

Newsletter – November 2015

MARKET TRENDS 9/30/2015

<u>US Stock Markets</u>	<u>Q3</u>	<u>YTD</u>
S&P 500 Index	-6.44%	-5.29%
S&P MidCap 400 Index	-8.50%	-4.66%
Russell 2000 Index	-11.91%	-7.73%

<u>Int'l Stock Markets</u>		
EAFE Index	-10.23%	-5.28%
Emerging Mkts Index	-17.90%	-15.47%

<u>Fixed Income</u>		
Barclays Intermediate Gov't/Credit Bond Index	0.95%	1.77%
Barclays Capital Muni Bond 3 Year Index	0.80%	1.20%

<u>Commodities</u>		
SPDR Gold Shares (NAV)	-4.97%	-7.39%
Goldman Sachs Commodities	-19.30%	-19.46%

<u>Real Estate</u>		
Dow Jones US RET Index	0.46%	-4.75%

<u>Yields</u>	<u>9/30/2015</u>	<u>12/31/2014</u>
6 Mo. US T-Bill	0.07%	0.12%
10 Yr UST	2.04%	2.17%

Sources: Total Returns from WSJ Market Data Group, Standard & Poor's, Barclays

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Market Recap

Volatility returned to the equity markets in the third quarter, impacted by economic stress in China, the world's second largest economy, and Greece, coupled with underwhelming corporate earnings reports and falling energy prices. Some parts of the economy that offered favorable news were housing and unemployment; others, including exports and wages, showed little in the way of positive movement. As a result, the Federal Open Market Committee once again declined to raise interest rates, noting that inflation still hadn't reached the committee's preferred target rate of 2.0%.

Despite a closing rally in the major equity markets, the third quarter ended a tumultuous period in negative territory. The Dow closed the month of September down 243.33 points for the month and 1,334.81 points for the quarter. The S&P fell 6.94% from the close of the second quarter and 6.74% for the year. The Nasdaq dropped 7.35% for the quarter, but only 2.45% for the year - markedly less than the other major indices. Domestic mid and small caps suffered bigger losses, down 8.50% and 11.91%, respectively. International equity markets did not fare any better with developed markets down 10.23% and emerging markets down 17.90%. On a sector basis within the S&P 500, energy and healthcare were significant drags on performance, down 17.41% and 10.67% respectively. Industrials, financials and telecommunication sectors were also down more than the S&P 500 average.

U.S. Treasuries were immune to the economic tumult that befell the third quarter as investors purchased the safe haven bonds. The yield on U.S. 10-year Treasury bonds fell 31 basis points for the quarter. Most bond sectors actually eked out positive returns in the quarter, although high yield, emerging market debt and inflation-protected securities produced negative returns. Oil prices (WTI) dropped from \$59 per barrel during the second quarter to \$46.36 per barrel at the end of the third quarter. This resulted in energy master limited partnerships getting hammered, down 22.10%, with concerns that lower oil prices would significantly slow future income distributions. Gold, meanwhile, also felt the effects of the weak global economy, finishing the third quarter at roughly \$1,114.50 an ounce compared to \$1,172 an ounce at the end of the prior quarter. Finally, not all falling prices are necessarily bad, as the average retail price of a gallon of regular gasoline fell \$0.48 to \$2.322 at the end of this quarter.

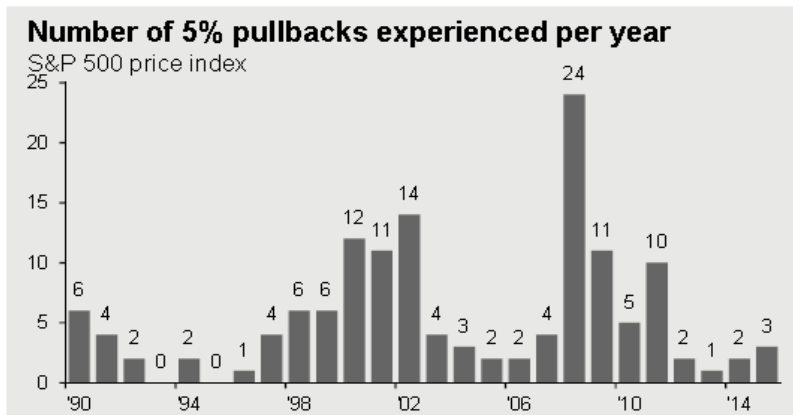
Commentary

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In the third quarter, the S&P 500 Index declined greater than 12% by August 25th from its all-time high, which was reached three months prior in May. It was the first 10% correction in four years! It is common to have a 10% correction every 12 to 18 months, so we were overdue, but it’s still not a pleasant experience. The S&P 500 rebounded from the August lows until mid-September before retreating into the end of the quarter. We had noted that the transportation index had turned lower and sure enough, transports led the equity market down.



For the quarter, two major issues preoccupied global markets: China’s economy and the expected timing of the Federal Reserve’s first interest rate increase since the Great Recession. To a lesser extent, investors also worried about:

1. The impact of the strong U.S. dollar on corporate earnings
2. The domestic economy and lower oil prices
3. The presidential political posturing especially with respect to the healthcare sector

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“...two major issues preoccupied global markets: China’s economy and the expected timing of the Federal Reserve raising interest rates.”

