFA

"Our investment team believes some of the US out-performance will reverse in 2015 as the landscape changes."

Geo-Political Update —Sheldon Reynolds, CFA

When making our forecasts, we always keep in mind that various events around the globe can affect both market conditions and the assumptions on which our forecasts are made. These considerations are an ongoing part of our investment management process. For 2015, we are keeping our eyes on several potential geopolitical risks and monitoring their effects on our outlook and the markets.

Negative consequences from oil price decline – While the decline in oil prices is a boon to the average American consumer, it is a net negative for countries that rely on oil exports as a large part of their economy. Russia, Venezuela, Nigeria and Saudi Arabia are the names that typically come to mind. Declining economic conditions in most of those countries due to lower oil prices is not likely to spread to other economies. However, concerns exist that if the economic conditions in Russia decline rapidly, the Putin regime may expand its incursions into Ukraine or other neighbors as a political strategy to firm up support within the Russian populace.

Chaotic conditions in IRAQ and Syria could spread – 2014 saw the brutal ISIS regime take over large parts of territory in Iraq and Syria. Neither the United States nor other NATO nations appear to have an appetite

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Sheldon Reynolds CFA

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Geo-Political Update (from page 2)

for any significant military involvement in the area. However, additional brutal executions of Westerners could change this stance. Additionally, an end to either the Syrian or Iraqi governments could lead to ISIS or like-minded groups becoming emboldened and expanding their incursions into other nearby countries.

Ebola could spread unexpectedly – While it appears that this in an unlikely scenario, the further spread of Ebola outside of western Africa could create fears which may cause negative repercussions in world markets. The 2014 Ebola deaths in the U.S. brought renewed focus on this disease.

Cyber terrorism could grow - The recent hacking of Sony Pictures, which is believed to be the work of the North Korean government or their allies, demonstrates the potential capabilities of terrorists or rogue states to exact retribution from those they view as enemies. It is too early to tell whether or not this is a sign of things to come or an isolated event. At a very minimum, it is likely to cause many companies across the globe to commit more resources to cyber security and security in-general.

Greece, again, really? - Some political forces inside of Greece are calling for the abandonment of austerity measures related to their previous bailout. It is likely that elections in late January will determine the future path of economic reform in this country. Investors are once again becoming concerned about Greek government bonds with yields rising in recent weeks. While Greece is a small part of the European Union, we have previously seen negative consequences to other EU states from Greek economic problems.

Fixed Income Outlook —Kate Braddock, CFA

Bond markets rallied in 2014 as the Federal Reserve Bank remained accommodative. The Barclays Aggregate index was +5.97%. The rally in longer dated treasuries in 2014 caught most by surprise. In 2013, the ten year bond yield had spiked from 1.76% to 3%, most expected rates to continue to rise to 3.5%. Rather, we saw the opposite occur. The yield on the ten year ended 2014 down 80 basis points at 2.2%. The market continues to see overseas demand for US treasuries outweighing the pressure for rates to rise. It is a game of relativity in which US rates are still attractive to many foreign buyers and the US continues to be seen as a safe haven in these times of geo-political upheaval.

Later this year, it is expected that the Federal Reserve Bank will begin to raise rates from the current levels of 0-0.25%, set in 2008. There are two main economic indicators that are being watched, employment and inflation. Altogether, employers added 2.95 million jobs in 2014, the biggest calendar-year increase since 1999. Monthly job increases averaged 289,000 per month in the final three months of the year, compared with 246,000 per month for all of 2014 and 194,000 for 2013. December was the 11th consecutive month of job gains and the unemployment rate now stands at 5.6%. Inflation remains tame and, with the recent 50% price drop, oil prices are not expected to be a concern. We expect to see the Federal Funds Rate rise toward 1% by year end 2015

The market is so focused on the question of when will the Federal Reserve raise rates that it is not addressing the more important question of how much will rates rise? Our expectation is that although we will see the Federal Funds Rate rise from its current level of 0; it will top out at around 2%, well below historical averages of 3-4%. Once the Federal Reserve Bank begins to

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Kate Braddock CFA

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Fixed Income Outlook (from page 3)

increase rates, we would expect to see steady 25 basis point increases announced at each meeting.

Once again, our expectation is for interest rates to rise in 2015. We would expect to see the ten year end 2015 in the 2.5 to 2.75 range. Globally, we expect further stimulus measures to be announced from the central banks in Europe and Japan.

While rising rates are generally seen as bad for bonds, the bulk of the increases are expected to be seen in the shorter maturities. Longer term bonds may remain attractive to foreign buyers based on relative yield, the US's status as a safe haven and the strength of the dollar. Thus the longer end of the yield curve may not see as much of an increase in rates resulting in a flattening of yield curve. Even with more modest returns expected for the coming year, bonds will continue to play an important role in most portfolios, providing income, balance and diversification.

2015 Forecast — John Largent, CFA, CFP®, CAP

John Largent
CFA, CFP®, CAP

"Fed Chair Janet Yellen and the rest of the FOMC will again have the market's attention as they watch economic conditions and respond accordingly."

2014 was a close repeat of 2013 in that it has been another great year in the history books as the US stock market increase exceeded most forecasts.

Members Trust Company's Investment Team Forecast for 2015 is as follows: an increase of 6.75% for the Dow Jones Industrial Average, which is slightly less than 2014's forecast, the S&P 500 up 6.61%, NASDAQ up 6.31%, developed international markets up 5.74%, and emerging markets up 6.73%. We forecast fixed income as the 10 year treasury increasing to a 2.65% yield from the current 1.88%. We are forecasting that the Fed Funds Rate will increase to an average of about .76%. Fed Chair Janet Yellen and the rest of the FOMC will again have the market's attention as they watch economic conditions and respond accordingly. MTC expects the year-over-year growth of the United States economy as measured by Gross Domestic Product (GDP) to be 2.97%. Regarding inflation, many have been concerned about a substantial increase because of the great amount of quantitative easing. This concern has been overstated for now and deflation is now moving up to be of greater concern. MTC expects inflation as measured by CPI of 1.63%, still slightly below the FED's target of 2%. Oil prices are a wild card. We see oil stabilizing around $72.00 up substantially from the current $45.00.

Everyone have a great New Year!

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