DMS

Discretionary **M**anagement **S**ervices, LLC

What We Are Telling Clients

By James F. Dykstal, CFA, Portfolio Manager, January 2014

Below is a summary of our views on the economy and markets, which we are sharing with discretionary clients. In essence, we believe that the risk in risk assets is underappreciated – especially in domestic small cap stocks. Some sectors have already corrected and we view those more favorably in the longer term.

Economic Outlook

- GDP growth of 2% should be constrained as growth in personal consumption remains slow (approximately 2%). Flat growth in household income will continue due in part to limited improvement in the employment picture.
- Inflation is expected to remain muted despite the Fed's effort to bring it up as a consequence of quantitative easing. Decreases in the unemployment rate are driven more by a drop in the labor participation rate than by job growth.
- The yield on the ten year Treasury ended the year above 3%, rising as the Fed's "tapering" decision was made known at the end of the year. The Fed's decision to continue to "taper" asset purchases in 2014 will be contingent upon improvement of inflation and employment indicators.
- The recovery in residential real estate will slow slightly due to the increase in longer term interest rates. Expect long term interest rates to fluctuate but ultimately trend higher as the Fed undergoes its "tapering".
- International economies will slowly recover throughout 2014. Both the European Central Bank and the Bank of Japan will continue with quantitative easing in attempts to spur GDP growth. The U.S. dollar will strengthen versus the euro and the yen.
- Growth in emerging markets will be higher than developed markets, even with slowing GDP growth in China. Consumers in emerging market countries continue to increase their percentage of global consumption.

Strategic Market Outlook and Tactical Allocations

- The downside risk of the stock market has increased in 2013. The market appears to be fully valued when compared to its longer term average. P/E ratios may contract slightly if interest rates increase with small cap stocks most at risk. Remain underweight small cap stocks relative to large cap stocks. Seek relative safety in dividend paying stocks.
- Developed international stocks offer relative value when compared to domestic stocks. Relative value is subject to continuation of GDP growth in Europe and Japan.
- While the returns of emerging market stocks have lagged developed markets, they ultimately will benefit from stronger economic growth in those countries and below average valuation.
- U.S. Treasury bond yields will trend slightly higher. Investors will continue to invest in higher yielding corporate bonds. High yield bonds and bank loans offer an attractive risk/return tradeoff.
- Commercial real estate offers compelling value when income returns are compared to investment grade bonds.

If you are interested in more information, please call Tom Woolwine, President, at (913) 981-1345 or email, twoolwine@dms-demarche.com.