

Newsletter – April 2014

First Quarter 2014 Market Recap

MARKET TRENDS 3/31/2014

<u>US Stock Markets</u>	<u>Q1</u>	<u>12 Mos.</u>
S&P 500 Index	1.81%	21.86%
S&P MidCap 400 Index	3.04%	21.24%
Russell 2000 Index	1.12%	24.89%

<u>Int'l Stock Markets</u>		
EAFE Index	0.66%	17.56%
Emerging Mkts Index	-0.43%	-1.42%

<u>Fixed Income</u>		
Barclays Intermediate		
Gov't/Credit Bond Index	1.64%	0.98%
Barclays Capital Muni Bond		
3 Year Index	0.33%	1.09%

<u>Commodities</u>		
SPDR Gold Shares (NAV)	7.41%	-19.51%
Goldman Sachs		
Commodities	2.94%	1.13%

<u>Real Estate</u>		
Dow Jones US REIT Index	8.75%	2.08%

<u>Yields</u>	<u>3/31/2014</u>	<u>12/31/2013</u>
6 Mo. US T-Bill	0.06%	0.09%
10 Yr UST	2.72%	3.03%

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

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The first quarter results broke from the steady and above average returns of 2013. As we expected, volatility increased significantly and we experienced a 6% correction in February followed by a move up to record high levels before a slight retreat at quarter-end. Volatility increased due to several concerns:

- 1) Emerging markets economic slowdown and currency weakness
- 2) The Federal Reserve/tapering
- 3) "Elevated" equity valuations
- 4) Mixed economic data
- 5) The upheaval in Ukraine, which led to a roller coaster ride in the equity markets

For the quarter, domestic equity markets were led by mid-caps (+3%) followed by large caps (+1.8%) and small caps (+1.1%). As for international equity markets, developed markets were up slightly (+0.7%), while emerging markets continued to be weak (-0.4%). As we have written previously, our allocation to emerging markets has been, and continues to be, a drag on performance, but our conviction has not wavered – more about our view later in this commentary. The mutual fund industry also experienced another quarter of positive cash flows into equity mutual funds – domestic and international – although still modest relative to the outflows of the last few years.

Fixed income rebounded from last year's weak fourth quarter results and produced positive returns across the board. To start 2014, the best performing sectors were the worst performers of last quarter. Emerging Bonds (+3.5%) led the way followed close by U.S. High Yield (+3%) and international developed markets (+2.8%). Mortgage securities, investment grade corporates, and treasury protected securities also produced solid results while U.S. government and municipal bonds yielded small positive returns. Fixed income was helped by the widely held belief that the Federal Reserve would keep tapering (the government's bond purchase program) for the foreseeable future.

Commodities were very strong in the quarter with the broader basket of commodities up 7%. Gold was up 7.7% but still down almost 20% over the last twelve months. The rebound in gold is likely attributed to the growing tensions in the Ukraine and its implications for global markets. In Q1, gold again acted as the "safe haven" for investors when fears about global currencies arose. Real estate had a stellar quarter (+7.7%) as interest rates decreased slightly; however, REITs are only up 2% over the last four quarters.

Identifying Opportunity. Navigating Risk.

“As the stock market has sharply rebounded from the 2009 low, the probability is that more gains will be realized in the future in the due course of managing your account.”

“Keep in mind that Shorepoint offers on-demand tax reporting packages for you and your tax-preparer; we recommend that you review this package at least annually in early November.”

“...January began with a minor correction with the S&P 500 Index falling about 6% from its peak.”

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Spotlight on Taxes: Pain!!!

As we pen this quarter's commentary, we are struck by the amount of calls, despite careful planning, that clients are making to us to help get them funds to pay their tax liabilities for 2013. Needless to say, our CPA colleagues are delivering messages to clients that are not welcome news - namely that an increased amount of taxes are owed.

Lillian Gonzalez, CPA, a neighbor of ours in our offices and with whom we share mutual clients, wrote in a succinct email to us recently:

“This year the nice market coupled with additional net investment taxes, Medicare surtax and phase-out of personal exemptions and deductions have partnered well to increase taxes beyond what the marginal rates are... My comment to clients, be grateful you are paying more taxes, it means you are making more money and your investment advisors are doing their job.”

To which we at Shorepoint say, “Amen.” We would add that our clients overall seem to be doing better as well from an earnings/income standpoint, so you have a powerful combination of factors leading to bigger tax liabilities.

We do our best to mitigate taxes on your portfolio by using individual securities where possible and performing tax loss harvesting when available throughout the year, while also trying to maximize tax-free income and income from qualified dividends as appropriate to your personal tax circumstances. However, paying capital gains cannot be completely avoided, and it is a necessary process of portfolio management as a stock's attractiveness may change or a position may grow too large in your portfolio due to its appreciation (a nice problem to have). As the stock market has sharply rebounded from the 2009 low, the probability is that more gains will be realized in the future in the due course of managing your account. ***Keep in mind that Shorepoint offers on-demand tax reporting packages for you and your tax-preparer; we recommend that you review this package at least annually in early November.***

Markets Mark Time

After an ebullient year for U.S. equity markets in 2013, January began with a minor correction with the S&P 500 Index falling about 6% from its peak. By the end of the first quarter, markets had stabilized and returned to about where they started the year. Although it was a period where markets marked time, there were interesting and differentiating movements in the markets as there always seem to be in the short term.

