

## Newsletter – February 2015

### MARKET TRENDS 12/31/2014

<u>US Stock Markets</u>	<u>YTD</u>	<u>Q4</u>
S&P 500 Index	13.69%	6.33%
S&P MidCap 400 Index	9.77%	7.85%
Russell 2000 Index	4.89%	11.36%

<u>Int'l Stock Markets</u>		
EAFE Index	-4.90%	-2.76%
Emerging Mkts Index	-2.19%	-3.70%

<u>Fixed Income</u>		
Barclays Intermediate Gov't/Credit Bond Index	3.13%	0.54%
Barclays Capital Muni Bond 3 Year Index	1.22%	-0.14%

<u>Commodities</u>		
SPDR Gold Shares (NAV)	-0.58%	-1.52%
Goldman Sachs Commodities	-33.06%	-27.51%

<u>Real Estate</u>		
Dow Jones US REIT Index	27.24%	12.26%

<u>Yields</u>	<u>12/31/2014</u>	<u>12/31/2013</u>
6 Mo US T-Bill	0.12%	0.09%
10 Yr UST	2.17%	3.03%

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

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### OFFICE NEWS - PROMOTIONS AND NEW HIRE

Happy New Year! We start the year with good news. First, Pamela Weldon has been named Operations Manager in addition to her Senior CSA role (Client Service Administrator). Ashley Buffone has been promoted to Senior CSA. Client feedback has consistently reflected our very positive day-to-day interactions with these two professionals. We rely on their good judgment and diligence daily and are pleased with their continuing development; they are both a joy to work with, and they support each other so well.

At our front desk and on the phone, you will now find Justine Carr has joined us as a CSA. Justine comes to us from State Street Bank where she was a Client Service Specialist and the point of contact for a large number of investment managers. Prior to joining State Street, Justine graduated from the University of Massachusetts – Dartmouth with a B.S. in Finance, minoring in International Business.

### INVESTMENT PERSPECTIVE: OIL, OIL EVERYWHERE AND WILL U.S. EARNINGS SHRINK?

Over the last several years, we have been conditioned that oil prices can only go up; the threat of an oil shock was always lurking, ready to drain our wallets at any moment with price gouging at the pump. So the conventional wisdom has remained: oil is in limited supply, and we are using more of it, so the price trend will be up, and since much of this commodity is sourced from unstable and/or governments hostile to us, the general upward trend will be punctuated by upward price surges connected to global and geopolitical conflagrations.

However, conventional wisdom is not always wise and group-think can be dangerous to your wealth. Economists have generally used \$100 per barrel of oil as the assumption for the year 2014 - with an expected rise in 2015 greater than the current low level of inflation. Surprise!!! At this writing, the price per barrel of crude oil was about \$45. Never underestimate the following: the ability for markets to surprise, to overreact to the point of being irrational, and to stay that way for too long. So why did the stock market go down on this surprise? Don't low oil and gasoline prices help U.S. consumers to have more cash flow, just like a tax cut?

Yes, lower oil prices do act like a tax cut, and are particularly helpful to those in society who need and spend it most: the lower and middle classes. All we can offer you on why the markets went down on the drop is conjecture, and hypothesizing is something we have never shied away from here at Shorepoint.

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*“Yes, lower oil prices do act like a tax cut, and are particularly helpful to those in society who need and spend it most: the lower and middle classes.”*

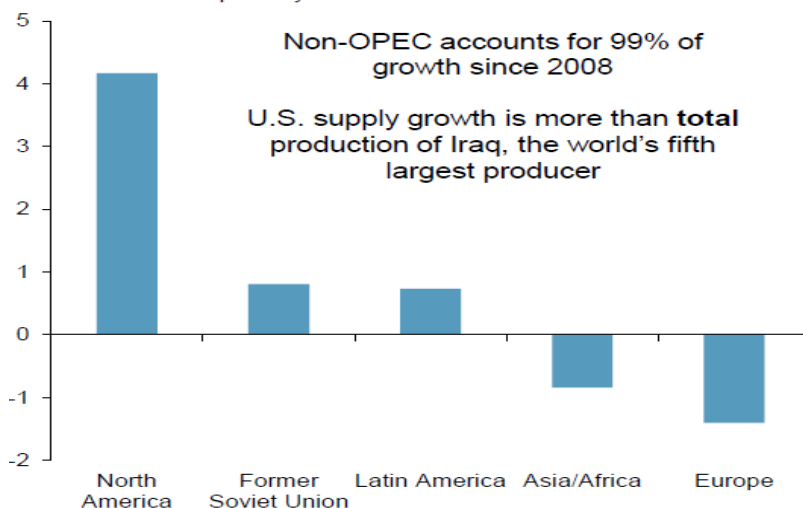
*“The oil glut and fall in subsequent prices was a major surprise in a classic, contrarian way; virtually no one predicted it, let alone the magnitude of the drop.”*

The oil glut and fall in subsequent prices was a major surprise in a classic, contrarian way; virtually no one predicted it, let alone the magnitude of the drop. The short term pricing of stocks today relies on some very unsettling methods, a process we call Cerberus, after the classic three-headed dog guarding the gates of Hades.

### Non-OPEC Crude Supply Growth since 2008

■ Change in Total Crude Production Since 2008

Millions of Barrels per Day



Source: Fidelity Investments

First, you have program and automated trades that are thoughtless, computer-generated, and powerful in that selling begets more selling as certain price thresholds are breached. Suffice to say then stocks are sold or shot first before any questions are asked or answered. There is no thinking here. Next, the new price data must be assiduously entered into spreadsheets all over the globe by young MBAs, CFAs, PhDs, assistants, or actual automatons. This is where some actual thought begins to occur - but very superficially and only in binary fashion at best - because everyone realizes that their models for valuing stocks are completely disrupted and wrong. Only the negatives of uncertainty are appraised, not the opportunities - thus more selling.

