STRATEGIC WEALTH PARTNERS INC.
Partners in Protecting Your Capital

Quarterly Report- 1st quarter 2015

On the Markets...

Last year the S&P 500 peaked on December 29, making a new high for the year, for the 16th time. But to enjoy that performance, intrepid investors had to endure a market which changed direction 20 times (!) and threatened to make new market lows on 9 separate occasions.

In 2015, this market has already changed direction 9 times in only the first 3 months. If you sat in an index fund that tracked the broad market, and wearily turned your back at Thanksgiving, determined to let this play itself out, deciding not look at your account value for the next 4 months- on April first you would be convinced you had been the target of an April fool's prank- for despite all the gyrations, your account value would be virtually unchanged.

No surprise, then, that this is one of the most distrusted, if not utterly despised Bull Markets in history, ironically joined to the slowest recession recovery in history, but moving almost indecisively higher, more than 6 years from the March 2009 trough of the global financial collapse.

In this environment we have remained invested and alert, with a keen focus on producing multiple income streams to strengthen your portfolio.

For 6 years there has been a shrill chorus of skeptics and deniers predicting an imminent market collapse. Eventually they may be right, like the broken clock which is perfectly accurate twice each day. But we are not in the "prediction" business. We are in the "aware and prudent judgement" business. As such, we are not trying to guess where the market will go, but instead, trying to follow the market in a responsible way, carefully gauging risk and reward. It has long been our judgement that historical chart patterns and traditional valuation models do not usefully serve to guide asset allocations in this market because aggressive central bank intervention has distorted the economic environment, creating what some have called an economic singularity.

Singularity was originally a mathematical term for a point at which an equation has no solution, because, in effect, the ordinary rules no longer apply. In physics, it was proven that a large-enough collapsing star would eventually become a black hole, so dense, that its own gravity would cause a profound distortion in the very fabric of space-time: a point at which many standard physics equations suddenly have no solution. Beyond the “event horizon” of the black hole, the models no longer work, and physics becomes very weird.

We believe we are sitting at an economic event horizon, where standard investment analysis has little application and economic life has become very strange. We read that some 25% of bonds in Europe now offer negative interest rates. German bonds have negative yields out to the eight-year mark. Switzerland is now issuing 10-year bonds at negative rates. How do standard value equations work in an environment of negative yields? In a world of negative interest rates it becomes mathematically impossible for pensions and insurance companies to meet their goals, given their investment mandates, and retirees and conservative investors suffer real pain. As the Federal Reserve here at home, and central banks globally attempt to stimulate markets with experimental and obscurely named tools, like Quantitative Easing, economists can argue and debate, but the rest of us have to navigate these uncharted waters very carefully.

In the U.S., nominal interest rates are not negative, although net of inflation real yields may be, but they are at levels last seen nearly 70 years ago. As a result, one explanation for the stock market’s rise, despite a slow overall recovery in jobs, wages and housing, is known as the TINA effect: There Is Nothing Else in which to invest for a reasonable return in this low interest rate environment.

In effect, manipulative monetary policy has diverted capital investment into the equity markets and prices have been driven higher by corporations buying back their own stock with cheap money and surprisingly robust corporate profits. Companies have struggled, much as consumers have, to generate revenue growth. The question going forward will be the sustainability of corporate earnings. If earnings are sustainable at this level, the market is being fairly valued.

This bull market is already 6 years old, but still only sixth in the longevity hall of fame; half the length of the 2 longest bulls. And as Leon Cooperman famously observed, bull markets don’t die of old age. They are killed by investment excess, like the dot-com bubble, or an economic recession.

Our indicators still show less than a 5% probability of a recession within the near-term 9 month window, but we are growing increasingly cautious. It is fair to say that we are now playing Defense, because market internals are becoming more fragile.

Old hands are quick to point out that the market climbs a wall of worry: slowing growth in China, the possibility of a Greek exit from the Eurozone, the dramatic decline & volatility in the price of oil, the eventual move by the Federal Reserve to raise interest rates, here in the U.S....we are watching these closely, and re-evaluating our base case frequently, but a proper discussion of these would require a much lengthier letter. If you have questions about any of this, we invite your inquiries or comments.

We shall close with the following story which comes from Warren Buffett's Letter to Shareholders, in the 1987 Berkshire Hathaway Annual Report.

"Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his. Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behavior, the better for you.... [A]n investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind."

Thank you, once again, for your trust and confidence. We welcome your feedback.

Sincerely,

M Lieber

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