“...expect the markets to continue to react, albeit irrationally at times, to Chinese news and monetary actions.”

“The over-emphasis on a 0.25% potential rate increase seems silly, but the concern will remain.”

“Now the question is whether the Fed will raise rates in December or wait until 2016, a Presidential Election Year.”

- **China slowdown:** While its economy is slowing, growth is still officially at about a 7% annual rate. It is widely believed that even if the government is overstating the growth, it is still well above zero and not close to a recession. The Chinese government has recently cut interest rates and devalued its currency to stimulate the economy. It wants to expand consumer spending to become less dependent on exports and recently reversed its one-child policy to stimulate its economy. We would expect the markets to continue to react, albeit irrationally at times, to Chinese news and monetary actions.

CHINA GDP ANNUAL GROWTH RATE



Source: TradingEconomics.com; National Bureau of Statistics of China.

- The Federal Reserve (“Fed”) didn’t raise interest rates in September due to concerns about slowing global economic growth and increased market volatility. This was not received well by the market as investors wondered if the Fed knew something more troubling that we didn’t! The over-emphasis on a 0.25% potential rate increase seems silly, but the concern will remain. Now the question is whether the Fed will raise rates in December or wait until 2016, a Presidential Election Year. The Fed’s lack of action likely makes the path for higher interest rates slower and longer into the future.

Conclusion

As we look back at the third quarter, our performance was hurt by our non-traditional investment approach to bonds - little to no exposure to U.S. Treasury Bonds or high grade corporate bonds. However, we continue to favor mortgage-backed bonds, municipal bonds (when appropriate), floating rate loan funds, international bonds, preferred stocks and energy MLPs. MLPs are down significantly in sympathy to lower oil prices but are yielding over 7% and are not dependent on the commodity price. MLPs have historically had substantial pullbacks followed by significant rebounds – requiring investor patience and discipline. We continue to be committed to these investments which seem attractively valued and remain an important piece of our bond allocation. Our allocation to international equities, developed and emerging markets, was also a drag on performance. We believe that international equities are undervalued and should be part of a diversified portfolio.

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"...allocation to international equities, developed and emerging markets, was also a drag on performance."

"...Shorepoint continues to harvest tax losses in your account."

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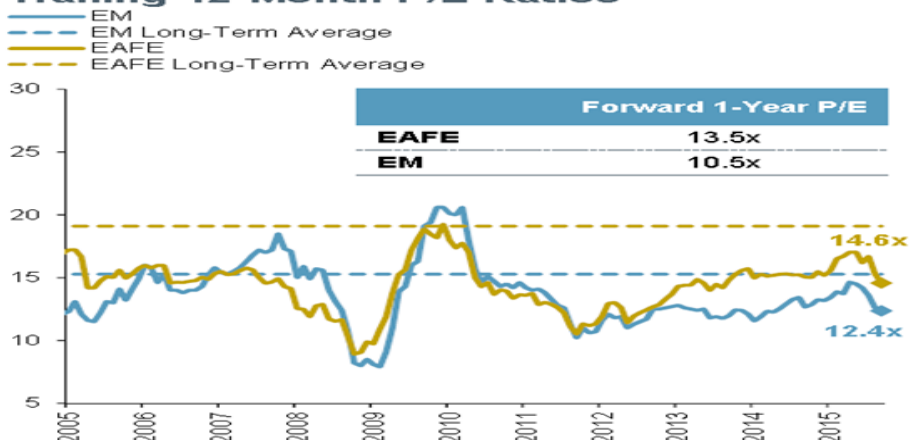
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Trailing 12-Month P/E Ratios



As we have done for all of 2015 in taxable accounts, Shorepoint continues to harvest tax losses in your account. We take three approaches to tax loss harvesting:

1. Sell the position and buy the same position back in 31 days
2. Double our allocation to the position and sell the highest cost with the largest loss in 31 days
3. Sell the position and buy a similar position in the sector

Clients benefit in couple of ways:

1. Offsets realized capital gains this year and/or in the future (losses can be carried forward) which can save you at least 20% to 40% plus in taxes, and/or
2. Can write off up to \$3,000 on your federal income tax return against income.

As for our view on the S&P 500 Index, it is fairly valued while domestic mid and small caps look attractive. However, relative to bonds and cash, the equity markets, domestic and international, are still significantly undervalued! Overall, investors are skeptical, worried, and in some cases expecting another 2008 bear market. As we noted in a chart in our last newsletter, we don't see the conditions for an equity bear market. Usually the last stages of a bull market are marked by euphoria, which is not the current case. However, we expect volatility to stay at an elevated level for a while.

As contrarians, we continue to allocate to weak areas in the equity market as well as using the volatility to upgrade portfolios into dividend paying and/or stocks with a valuation margin for safety. Shorepoint believes that discipline and patience are vital to keep risks down, in order to find value in the places others don't see it, or to wait for it to emerge. We continue to favor higher quality companies that are attractively valued, with solid balance sheets and that are strong cash flow generators.