

# Roosevelt Investments: Thoughts from our All Cap Core Equity Team

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**January 2013**

*A cloud of political uncertainty hovered above the markets in the fourth quarter of 2012. Fortunately, an accommodative Fed and some decent economic indicators cast a bit of sunshine and prevented major sell-offs. Looking ahead, the debt ceiling negotiations could present a serious challenge both to lawmakers and the markets over the coming months. Nevertheless, reasons for cautious optimism exist. Easy monetary policy and economic improvements may trump political instability.*

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## **Stepping Back from the Cliff**

Political considerations overshadowed the fourth quarter of 2012. First came the uncertainty about the presidential election; then came the 11th hour wrangling over the fiscal cliff. Yet, buoyed by an expansion of the Fed's quantitative easing program and some passable economic data and other developments, the market managed to end the quarter essentially unchanged.

Over the last couple of months, the Chinese economy began to show signs that it was rebounding from slower growth earlier in the year. Chinese industrial production and retail sales both advanced sharply in November. In addition, manufacturing activity in December exceeded expectations. The World Bank increased its Chinese GDP growth outlook for 2013 to 8.4% from 8.1%, a likely acceleration from 2012 growth levels. Furthermore, the new leadership in China may seek to improve the sustainability of the country's economic growth by reducing its reliance on exports while increasing domestic consumption.

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On the home front, economic data largely took a back seat to the fiscal cliff negotiations, but there were signs of continuing, albeit slow, progress. The weekly unemployment claims are at the lowest level we've seen in a while, although the overall jobless rate remained too high at 7.8%, with a modest addition of approximately 150,000 jobs per month. Retail sales for December came in at 4.5%, ahead of a previous estimate of 3.3%. Discounting may have driven some of this gain, but given the macro uncertainties and the atypically warm weather the overall results were better than some had feared.

The housing market continues to improve. Existing home sales in November were at the highest level in three years, while new home construction continued to trend strongly upward. Inventories remained lean with 4.8 months of supply on the market, marking a 7-year low. Prices are firming as well with the median sales price for a new home rising nearly 15% in November.

The Federal Reserve also continued its accommodative monetary policy. Even as Operation Twist came to an end, the Fed continued to purchase \$45 billion of Treasuries per month, maintaining its total monthly purchases of bonds and mortgage securities at \$85 billion.

## ***Looking Forward to the Year Ahead***

Heading into 2013, we are cautiously optimistic about the U.S. equity market. The economy, while certainly not robust, has exhibited encouraging signs of stability even amid the fiscal cliff negotiations. We believe that the strength of the housing market could have broad economic ramifications. For example, consumers may increase spending if they see their net worth improving as a result of higher home prices.

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The Fed's continued accommodative monetary policy offers another reason for optimism. Short term interest rates are still near zero and the Fed is also targeting longer term interest rates through its quantitative easing program.

We are also encouraged by improvements in the Chinese economy. With GDP forecasts indicating expectations for accelerated growth in 2013, we are a far cry from earlier in 2012 when China watchers feared a potential hard landing. The implications of this are widespread. Commodity producers across the globe would benefit from a strengthening Chinese economy, as would the many businesses here in the United States that operate in the country.

On the political front, however, things remain dicey. Although some political questions have been resolved, a big question remains: How will Washington solve the twin issues of the debt ceiling and sequester? Until there is some finality, these issues may continue to impact market stability. That said, we do believe that lawmakers will find a solution, though perhaps no more gracefully than they solved the fiscal cliff crisis. Another cause for some concern is the elimination of the payroll tax cut. Most workers will now see a reduction in their paychecks, which could impact spending.

In short, we believe that stock prices are likely to rise modestly in the near-term and we have positioned our portfolios accordingly. We have reduced our risk tools but are maintaining a modest level due to our concerns about the debt ceiling negotiations.

