

Newsletter – May 2015

MARKET TRENDS 3/31/2015

<u>US Stock Markets</u>	<u>Q1</u>	<u>12 Mos.</u>
S&P 500 Index	0.95%	12.73%
S&P MidCap 400 Index	5.31%	12.20%
Russell 2000 Index	4.32%	8.22%

<u>Int'l Stock Markets</u>		
EAFE Index	4.88%	-0.92%
Emerging Mkts Index	2.24%	0.44%

<u>Fixed Income</u>		
Barclays Intermediate		
Gov't/Credit Bond Index	1.45%	3.58%
Barclays Capital Muni Bond		
3 Year Index	0.41%	1.30%

<u>Commodities</u>		
SPDR Gold Shares (NAV)	-1.12%	-8.48%
Goldman Sachs		
Commodities	-8.22%	-40.32%

<u>Real Estate</u>		
Dow Jones US REIT Index	4.27%	22.00%

<u>Yields</u>	<u>3/31/2014</u>	<u>12/31/2014</u>
6 Mo. US T-Bill	0.13%	0.12%
10 Yr UST	1.93%	2.17%

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

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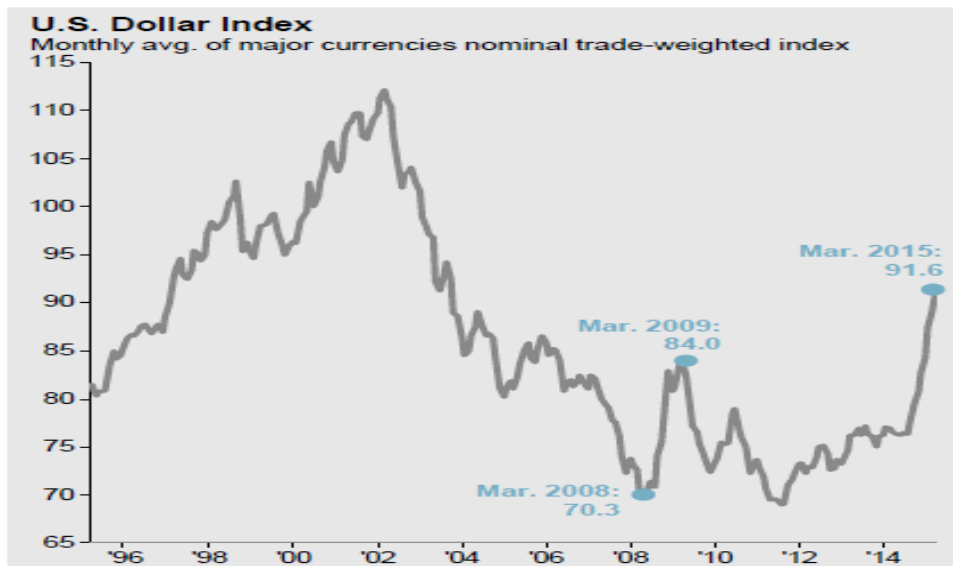
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Choppy and Volatile Markets

The first quarter of 2015 was marked by volatility in the equity markets. There were more up and down moves of 1% than there were for the entire year 2014. One surprise that has continued to hamper and trouble the markets has been lower oil prices. After more than a 40% drop, oil has remained low but is starting to show the first signs of firming.

The stronger dollar has been another source of ongoing uncertainty for markets to digest. For years, the U.S. Treasury has talked about the need for the U.S. dollar to be king of all currencies, while the U.S. dollar remained stubbornly weak. The upside of that trend was the tailwind provided to our exports. Now that the dollar has strengthened, this weakness of our currency works as a headwind to our exporters who will have trouble competing in an increasingly global world. The positive effect of the strong dollar is that oil is priced in U.S. dollars, hence the drastic price reduction at the pump, which has resulted in a major short-term tax credit to individuals heading into the driving season. Granted we have yet to see the welcome assistance that cheap gas provides to retailer and small businesses, but we still believe the U.S. consumer, who drives about 70% of our economy, will provide strength to an economy that has slipped a bit thus far in 2015. Time will tell if the soft first quarter has more to do with weather or something more significant.



Identifying Opportunity. Navigating Risk.

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“Short-term volatility has been further exacerbated by Wall Street’s addiction to low interest rates.”

“Again, how foolish the market can be in the short term - but rarely is it so over the long term. And that’s where we need always to focus - on the long term.”

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As if these concerns were not enough, global conflicts and anxieties have continued as well. The U.S. and Iran completed a batch of arduous nuclear negotiations that looked somewhat successful, though the ripples are being felt throughout the Arab world and beyond the Middle East. The role of Russia will be impacted from this “pact” in ways that are still emerging, and the effect will be felt in all of Europe as well. In the archetypal, perpetual war of good versus evil, we have seen the galvanizing effect of treachery that groups like Islamic State of Iraq and the Levant (“ISIL”) foment when they go too far. We can only hope that the world unites to stamp out groups like these that exist only to commit atrocities in the name of hatred.

Interest Rate/Fed Fears

Short-term volatility has been further exacerbated by Wall Street’s addiction to low interest rates. Never have we seen the Federal Reserve’s (“Fed”) statements so analyzed, so parsed and chopped and diced, as analysts and money managers try to read the tea leaves to guess when rates will rise. When economic numbers come out weak, many of us watch as day traders run the market up with the hope that the Fed will have to wait to raise rates. How foolish! We want the economy to strengthen so people can find better jobs, so we can all enjoy a fuller employment society. We should want the Fed to raise rates because it will mean that things are getting better for our country and that we can get back to more normal, market-based levels for interest rates rather than the artificial ZIRP (zero interest rate policy) that was utilized under Bernanke initially to stave off a global economic collapse. Instead, we have seen the opposite - the selling off of markets when economic indicators strengthen. ***Again, how foolish the market can be in the short term - but rarely is it so over the long term. And that’s where we need always to focus - on the long term.***

To short term market traders, we say get a life! Whether the Fed raises rates in June or December (or any other time in between) and whether they raise rates 0.25% or 0.50% should not deserve the emphasis it has been receiving. We will continue to look for the unloved, unpopular contrarian opportunities created by the trampling sounds of crowds and fast thoughtless money.