“...the broader market is trading at a price/earnings ratio of 15.2x versus the 20 year average of 19.4x. This valuation level seems reasonable especially factoring in the current low inflation and interest rates.”

“...market ‘bubbles’ do not usually occur when investors are asking about bubbles.”

“We are prepared to look ‘foolish’ near-term, but our conviction is strong.”

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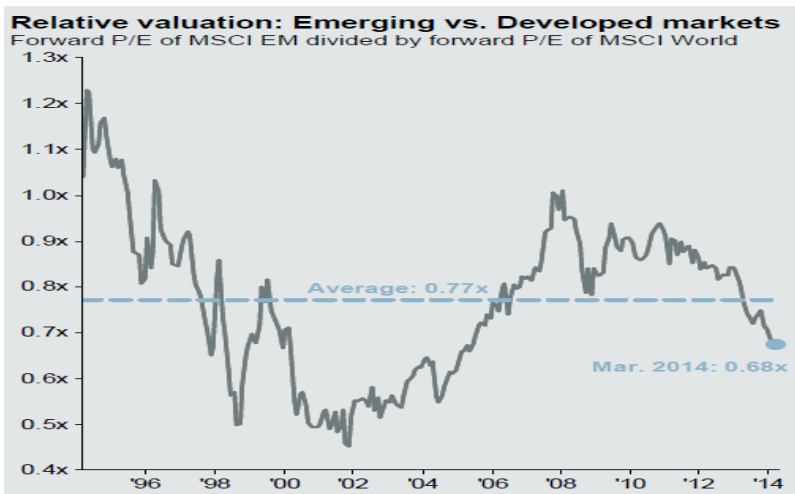
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“Are We In A Bubble?”

There have been numerous articles written asking if we are in an equity market “bubble”. We have also received the question from several clients. The flood of initial public offerings (“IPOs”) are part of the evidence being used to suggest a “bubble”. Well, we acknowledge that there are pockets of overvaluation – in small cap biotech, internet/social media related, and small cap technology stocks. However, the broader market is trading at a price/earnings ratio of 15.2x versus the 20 year average of 19.4x. This valuation level seems reasonable especially factoring in the current low inflation and interest rates. Also, we are not investing blindly in the market but instead are investing in what we view as attractively valued securities. Lastly, market “bubbles” do not usually occur when investors are asking about bubbles – they happen when the question is not raised because “it’s different this time” and money is flooding indiscriminately into equities – think of 2000 and 2007!

Opportunities for Contrarians

As contrarians, the first quarter presented us with better buying opportunities than we have had of late. We used the 6% equity correction to add to equities and/or shift to higher quality stocks with attractive dividend yields and valuation. We continued to add and dollar cost average into emerging market equities. Emerging markets are “hated” by investors and experienced some significant cash outflows. We believe this provides us with an investment opportunity, although it may take time to bear fruit. We are prepared to look “foolish” near-term, but our conviction is strong. As the following chart indicates, we think emerging market equities are attractively valued as is the debt (74% of which is rated investment grade) for that matter. This is actually a contrarian call as the consensus believes continued weakness will remain in emerging markets.



“...we expected greater volatility in the equity markets...”

“We view equity market pullbacks and over-reactions to company stock price gyrations as buying opportunities.”

“The last twelve months have reminded us yet again that markets are impossible to predict in the short run.”

As an example of a past contrarian investment, we want to discuss Vodafone (“VOD”). We have owned VOD in most of our stock accounts since 2011 even as it underperformed the S&P 500 Index and Verizon stock. It was our belief that the underlying value of Vodafone’s ownership of Verizon Wireless (the most attractive part of Verizon) was not reflected in its stock price and that VOD would be a better investment than Verizon stock directly. Well, that all changed in 2013 when Verizon agreed to buy VOD’s ownership in the wireless business in a complicated but very lucrative transaction. The result is the following:

	VOD	VZ	S&P 500
2011	13.8%	17.6%	2.1%
2012	-4.8%	12.9%	16.0%
2013	62.4%	18.4%	32.4%
2014*	29.0%	-2.1%	1.8%
Total Return*	69.8%	47.3%	49.1%

**Vodafone return includes regular dividend, special dividend and distributed Verizon shares*

Data as of 3/31/2014

Conclusion

As we indicated in our last newsletter, we expected greater volatility in the equity markets especially after such a robust 2013. Well, we have had two 4% plus corrections in the S&P 500 Index so far in 2014, one in February and one in April. We view equity market pullbacks and overreactions to company stock price gyrations as buying opportunities.

We think that the U.S. economy will grow faster than people expect and it is more likely to surprise on the “upside”. Europe seems to have bottomed economically and we are seeing signs of a rebound. Generally, the stimulative global monetary policy, despite the Federal Reserve tapering, is still positive for markets as is modest global inflation. Financial markets have been extremely resilient considering the tensions in Ukraine, severe winter weather conditions (a negative impact to the economy and corporate profits in the quarter) and the flood of IPOs to market.

The last twelve months have reminded us yet again that markets are impossible to predict in the short run. And we should not set expectations or manage investment portfolios without a long-term view and strategy. ***Although our expectation is for more subdued returns for 2014, we still find attractive areas of relative valuation in global stocks, non-traditional bonds and in dividend-paying stocks.***

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