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**We remain positive  
with regards to our  
Reconstructing  
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and continue to  
see value despite  
significant gains  
that many of our  
holdings have  
accrued.**

## ***The Themes to Watch***

We remain bullish on our **Healthcare Revival** theme. Our enthusiasm is based on our belief that companies in the sector are becoming more efficient with respect to their R&D outlays. We are also encouraged by the Food & Drug Administration's more accommodative drug approval stance. In 2012, the FDA approved 39 new drugs; the largest amount in 16 years. This should bode well for the growth of pharmaceutical companies' earnings going forward. Furthermore, as a result of Obamacare, the Congressional Budget Office anticipates an additional 14 million insured Americans by next year, which should positively impact health care spending.

The **Energy Arbitrage** theme also continues to unfold. This theme was developed to identify beneficiaries of the boom in unconventional natural gas production and the resulting drop in the commodity's price. The Department of Energy recently completed an analysis of the pros and cons of exporting liquefied natural gas (LNG), concluding that selling the gas abroad would result in net benefits for the domestic economy. We believe that more supportive government policies for LNG exports would benefit those Energy Arbitrage companies in our portfolio that are involved in the transportation of natural gas.

We remain positive with regards to our **Reconstructing Housing** theme and continue to see value despite the significant gains that many of our holdings have accrued. There were concerns that a fiscal cliff resolution would negatively impact the housing market, for example if the interest deduction for mortgages was eliminated, but as it turns out the housing market came away largely unscathed. In fact, the Obama administration has lately hinted that it might step up its efforts to further stimulate the housing market.

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**As always, we  
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Lastly, while an economic rebound in China is not currently a portfolio theme, based on current information, we have added stocks that could stand to gain should the Chinese economy continue to improve.

As always, we continue to seek out new themes in an attempt to generate returns and aid in diversifying our portfolios. We also continually look for additional companies which may benefit from the themes that we are already invested in. Lastly, while our cautious optimism has dictated that we deploy a relatively low level of risk tools at the current time, we stand ready to adjust that weighting as necessary to reflect an ever changing investment climate.

**Roosevelt Investments**

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Risk Tools: Cash, Zero-Coupon Treasury ETFs, TIPS ETFs, Inverse/Leveraged Inverse ETFs and Precious Metal related securities are used as needed.

Inverse/Leveraged Inverse ETFs - Leveraged ETFs are securities that attempt to replicate multiples of the performance of an underlying financial index. Inverse ETFs are designed to replicate the opposite direction of these same indices, often at a multiple. These ETFs often use a combination of futures, swaps, short sales, and other derivatives to achieve these objectives. Most leveraged and inverse ETFs are designed to achieve these results on a daily basis only. This means that over periods longer than a trading day, the value of these ETFs can and usually do deviate from the performance of the index they are designed to track. Over longer periods of time or in situations of high volatility, these deviations can be substantial.

Precious Metals - The value of precious metals may be affected by various and often unpredictable factors, including, but not limited to, the economic, financial, social and political conditions globally and in particular countries. A precious metal's market price and the liquidity and trading values of precious metals may be affected by, retail markups, safekeeping charges, shipping costs, the actions of sovereign governments that may directly or indirectly impact the price of a precious metal. Precious Metals markets are subject to temporary distortions or other disruptions due to various factors, including the lack of liquidity in the markets, the participation of speculators and government regulations and intervention. In addition, U.S. futures exchanges and some non-U.S. exchanges have regulations that limit the amount of fluctuation in futures contract prices that may occur during a single business day. These limits are generally referred to as "daily price fluctuation limits" and the maximum or minimum price on a contract on any given day as a result of these limits is referred to as a "limit price". Once the limit price has been reached in a particular contract, no trades may be made at a different price. Limit prices have the effect of precluding trading in a particular contract or forcing the liquidation of contracts at disadvantageous times or prices.

TIPS - Treasury Inflation Protected Securities.

Zero-Coupon Treasury - U.S. Treasury debt security that does not pay interest (coupon) but is issued at a discount.