ClearStone Capital Management

Market update for January 2015

2015: THE YEAR FOR VOLATILITY?

In this update: Current Market Issues, What this means to the Market & ClearStones Response & Reactions.

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Current market issues

ECB Embarks on Quantitative Easing

This past week signaled the European Central Bank's (ECB) entry into its own version of broad-based Quantitative Easing, or QE. ECB President, Mario Draghi, announced a plan on January 22nd to by 60 billion Euros per month of member nation's sovereign debt in an attempt to stimulate the stagnant Eurozone economy and stave off deflation.

The Eurozone QE situation is unlike the US Federal Reserve's massive stimulus in that national central banks will assume 80% of the responsibility of losses from any defaults or restructuring of their national debt. This was put in place after pressure from Germany who believes that unfettered quantitative easing could be seen as a bailout of weaker Eurozone economies and may encourage countries to forgo needed reforms aimed at restructuring their economic competitiveness.

We view this recent move as a positive step towards economic stability in the region and could pave the way for economic growth going forward. As in the past, it will be interesting to see if all the member countries remain unified in this move or if we start to see dissenting parties start to voice opposition. A unified Eurozone could go a long way towards restoring confidence, but that might be easier said than done. Promoting a unified currency, and the policies that entails, in a group of countries of differing economic strengths and situations has proven to be a difficult balancing act.

Greek Elections

National elections in Greece were also held this past week with the Syriza party winning majority campaigning on an anti-austerity platform. It was 2010 when the first bailout package was agreed upon that would send financial assistance to Greece in exchange for harsh austerity measures to reduce government spending and cut the budget deficit. Greece has continued to receive payments on that, and subsequent agreements. The austerity measures have been a bitter pill to swallow for Greek voters as cuts in government spending and programs have led to high levels of unemployment and continued weak economic conditions. Syriza hope to restructure the country's debt obligations in an effort to ease the economic hardships in the country. They campaigned on promises of seeking debt forgiveness from the country's creditors. Creditors have already dismissed that as not a feasible solution but there has been some discussion of renegotiating terms of the debt and possibly allowing a longer time frame for the country to repay its debtors. It will be worth watching how this plays out given previous market reactions to the issue and the somewhat fragile state of the Eurozone economy.

Saudi Arabia And Oil

Saudi Arabia's King Abdullah died this past week touching off some debate regarding the future stance of the country's oil production. Oil prices have been on the decline since mid-2014 and OPEC has refused to cut production to stabilize the price. Saudi Arabia in particular has made it known that they plan to maintain their market share and continue to produce at current levels rather than cutting production. Saudi Arabia's new king, Salman, has stated that he will continue the policy and production will remain at current levels. Lower oil prices have been an economic positive for oil-importing nations, but concerns about the economies of oil-exporting countries have been growing. Most countries that rely on the income from oil sales for their state budgets had projected oil prices much higher than where they currently reside and the risk of economic problems in those countries would seem to increase the longer oil prices stay at current levels. Some believe this move by OPEC is a challenge to the United States burgeoning oil industry. Over the past few years, oil shale production in the U.S. has experienced tremendous growth. New techniques like horizontal drilling and "fracking" have unlocked large oil and gas deposits flooding the market with new supply at the same time that global growth appears to be slowing slightly (the International Monetary Fund recently reduced its forecast for global economic growth from 3.8% to 3.5% in 2015 and from 4.0% to 3.7% in 2016). This increase in supply combined with a sluggish demand outlook has led to the dramatic drop in energy prices. These new deposits in the US are generally more expensive to pull out of the ground than more traditional deposits.

The production stance taken by Saudi Arabia could be intended to lower the price of oil in the short term in hopes of driving higher cost producers out of the market. A lot of how this plays out will depend on global economic growth going forward and if there are advances made that would reduce the cost of production going forward.

What this means to the market

A relatively healthy US economy, the Federal Reserve's exit from its Quantitative Easing program along with the initiation of the ECB's own QE program should continue to promote a strong US dollar relative to most foreign currencies. This should be another factor holding oil prices lower for the time being. A strong US dollar should have a slightly negative earnings impact on US companies that export a high percentage of their goods or services overseas.

Clearstone's response & reactions

So, while our Investment Committee is committed to promoting a diversified and balanced investment strategy, we are suggesting a slight tactical overweight to US equities relative to international equities based on stronger expected economic activity. In addition, we feel that small and mid-cap US equities may be the best play as they generally have less currency exposure to overseas sales and are a more "pure play" on US economic strength. Internationally, we have Japan at a slight overweight to relative to Europe and in the emerging market space, we find India particularly attractive. Both Japan and India are big oil importers and the low current levels of crude should be a positive for them on top of their pro-growth government policies.

In fixed income, we continue to like longer dated US Treasury bonds as a preferred hedge against market volatility. We realize they are less attractive as the prices have run up but feel there is no better hedge against the uncertainty of the markets and continue to hold our positions. It is our view that ECB QE could actually serve to keep US rates down as that money seeks out a home. Some of those dollars could find their way into the safety of US Treasury bonds, keeping prices elevated and yields low.

Finally, from a sector perspective, we think that US growth could actually exceed expectations slightly and therefore are suggesting overweighting cyclical areas of the economy such as the Technology, Industrials and Consumer Discretionary sectors while underweighting more defensive areas in Consumer Staples, and Utilities. The strong dollar and the current oil environment lead us to underweight the Energy and Materials sectors as well.

Thank You!

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If you are a prospective client or if you wish to forward this to a friend please do so, we welcome the interaction.

Our main contact information is 866-534-0530 and clearstonecapitalmanagement.com

Sincerely,

Trent Bowers, Jared Stubbs, Curtis Lamb & Michael Robinson
ClearStone Capital Management's Investment Committee

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