“SIDEWARDS”

“In investing, what is comfortable is rarely profitable.”
-Robert Arnott

February typically brings two things to the Whistler family household: cold winter weather & my youngest son’s birthday. Among his many charms and talents (I’ll leave his mischievous qualities for another missive), is a frequent but wonderful misuse of the English language. His arcane lexicon has grown quite robust over the years, as his parents would often find certain mispronunciations amusing and fail to correct him, hoping to preserve forever some childhood innocence. As he turns 11, most of his mispronouncements are now for his own amusement, and oftentimes mine. Perhaps our favorite is the term “sidewards”, his early attempt at “sideways”, and generally meant to signify something that will remain somewhat directionless.

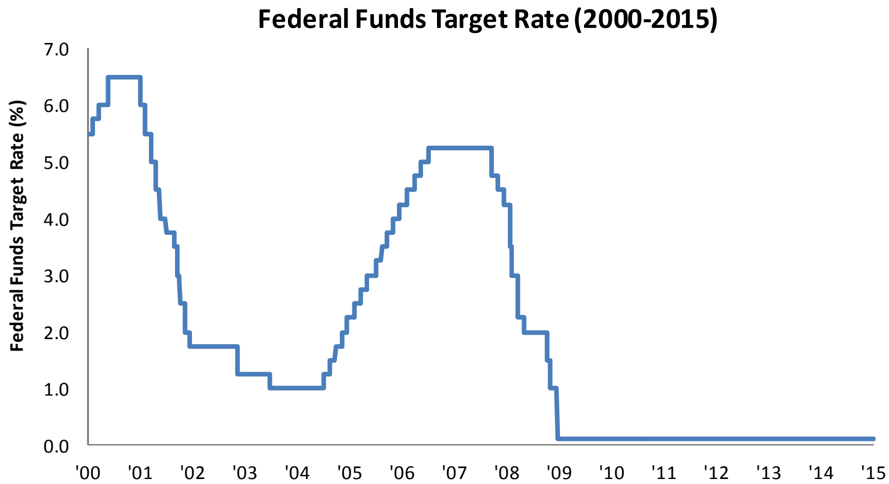
This term has come to mind a lot as of late, as I ponder the future direction of both the equity and fixed income markets. I’ve even come up with some of the key tenets of a “sidewards” market: <u>maddeningly trendless, drifting markets; sometimes higher, but occasionally lower; and very often unpredictable.</u> Although we’ve experienced these types of markets before, what’s unique today is that I think this trend will extend to both stock and bond markets over the coming year or two. For instance, we’ve never had seven years in a row of an “up” market in equities (see below) and at the same time the Fed is poised to raise interest rates for the first time in nearly ten years.

Number of Consecutive Years of Positive Returns on the S&P 500

Source: Doubleline, Robert Shiller, Yale University

This chart, originally produced by Robert Shiller, indicates 2015 would mark the first time ever that the S&P 500 has gone up for 7consecutive years, the most ever being 6. There’s a first time for everything, I guess…

2015 should mark the Fed's initial attempts at normalizing monetary policy. Most bets are for initial interest rate hikes taking place around September or so. Managing market expectations is key.



