Roosevelt Investments: Thoughts from our All Cap Core Equity Team

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November 2012

After a strong September, the stock market ceded ground in October and ended the month about 2% lower than where it began. Third quarter earnings were disappointing as many companies struggled to achieve more than modest revenue growth. Guidance for future growth was lackluster given macroeconomic pressures from Europe and China in addition to fiscal cliff-related uncertainty. Housing data continues to point toward recovery, while the employment picture remains mixed.

At this juncture, most of the companies in the broader market have reported third quarter earnings. As the month of October progressed, corporate earnings releases provided evidence that revenue growth was generally challenging, especially from outside the U.S. Economic pressures in Europe and China were cited as reasons for weaker growth, as well as the uncertainty relating to the then-pending U.S. election and fiscal cliff negotiations. These results dovetail with the tepid economic growth backdrop in the U.S.

Despite weakness in the corporate environment, consumer sentiment is near a multi-year high, supporting stronger than expected retail and automobile sales. Another source of help to the consumer is a housing market that is showing clear signs of recovery, with home prices rising nationwide, strong mortgage refinancing activity and a drop in foreclosure activity. The recent decline in gasoline prices also provides relief to the consumer.

Regarding negotiations surrounding the fiscal cliff, it is very early in the process, but so far both sides have been making conciliatory remarks that indicate they are willing to meet in the middle. Nevertheless, negotiations may go awry or drag on.

With the election now behind us, we know the composition of Congress and the White House. Investors are currently assessing the odds that negotiations between the two governing parties will steer the nation away from the fiscal cliff. It is very early in the process, but so far both sides have been making conciliatory remarks that indicate they are willing to meet in the middle. The environment of the last several years in Washington has been quite polarized, but we are hopeful that the two sides will reach an agreement. Nevertheless, negotiations may go awry or drag on until the final hours before the deadline, creating heightened market volatility.

Tempering this uncertainty somewhat is the initiation in October of the Federal Reserve's latest quantitative easing program which will purchase $40 billion of securities each month. These incremental purchases may be more stimulative to the economy than the previous easing program since they are not sterilized (offset by the sale of other securities). In addition to the Fed's stimulus, central banks around the world have also been in easing mode for much of the past two years. Such stimuli tend to have a lagged effect, and therefore 2013 may see some of the impact of this record amount of monetary stimulus. This impact could be positive, as a boost to the economy and capital markets, or negative in the form of inflation that is higher than expected.

Another bright spot in recent weeks is an improvement in some of the data coming out of China, which include stronger export growth, retail sales, rail freight, bank loans, and consumer confidence. Importantly, inflation statistics have been on the decline in China for many months, which provides room for monetary authorities to kick start the economy with additional measures if needed.

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We stand ready to adjust our hedges as needed.

In response to the heightened risks to economic growth and the likelihood of market volatility ahead of fiscal cliff negotiations, we have modestly increased the weight of risk tools in the portfolio from the prior month. At the same time, however, we are cognizant that a successful resolution of the negotiations could potentially spark a rally in the market, and we stand ready to adjust these hedges as needed.

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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.

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