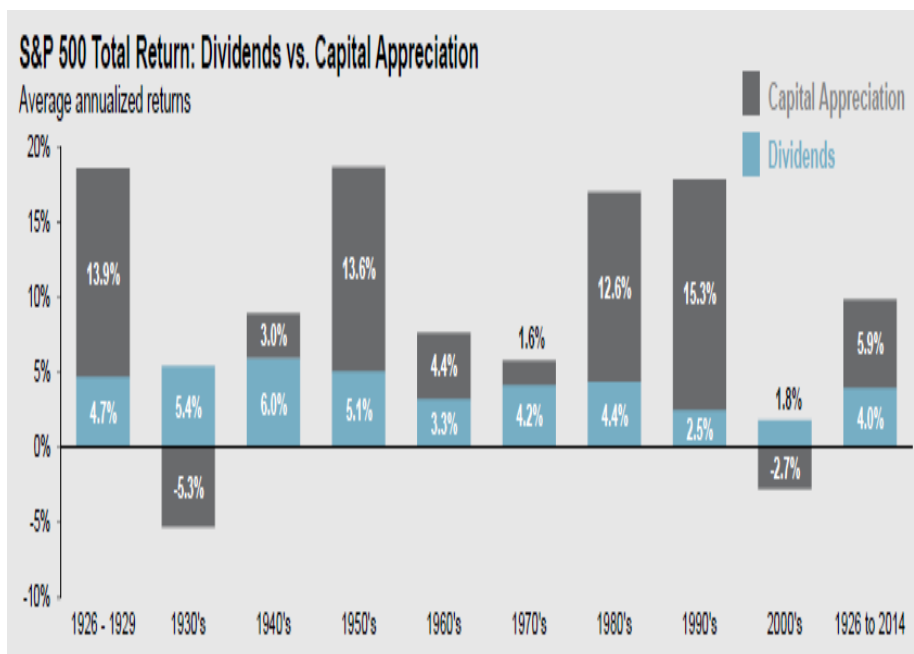
“Shorepoint has always emphasized dividend-paying stocks that have the potential for dividend growth.”

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Dividends - A Strategy for All Seasons Exemplified by Recent Kraft-Heinz Merger

Shorepoint has always emphasized dividend-paying stocks that have the potential for dividend growth. We also search for companies that have the ability to initiate dividends in the future – companies with strong free cash flow. Why this focus? Well, dividends provide an excellent source of income for clients and they are taxed at a preferential rate, less than those on interest and ordinary income. **Historically, dividends have comprised 40% of equity returns so it is an essential piece of the investment puzzle.** Also, companies that pay consistent, rising dividends are usually financially healthy firms that generate consistent cash flow (this cash, after all, is where the dividends come from). It's certainly not guaranteed; however, once a company has a track record of delivering reliable dividends with increases over time, it is going to work hard not to disappoint investors. These companies are often stable, and their stock prices tend to be less volatile, less risky than the general equity market.



Periodically, dividend-paying stocks fall out of favor especially in more bullish times, and provide us with a buying opportunity. When investors overreact to short-term events, we will initiate a position or add to positions if the dividend seems safe and the stock is undervalued.

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“However, these stocks can be lower risk, undervalued (in some cases significantly), and out of favor, which fits well with our contrarian bent.”

“Our contrarian allocation to weak areas such as energy stocks, MLPs, domestic small caps and international equities are starting to bear fruit.”

“Shorepoint continues to favor higher quality companies that are attractively valued, with solid balance sheets and that are strong cash flow generators.”

We try to remain patient as it can take time for the market to reward companies and their stock prices. For example, it took about three years to be rewarded for our Vodafone position and its ownership of Verizon Wireless, both in receiving Verizon stock and a special dividend. Our patience in our Abbott Labs position and subsequent spinoff of Abbvie has also paid off. Most recently, our languishing Kraft Group position was rewarded by the news of Heinz merging with Kraft - a quick 40% increase in the stock price and an expected \$15+ dividend per share distribution later this year. Some investors think dividend-paying stocks are boring. However, these stocks can be lower risk, undervalued (in some cases significantly), and out of favor, which fits well with our contrarian bent.

Conclusion

The anticipation of the Federal Reserve hiking domestic interest rates resulted in dividend-paying stocks (domestic and international) underperforming the broader equity markets in the first quarter. After a weak 2014 for international stocks, which we have owned, both developed and emerging market equities have shown signs of life and outperformed domestic stocks so far in 2015. We continue to view international equities as undervalued especially with European Central Bank starting their own quantitative easing (QE). The strength of the U.S. dollar is a headwind for domestic investors, but QE should provide price support and valuations are attractive.

Overall, the domestic economy is experiencing the following positives: steady job growth, low inflation, and an oil “tax cut”. Our contrarian allocation to weak areas such as energy stocks, MLPs, domestic small caps and international equities are starting to bear fruit. We view the S&P 500 Index as fairly valued based on current interest and inflation rates. However, relative to bonds, the equity market is still significantly undervalued! We expect continued volatility in the markets and view pullbacks as a buying opportunity while still being selective and disciplined. Shorepoint continues to favor higher quality companies that are attractively valued, with solid balance sheets and that are strong cash flow generators.

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