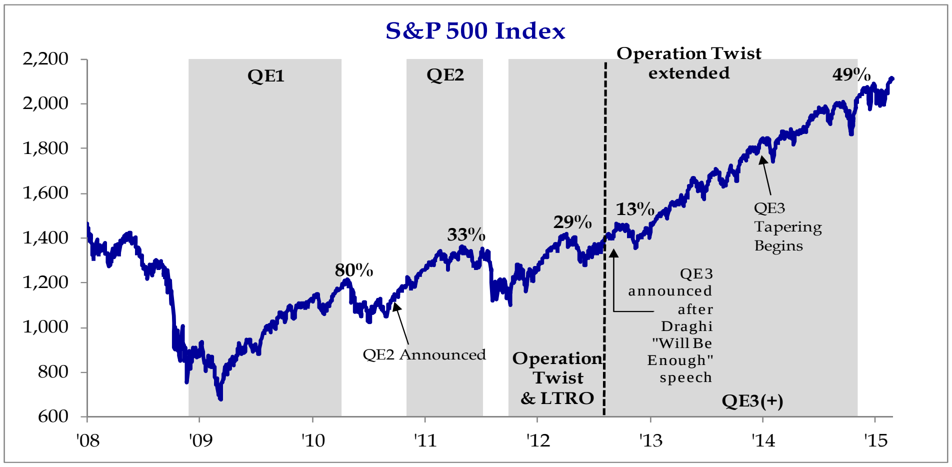
Source: St. Louis Federal Reserve

Maybe after 6 years of an equity bull market and 30+ years of a bond bull market, a pause is warranted. Valuations on most asset classes we follow are a bit stretched, although arguably "fair" in light of the Fed's zero interest rate policy. Absent a surprise surge in earnings (anything north of $130 per share for 2015 on the S&P 500 would qualify), further gains in U.S. equities would push us well into overbought territory in our view, while a 10-year Treasury yielding just 2.0% implies some pretty muted growth and inflation expectations in the years ahead. I'd like to be more bearish on both fronts actually; however, I just can't generate the conviction. The U.S. economy continues to improve, along with the labor market, and declining energy prices and renewed fiscal spending should nudge GDP growth north of 3% by year-end.

There certainly exist sectors of the market that, though not "cheap" by our standards, are worth maintaining exposure to. International equities and debt are two of the more interesting areas to us currently. Although international equity returns have been disappointing the past couple years, there's a lot of bad news already priced in and there is plenty of room for upside should the ECB have half as much success in elevating asset values as the Fed did with its QE program(s).

As for international fixed income, we would vastly prefer to own bonds in countries experiencing disinflation (EU area) versus those aggressively re-inflating (US). Despite meager yields, (Germany actually sold 5-year notes this week with an average yield of -0.08%, with investors essentially paying the German government for the right to hold their debt for 5 years!), the prospects for a positive total return over the coming 2-3 years are strong.

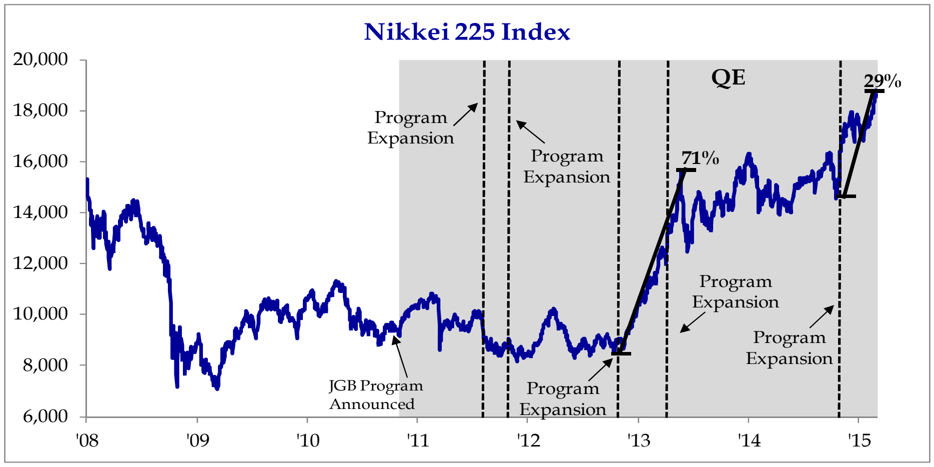
The European Central Bank has only recently embarked on wide-scale quantitative easing, yet the early returns are impressive. Should Mario Draghi experience the kind of success that Bernanke/Yellen and Abe/Kuroda have, we would expect robust equity returns over the next 1-2 years. A lot could go wrong still (Greek exit, bank failures, etc.), however we remain optimistic. It's still early and eurozone markets are likely to rally should the economic green shoots we've recently seen continue to develop. Germany will likely be the key player in any successful outcome, as they have the most riding on keeping the eurozone together with exports to fellow EU countries continuing to drive their economy.



Say what you will about the Fed's grand QE experiment, it did succeed in elevating asset values, primarily US equities. With the focus now on unwinding QE, it remains to be seen how the market(s) will behave absent such large scale stimulus. The "landing" will likely be bumpy.

Source: Strategas RP

Shinzo Abe's bold gamble to go "all in" against Japanese deflation has succeeded in dramatically weakening the Yen, increasing exports and generating some, albeit modest, inflation. Time will tell if Japan can successfully grapple with its worsening demographic problem and need for structural reform.



Source: Strategas RP

The trick for investors over the coming year will be staying the course. These "sidewards" markets can test even the savviest investors' patience, as returns can be paltry while volatility rises. Often, investors will give in to despair during one of the many downward turns, and frankly, after 6 successive years of positive U.S. returns, it may come as a shock to some should we see a decline in 2015. While international diversification hasn't paid off over the past two years, our bet is that this will change soon.

