HAVERFORD

2015 SPRING OUTLOOK

Past, Present, and Future

The US stock market continued to achieve new milestones during the first quarter of 2015. After a brief and shallow pullback to start the New Year, both the S&P 500 and Dow Jones Industrial Average (DJIA) climbed to new all-time highs by March. The most impressive milestone occurred on March 2, when the NASDAQ closed above 5,000. Fifteen years ago, the NASDAQ crossed above the 5,000 mark for two brief days before plummeting nearly 80% in the subsequent three years. Some investors believed they would never again see the NASDAQ at 5,000. Twelve years after the bottom they have, but it is a very different index indeed. The table below shows the ten largest companies and their valuations—then and now.

Three things stand out. First, there are only four holdovers from 2000—Microsoft, Intel, Cisco, and Qualcomm. Their valuations today are decidedly much more reasonable. Second, the index has become diversified beyond just technology and telecom companies: Gilead Sciences, Comcast, and Amgen, for example. Looking beyond the top 10 would include retailers such as Costco, Starbucks, eBay, and Priceline. Lastly, the Technology sector only constitutes 43% of today's NASDAQ, compared to a hefty 65% fifteen years ago.

NASDAQ Composite—Then and Now

Below are the top 10 stocks in the NASDAQ Composite Index—in 2000, and now. Only Cisco, Intel, Microsoft, and Qualcomm remain on the list today.

March 10th, 2000				March 18th, 2015			
Company	**P/E**	**Market Cap**	**% of Index**	**Company**	**P/E**	**Market Cap**	**% of Index**
Microsoft	54	$525 B	8.0%	Apple	14	$740 B	9.2%
Cisco	113	$466 B	7.1%	Google	19	$380 B	4.7%
Intel	42	$401 B	6.1%	Microsoft	15	$342 B	4.3%
Oracle	117	$232 B	3.5%	Facebook	38	$222 B	2.8%
Sun Microsystems	87	$165 B	2.5%	Amazon.com	552	$173 B	2.2%
Dell Computer	53	$131 B	2.0%	Intel	14	$145 B	1.8%
Qualcomm	112	$96 B	1.5%	Gilead Sciences	10	$150 B	1.9%
Yahoo!	453	$94 B	1.4%	Comcast	18	$150 B	1.9%
Applied Materials	44	$75 B	1.1%	Cisco	13	$144 B	1.8%
JDS Uniphase	281	$69 B	1.0%	Qualcomm	13	$115 B	1.4%

Source: Bloomberg, Factset, *The New York Times*. P/E ratios based on anticipated calendar earnings.

The change in leadership within the Technology sector points to the very fragile nature of tech companies. In addition to being affected by the economic cycle, technology companies are uniquely challenged by product obsolescence. What is high-tech today is often low- or no-tech tomorrow. Facebook and Google did not exist in 2000. Apple, the world's largest company by market capitalization and earnings, and the newest member of the Dow Jones Industrial Average, was Lilliputian compared to today. Ninety percent of Apple's revenues come from products (such as the iPhone and iPad) that did not exist in 2000.

Consumer products companies offer an interesting contrast to the ever changing landscape of technology. Coca-Cola and Pepsi are still the leading non-alcoholic beverage companies. Procter & Gamble remains the leader in consumer products. Hershey continues to be the leader in kisses.

The NASDAQ at 5,000 also adds fuel to those predicting an imminent market crash. We believe this is highly unlikely. Today's NASDAQ sells at a Price-to-Earnings (P/E) multiple of 20, compared to over 100 at its peak in March of 2000. While there are some pockets of speculative excess (biotech and social media, for example), most of today's NASDAQ companies, and the S&P's for that matter, have solid fundamentals with reasonable valuations. We are not suggesting the markets are immune to a correction. The equity markets have not experienced a correction (defined by a decline of 10% or more) in three-and-a-half years. It is worth reminding investors that corrections are a normal occurrence in every bull market.

