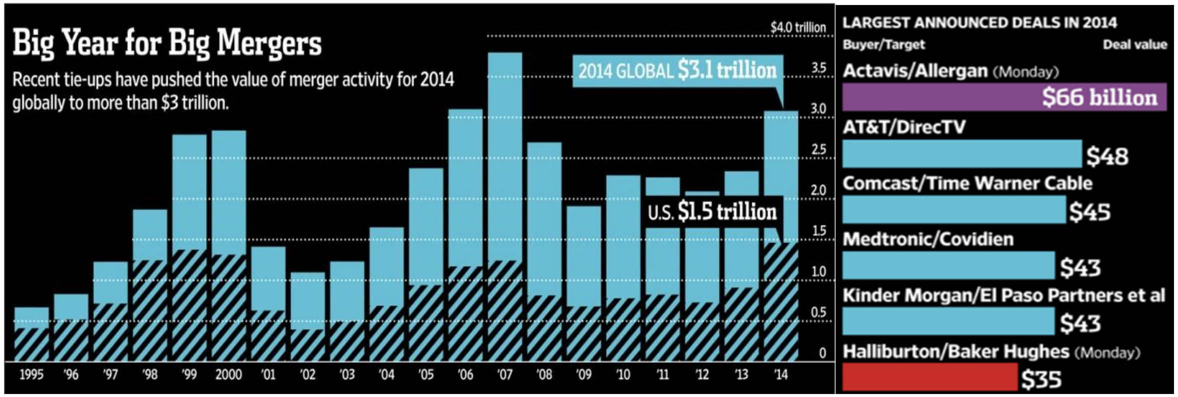
Market Recap

Market Return Contributors Since 1985

Source: Cornerstone Macro

Perhaps surprisingly, the highest stock market returns are typically not achieved when company earnings growth rates are at their peak. Rather, the market has recorded its highest returns when companies report moderate EPS growth *AND* stocks enjoy Price to Earnings (P/E) expansion. This is exactly the scenario in which we find ourselves today as we witness moderate EPS growth, coupled with significant P/E expansion. Returns tend to be stronger in years in which estimated EPS growth is lower, because strong EPS growth is usually accompanied by high inflation, rising commodity prices, and a tightening Federal Reserve – none of which supports P/E expansion. Today, the market is also aided by benign inflation and falling commodity prices.

Merger Activity



Source: Dealogic; WSJ

Global merger activity has reached historic levels this year. At roughly $3.1 trillion, the current dollar volume of announced deals is higher than in any full year since 2007. In the U.S., transactions have already exceeded previous full-year levels. Dealmakers point to a number of factors for the pick-up in M&A activity: 1) easy-money policy from the Federal Reserve and other global central banks has driven credit costs down and stock prices up; 2) high stock prices have given company executives the confidence and currency to make bold acquisitions; 3) takeover deals are seen as particularly attractive now because they can lead to vast cost savings amid lackluster economic activity. While several of the present financial ingredients may have been in place for a few years, corporate executives are finally capitalizing on them opportunistically.

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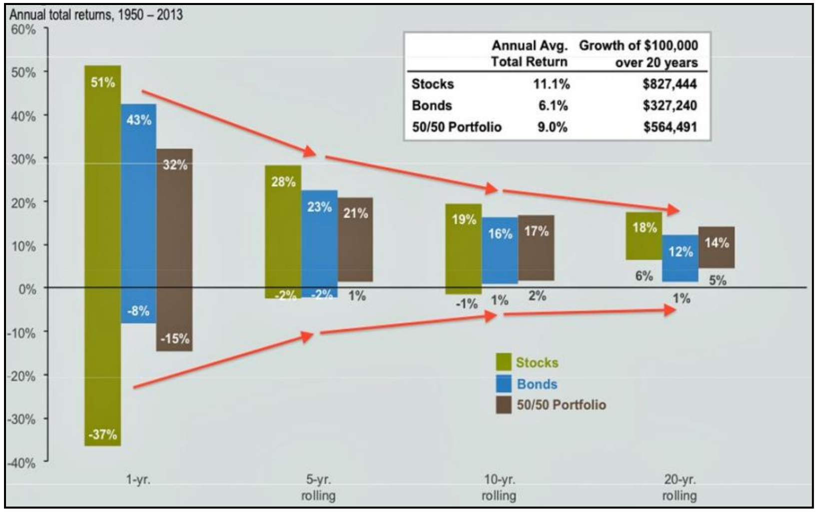
Range of Returns for Stocks, Bonds, and Blended Portfolios



Source: Barclays; Factset; J.P. Morgan

Investors are often taught – and, therefore, expect - that the stock market should generate returns of approximately 10% per year, while bonds should return half of that (5%) annually. The problem with these expectations is that these averages rarely reflect what happens in any given year. The market is more likely to deliver this level of returns over a longer timeframe. The longer your holding period, the more predictable and typical your annualized returns become. Over a one-year period of time, stock returns may be as high as +51%, or as low as -37%. If you extend the holding period to 20 years, the range of stock returns shrinks to +6% to +18% on an annualized basis, and the average is 11.1% - very close to the 10% average investors are taught. Variability of returns across every time period is reduced when multiple asset classes are utilized, such as a 50/50 portfolio of stocks and bonds.

Top Album Sales in Debut Week Since 1991

	Artist	Album	Year	Number of copies
1	'N Sync	No Strings Attached	2000	2.415m
2	Eminem	The Marshall Mathers LP	2000	1.760
3	Backstreet Boys	Black & Blue	2000	1.591
4	Britney Spears	Oops!...I Did It Again	2000	1.319
5	Taylor Swift	1989	2014	1.287
6	Taylor Swift	Red	2012	1.208
7	50 Cent	The Massacre	2005	1.140
8	Backstreet Boys	Millennium	1999	1.133
9	Lady Gaga	Born This Way	2011	1.108
10	Usher	Confessions	2004	1.096
11	Garth Brooks	Double Live	1998	1.085
12	Limp Bizkit	Chocolate Starfish And The Hot Dog Flavored Water	2000	1.054
13	Taylor Swift	Speak Now	2010	1.047
14	Norah Jones	Feels Like Home	2004	1.022
15	Lil Wayne	Tha Carter III	2008	1.005

Source: Neilsen

Spotify, the largest music streaming service, and Taylor Swift, the best-selling pop artist in 2014, are embroiled in a battle that may reshape the music industry. Spotify offers unlimited streaming of millions of songs for a $10/month subscription fee. In turn, Spotify pays a royalty equal to $0.006 to $0.0084 per stream back to the artist, resulting in payouts of ~$500 million in 2013 (across all genres and artists). While an improvement over piracy, this sharing arrangement still disadvantages the artists. Their revenue model shifts toward income generation through live shows and tours in light of the dramatic reduction in proceeds received from album sales. With the release of her new album, '1989', Swift pulled her entire back catalog off Spotify, denying Spotify (and its patrons) the opportunity to participate in her success. The debate over music delivery continues as other artists have followed Swift's lead.

Contact: If you have any questions or comments, please do not hesitate to contact us at 703.992.6164. For more information about Harbour Capital Advisors, please visit our website at www.harbourcapitaladvisors.com.