Rebalancing

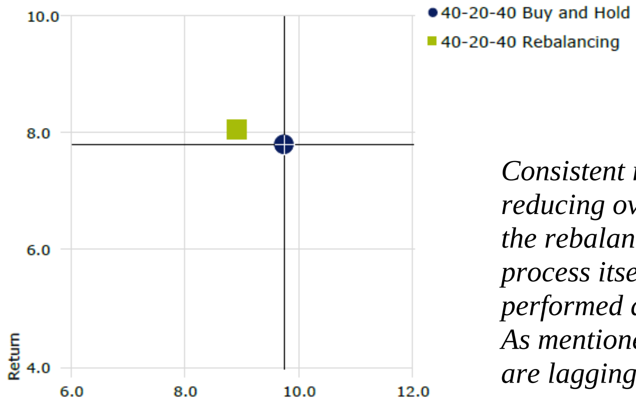
One of the secrets to successful investing is periodic rebalancing. This involves taking some chips off the table when times are good, and often "doubling down" when things aren't so good. In practical terms, it involves keeping one's stock/bond mix uniform over time, buying stocks in 2009 for example, and perhaps selling some today. It takes discipline and fortitude to sell winners and buy losers, but academic research, and history, both reinforce the importance of periodic rebalancing.

At Nottingham, we typically employ a "tolerance band" around the asset mix. Hence, a move from 60/40 stocks/bonds to 61/39 won't trigger a rebalance, but a change to 65/35 might. The reason we employ bands is that volatile markets can cause the mix to change back and forth in a narrow range for a while. Transaction costs and taxes can eat up the benefits of rebalancing if done too frequently.

Risk-Reward

Time Period: 1/1/1995 to 12/31/2014

Currency: BASE Source Data: Total, Monthly Return



Source: Morningstar Direct

Return Summary

Time Period: 1/1/1995 to 12/31/2014 Currency: BASE Source Data: Total, Monthly Return

	Return	Std Dev	Sharpe Ratio	Cumulative Return
40-20-40 Buy and Hold	7.79	9.75	0.54	348.52
40-20-40 Rebalancing	8.05	8.93	0.61	370.56

Consistent rebalancing over time can enhance portfolio return while reducing overall portfolio risk. As illustrated here, over a 10 year period, the rebalanced portfolio generated an incremental 22% return! The process itself should be consistent, utilizing tolerance bands, and performed despite whatever external noise might be occurring at the time. As mentioned, it takes courage to sell winners and reinvest in areas that are lagging, yet it's critical to optimal long term performance.

After six years of a bull market in equities, and despite the continued grind higher in bond prices, many investor portfolios are outside their optimal long-term asset mix. The temptation is to succumb to greed and hold on for a while longer. As I said earlier, it takes discipline and faith to take chips off the table when things are good, and reinvest proceeds in things that haven't appreciated as much. I can tell you, though, it works over time. Many of the routine trades we make here at Nottingham are just that, rebalancing trades. It's a core part of our process.

Summary

So, as I served my son his "vallina" ice cream with his cake the other night, my thoughts turned ever so briefly to these "sidewards" trending stock and bond markets (I was quickly brought back into the moment as his new basketball flew precariously close over my head). We would be thrilled if 2015 turned out to be lucky #7 in terms of positive US returns; however we aren't banking on it. Rather, we're searching out opportunities overseas where things haven't gone so well (partly due to lack of central bank intervention and partly due to structural challenges).

Perceived risk may be higher in these markets; so too, should be one's expected return. As with all things at Nottingham, the basis for our investment thesis today is maintaining diversification in the face of uncertainty. We continue to keep portfolio expenses low via liberal use of index-based ETF's, high-quality taxable and tax-free bonds and timely yet disciplined portfolio rebalancing, all while managing risk equally with return. Client-centered investing remains our mission. As always, we welcome your feedback, questions, concerns - and referrals. And we once again thank you for putting your trust in us to help you achieve your financial goals.

From cold and snowy Buffalo,

Larry Whistler, CFA
President/Chief Investment Officer
March 2015

We, our affiliates and any officer, director or stockholder, or any member of their families, may have a position in and may from time to time purchase or sell any of the herein mentioned or related securities.
All opinions and estimates included in this report constitute the firm's judgment as of the date of this report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

www.nottinghamadvisors.com

NEW YORK OFFICE : 100 Corporate Parkway : Suite 338 : Amherst, NY 14226 : 716-633-3800 : 716-633-3810 Fax

FLORIDA OFFICE : 772 U.S. Highway One : Suite 100 : North Palm Beach, FL 33408 : 800-281-8974