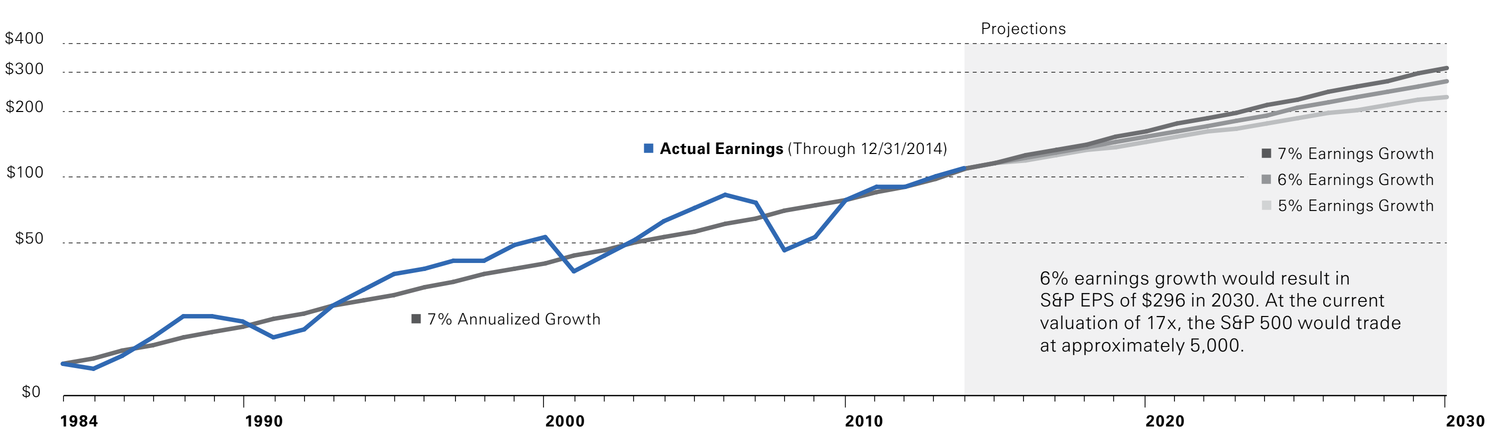
The year 2000 was a unique period in terms of investor sentiment. Fear and greed are the two emotions that most affect investors. Generally speaking, fear is a stronger emotion than greed. An exception occurred in the late 1990s, when greed became so pervasive that it actually turned into fear that you weren't keeping up with other investors who were making a fortune in the new dot-com world. How else could you explain the lofty valuation given to any company associated with the internet? At extremes, fear and greed are good contrary indicators.

Despite a six-year bull market, we continue to believe sentiment is nowhere near a greedy level that would warrant caution. Fearful investors pour money into bond funds paying paltry yields and hold vast sums of cash that pay no interest. The sovereign debt of many European countries trades at negative yields. Investors fearful of deflation are paying interest to governments for the safety and comfort of owning their debt! This investor action does not reflect greed, but rather the continued anxiety that has characterized this bull market.

Looking ahead to the seventh year of this bull market, the fundamental picture remains strong. The economy is as strong and broad as any time since the expansion began in 2009. The employment picture continues to steadily improve. Jobs are being created at an approximate rate of 250,000 a month. The unemployment rate is down to 5.5%, compared to 10% six years ago. Wages are slowly rising. We view it as good news that Walmart, along with several other national retailers, have made headlines announcing wage increases. Consumer confidence continues to rise aided by the gift of lower oil prices. Household net worth and corporate profits are at record levels and inflation remains benign. First quarter GDP growth might disappoint due to adverse weather in the Northeast and the West Coast port strike. Notwithstanding this temporary blip in growth, the US economy is the leading engine in the developed world. This better growth is being reflected in the dollar's continued strength.

This review of short-term, high-frequency economic data is important, as it adds context for investors. But for those looking to the future, not becoming fixated on a single data point such as the latest employment figure should be the most important endeavor. The last fifteen years have taught us that economic cyclicality occurs in a broader context of increasing economic activity that rewards long-term investors. It is very difficult to correctly forecast what will happen this year or next, but we are quite confident that fifteen years from now investors will be enjoying higher equity prices supported by much higher earnings and dividends.

S&P 500 Earnings Projections



Source: Standard & Poor's. Actual S&P EPS represents annual operating earnings. Projected earnings growth trends begin in 2015. Past performance does not guarantee future results.

It is probably easier and more productive for us to make a fifteen year predication on the market than it is to predict next year. We predict that global economic prosperity plus a bit of inflation can lead to S&P 500 earnings growing 6% per year from here, which is below the 7% enjoyed the last fifteen years. Since stock prices are highly correlated with earnings and current multiples (approximately 17x) are about average, we believe that in fifteen years investors will be celebrating the S&P 500 at 5,000! Along the way, investors will continue to collect a 2% dividend payment regardless of market volatility leading to a total return potential of ~8%.

Despite our optimism, reality dictates that setbacks are inevitable. At this stage in the bull market and despite our long-term predictions, it is important to temper return expectations. It is not that we think the bull market will end soon—we do not—it is because the S&P 500 has produced annualized total returns in excess of 21% for the past six years.