Last comes capitulation; greed turns to fear. Further selling ensues because cash doesn't go down, career risk has risen, and money managers push the "Easy Button", the do-over, the escape hatch; they liquidate holdings that are still perfectly fine to have held. As the great value investor, Jeremy Grantham, teaches us about Wall Street research, it's okay to be wrong but not to be wrong alone. No one wants to be seen holding too much in oil stocks and then suddenly it turns to selling stocks in general. From machine to primitive brain to raw and few emotions - the fear/greed trap - all roads lead to short term selling pressure and away from rational analysis.

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*“We strive to be disciplined and conservative in our investment approach and not overreact to near-term events and/or these types of macro calls.”*

*“In the last 30 years, oil has experienced three major drops in price, and these plunges haven’t been bad overall for stocks or the U.S. economy. As a matter of fact, each time the S&P 500 Index traded higher 12 months later.”*

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This is why we became independent advisors - so we could remain moderately wrong for you in the short term, **while doing what is best for you in the long run - buying cheap assets, adding to them when they get cheaper, and holding them in a portfolio as tax-efficiently as we can.** We try to keep our doses of conventional wisdom, big swings at the plate, and bold calls to a minimum. We want to think for ourselves and for our clients untainted by the black and white reactive trading that usually produces poor results over time when compared to nuanced thinking on matters that are truly gray.

So let’s take a more specific look at the causes of lower oil prices, the stronger dollar and interest rates as well as the major potential implications:

- **Lower Global Oil Prices** – 1) The global supply of oil itself has increased especially in North America due to new fracking technology. Over the last few years, U.S. oil production has increased steadily with the U.S. moving towards energy independence. 2) OPEC’s decision to maintain current production levels at lower and lower prices puts further downward pressure on prices. The combination of increased domestic production and OPEC’s output has resulted in an “over” production of oil. However, as recently as 2002, the worry was that we were reaching “Peak Oil”, the perpetual decline in annual global oil production. Based on M. King Hubbert’s theory:
  - Optimistic forecasts put global production in decline around 2020.
  - Pessimistic predictions stated that either the peak had already occurred or that it would occur shortly.

Obviously, these predictions are proving to be way off and too binary which demonstrates the danger of making extreme macro calls or large investment “bets”. We strive to be disciplined and conservative in our investment approach and not overreact to near-term events and/or these types of macro calls.

The sharp oil price drop is a near-term negative for earnings of companies linked to the energy sector, and these companies have already slashed capital expenditures by \$30 billion to preserve cash flow and dividends. As with every major dislocation, there will be winners and losers. In the last 30 years, oil has experienced three major drops in price, and these plunges haven’t been bad overall for stocks or the U.S. economy. As a matter of fact, each time the S&P 500 Index traded higher 12 months later. With 70% the U.S. economy being driven by consumer spending and with the consumer being the primary beneficiary of lower prices, we should begin to realize the benefits in the months to come – we believe the market is overreacting and fixating on the 15% of the economy that is negatively impacted and not the 85% that will benefit from lower oil prices.

*“The currency markets are experiencing unprecedented volatility.”*

*“...lower interest rates are stimulative for consumers and corporations who can borrow and refinance debt at historically low levels.”*

*“So we are finding more opportunities now with the dislocations in the energy patch and the overall volatility in the markets.”*

- **Strong U.S. Dollar** – The dollar has appreciated significantly over the past few months especially versus the Euro, due to falling oil prices plus diverging economic growth and monetary policies between the U.S. and other countries. The currency markets are experiencing unprecedented volatility. As U.S. multi-national corporations report results, the currency translation of revenue and earnings to dollars is a near-term negative. This is adding to the volatility to the equity markets which we expect will persist. We anticipate that financial expectations will be reset lower in the near-term to account for the negative currency impact; however, this is generally a transitional and more of a reporting issue than a longer-term statement on corporate earnings.
- **Interest Rates Down Again** – U.S. Treasury interest rates continued to make fresh lows contrary to most investors’ expectations including Shorepoint’s. The main causes of low U.S. interest rates are: weakening of global economies, strength of the U.S. Dollar, higher rates relative to international markets, and low inflation. Low interest rates should support higher stock valuations and business expansion; however, the concerns about the negative impact of lower oil prices and strong dollar on corporate earnings seem to be overwhelming these factors. At some point, interest rates will rise. The market still expects short-term rates to increase by this summer; however, the Federal Reserve indicated that it is concerned about international markets which are weakening and beginning their own quantitative easing amid fears of deflation. In the interim, lower interest rates are stimulative for consumers and corporations who can borrow and refinance debt at historically low levels.

### **CONCLUSION**

Domestically, we continue to have growing employment, record levels of cars being sold, low inflation, an oil “tax cut”, a strong housing market, and rising home equity balances - good for the economy for sure, if not the equity markets. The S&P 500 Index is trading at an average valuation but with a dividend yield greater than 10 year U.S. Treasuries. We expect continued volatility in the market after years of below average volatility, and we view equity market pullbacks as opportunities to add to high quality, attractively valued, dividend-paying stocks as well as adding to underperforming areas such as: international equities, MLPs, domestic small caps and selective energy stocks. We are finding more opportunities now with the dislocations in the energy patch and the overall volatility in the markets. Stocks still look relatively better to us on a valuation basis than do any other major asset classes.

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