Market Commentary as of Dec. 17, 2014

Volatility has returned to stock markets in a big way this December and stocks last week had their worst performance all year. This has happened despite mounting evidence that the US economy is accelerating, including the strongest labor report in a decade and rising confidence of consumers and businesses alike. Three factors have been behind the fear: Wednesday's meeting of the Federal Reserve, the sharp decline in crude and a currency crisis in Russia. We don't believe the US recovery is in danger of being derailed by any of these three concerns.

Fed: The Federal Reserve held its last meeting of the year Wednesday and made a few slight changes to their forecasts, along with the wording of their statements. Although the Fed removed its promise to keep interest rates close to zero for a "considerable time", they coupled those tightening statements with new language that it would be "patient" before raising rates. The somewhat altered language shows the Fed is still prepared to raise short-term interest rates by the middle of 2015, but also be flexible depending on current economic data. Yellen also pointed out that they do not expect to raise rates over the next couple of meetings and lowered its forecast of where it thinks rates will be, which quelled investor's fears of another May 2013 "Taper Tantrum".

The S&P 500 and Dow Jones Industrial Average had their best one-day gains of 2014 and the 10 year Treasury yield rose to 2.14% due the positive assessment the Fed gave on the American economy, its resilience to a slowdown overseas and the gradual rise in interest rates going forward.

Oil: Since its peak at $107 a barrel in June, crude has steadily sold off more than 45% and is now trading below $60/barrel for the first time in five years. The selloff has spooked the market with energy stocks, MLPs, and the high yield bond market seeing the worst losses. While it's true that crude declines during recessions, we think the dynamics of this selloff are fundamentally different and actually bullish for the US economy. The price does not reflect lower economic activity but rather too much supply from both the US fracking industry and Saudi Arabia, which is refusing to cut production. We believe the selloff in MLPs is a particular overreaction since their business models are based on the volume rather than the price of crude as well as other fuels like natural gas. For the US economy, this selloff should create more winners than losers. Cheaper gas prices will result in more cash to the American consumer which, combined with the broad improvement in the labor market, should provide the missing link in the recovery.

Outside of the US, the impact can be very negative for countries that export oil and have a high cost of production. Brazil and Russia are examples of countries already dealing with headwinds and are now trying to cope with the lower oil prices. Other emerging and frontier markets that export oil are vulnerable as well. On the other hand, oil importing countries like much of the Eurozone and select emerging markets should see some of the same benefits as the US.

Russia: Russia's central bank stunned markets this week by raising their policy rate by 6.5% at an emergency midnight meeting in an attempt to halt the decline of their currency, the ruble, which has lost half its value since oil prices began falling. The drastic move was initially unsuccessful. The ruble plummeted during trading yesterday but has since stabilized at the level it was before the central bank decision. The trigger for the currency crash is still unclear, but Russia's economy has many problems: their budget requires oil at about $100, they have slowing growth with rising inflation, and are dealing with sanctions from their conflict in Ukraine. The situation could get worse before it improves.

The Asian crisis of 1998 has many similarities to Wednesday's events. Then as now, crude and emerging market currencies were falling, the US dollar and bonds were rallying, and the Fed was beginning to tighten. Making matters even worse was that emerging market countries had fixed exchange rates, lower reserves, and more debt denominated in US dollars than Wednesday. While markets were volatile during this timeframe (including a 19% decline in a 3 month period) stocks were actually up 40% when the dust settled and GDP growth averaged more than 4%.

We believe this is a good indicator for what to expect in the coming months: increased volatility but ultimately solid performance out of the US based on the fundamentals of an improving consumer in an economy that relies relatively little on global growth to fuel its engine. •