Morris Capital Advisors, LLC

Investment Commentary
December 31, 2014

Dealing With Mayhem

A recent series of commercials are based on a character that leaves a path of destruction in his wake. He can be a teenage driver crashing through a parking lot, poorly secured equipment falling from a pickup truck, or accidents close to home. It really doesn't matter because the result is always the same. The only solution, of course, is to protect yourself from this "Mayhem" by purchasing their insurance product.

The financial markets have their share of mayhem to deal with, as well. It is not limited to company specific events and US macro-economic news, but also global economic and geopolitical developments. As we close out the year, it might be useful to review market activity in the context of these domestic and global events.

From the outset the markets had a tough act to follow. Stocks gained more than 35% in 2013, and that, coupled with a rise in interest rates from 1.84% to 2.98% in the 10-year US Treasury note (a 62% increase), should have been enough to give the markets pause. Since many analysts thought the markets were overextended some pullback was to be expected.

On the global geo-political front, continued unrest in the Middle-East culminated in a seven week conflict in Gaza, leaving no clear resolution. Further deterioration in the Syrian civil war, the concurrent rise of ISIS there and in Iraq, Russian strategic moves in Crimea and Ukraine, including the downing of a civilian aircraft, and rising terrorism in Africa and Europe had broad implications. On the global economic front, the Euro-crisis resurfaced with problems in Greece, once again. Economies around the world experienced slowdowns, especially in the Eurozone, China, and Japan. At the same time central bankers found traditional policy tools less effective as a 40% rise in sovereign global debt over the last 5 years created debt to GDP ratios over 100%, the highest since World War II. While borrowing rates are low, the debt loads by major economies are a drag on growth and reduce the ability of government entities to stimulate their economies.

Domestically we have begun to see signs of an improvement in economic growth. GDP growth is better and job growth has been steady. This improvement, as compared to other major economies, has led to a sharp increase in the value of the dollar, has allowed the Fed to end its outright purchase of securities in the market, and discuss the possibility of an increase in interest rates. At the same time, however, the improving economy and job growth have not increased labor force participation or generated income growth, especially for the middle class. The dramatic decline in the price of oil has certainly lowered the price of gasoline at the pump, but this increase in spendable consumer income will be offset somewhat by reduced revenue for our resurgent energy exploration industry and exchange rate pressure on our trading partners.

Despite all of this, we ended up with a double-digit rise in the S&P 500 and a bond market rally as 10-year treasury yields declined from 2.98% to 2.17%. It was an impressive performance, back to back, especially considering the domestic and global events throughout the year.

There is no doubt that we will experience our share of mayhem again this year, and it might well translate into increased market volatility. Many of the geopolitical events of the past 12 months are still simmering, and in some cases they are getting worse. Japan's ever increasing foray into quantitative easing has had little impact on their economy, and now Europe is preparing to buy sovereign bonds, as well. Economic growth remains tepid, and the decline in oil prices, driven partly by a decline in demand, is another indicator of slowing growth. Growth has improved in the US, but stagnant middle class income growth, higher employment costs, and the prospect of interest rate increases by the Fed, raise concerns about a market pullback.

As the perceived risks accumulate some investors seek protection but this focus on the downside overlooks one of the basic lessons of the market. Even in the face of tremendous uncertainty, the markets can perform well (as they did the last two years). Seeking protection, while it may provide comfort when the inevitable decline arrives, often sacrifices too much of the upside.

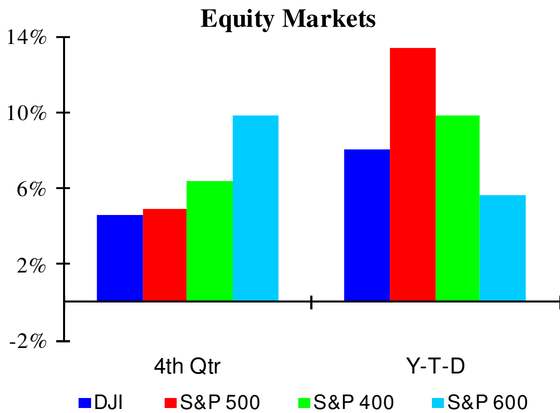
We continue to believe that a disciplined long-term investment strategy, beginning with a proper asset allocation to manage risk, will be successful over market cycles. For us, that disciplined strategy is built on a diversified portfolio, invested in companies that are priced attractively relative to their growth potential. We add our own measure of protection by including companies built on a foundation of substantial assets, reasonable debt levels, and with significant cash flow to withstand difficult times. We believe that our approach will continue to provide a level of protection from the mayhem while not sacrificing opportunities in the market.

Sincerely,
Daniel A. Morris

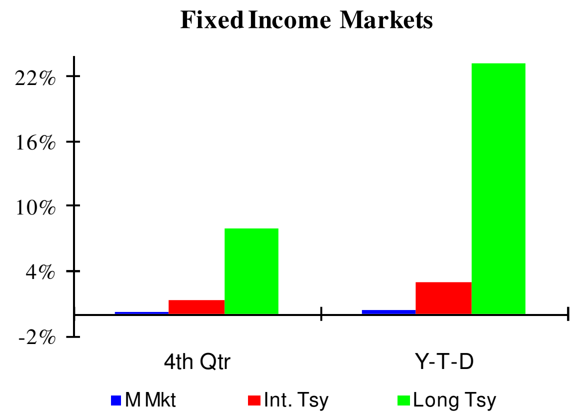
Market summaries on reverse page

Morris Capital Advisors, LLC

Market Summary
December 31, 2014



Market volatility reasserted itself in the fourth quarter. Stocks began October by correcting sharply, continuing a trend begun in the third quarter, only to rebound even more strongly as central bankers worldwide responded by promising more liquidity generation if necessary, especially in Europe. As a result the dollar appreciated strongly. Oil prices collapsed after OPEC indicated it would not cut production to offset increased US supply. The year ended with a renewed selloff. For the quarter as a whole large cap stocks performed well, and small cap stocks did even better, but most energy stocks endured double-digit declines.



Yields on long-term US Treasury Bonds remained on the declining trend they have followed for most of 2014. Concerns about a slowing global economy and low inflation were compounded by the dollar's sharp appreciation against most currencies, which led to a marked shift of global asset flows to US dollar-denominated securities. Longer-term interest rate levels approached lows last seen in mid-2012. Longer maturity bonds outperformed shorter bonds, and the yield curve flattened further.