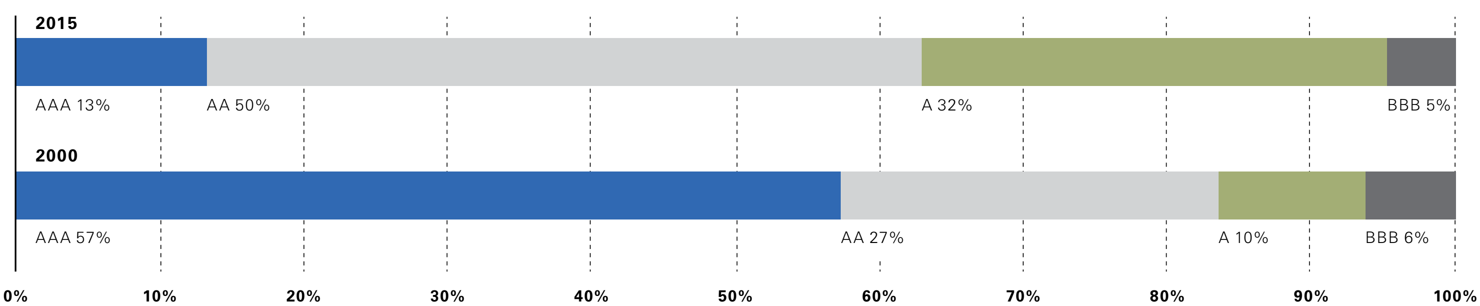
Much like the NASDAQ, the bond market has experienced material changes over the past fifteen years. As measured by the Barclays US Aggregate Index, the market has almost tripled from $6 to $18 trillion. US Treasuries as a percent of the index have increased from 27% to 36%. This data excludes the $4 trillion of US Treasury debt held by the Federal Reserve. The Credit sector has also increased from 24% to 28% as a result of corporations taking advantage of low yields to extend the maturity of their debt. Corporations now rely far less on short-term debt, making a reoccurrence of a 2008-like credit freeze much less likely.

The 2008 financial crisis also materially affected the other two sectors of the market index. Mortgage-backed and other securitized issues have declined from 39% to 31% of the Index. The US Agency component (Fannie Mae and Freddie Mac) has seen its representation halved to 5%. Agency bonds yield only slightly more than comparable Treasuries and well less than Corporate bonds. Accordingly, we continue to reduce our exposure to Agency debt.

Growth in the tax-exempt Municipal bond market has been well below the expansion of other markets. From $747 billion in 2000, the muni market has grown 81% to its current $1.4 trillion. The most dramatic impact on the Municipal market during the past fifteen years has been the demise of the bond insurers. The "AAA" rated portion of the index has plummeted from 57% to only 13%! We believe that our long-standing discipline of looking through any credit enhancement (bond insurance) to the underlying quality of the issuer has served our clients well during this period.

Looking to the future, we continue to believe it is highly likely that the Federal Reserve will begin to normalize policy sometime during 2015. Trying to guess the exact timing of their moves remains a speculative exercise at best. This normalization process will likely be a lengthy endeavor spanning many years. It will introduce volatility not only to the fixed income markets, but all financial markets globally. We also continue to believe that the combination of low global yields, minimal inflation, and demand for safety will keep rates below where they might be otherwise.

Barclays Municipal Index Quality Ratings—Then and Now



Source: Barclays

The specter of continued low, but rising, rate environment brings us back to our outlook for the ever-resilient equity markets. It has become our mantra to remind investors that a correction will eventually come, but from what level is difficult to forecast. What we do know is that none of the classic indicators that have signaled past recessions currently point to any prolonged weakness in the economy. Market corrections are usually associated with recession scares.

The price investors are willing to pay for expected earnings has increased during the past twelve weeks to slightly more than 18x for the S&P 500. Earnings expectations for the market are down, driven by the decline in oil prices (the oil sector is about 10% of the S&P 500) and the appreciation of the dollar. We believe the market is correctly looking beyond these transitory earnings hits to a time when both currencies and oil prices stabilize. The companies in which we invest are seeing their financial statements affected by currency translation, but in most cases there is little effect to their operations or true economic returns.

The ride may have gotten a little rougher and the outlook may seem a little more uncertain, but the underlying conditions remain the same. Staying true to one's strategy and focused on the end goal, yet flexible to adjust course is key to the investment success.

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* Including assets under management or consultation for The Haverford Trust Company as of 12/31/14.

All data as of March 18, 2015 unless otherwise noted. This material has been prepared by Haverford and is provided for educational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities. It does not take into account the particular investment objectives, restrictions, tax and financial situation or other needs of any specific client. Special risks are inherent in international investing including those related to currency fluctuations and foreign, political, and economic events. Any forecasts are estimates based on assumptions and are subject to significant revision and may change materially as economic and market conditions change. Haverford has no obligation to provide updates or changes to these forecasts. Past performance does not guarantee future results, which may vary. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur. Indices are shown for illustrative purposes only. It is not possible to invest directly in an index. Although certain information has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness, or fairness.

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