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SPECTRUM

STRATEGIC CAPITAL MANAGEMENT, LLC

Q1 2015 Newsletter By: Jeff Griggs

On the Fridge

REITs

REITs rallied in the 4th quarter as the 10yr dropped as low as 2.06%. The asset class beat all others returning 15% in Q4.

No Commodity Exposure

We maintained no direct exposure to commodities, a bright spot for clients as commodities fell –12% for the second straight quarter.

UnitedHealth (UNH)

As ACA pressures subsided UNH rose 19.5% in Q4 (38% in 2014), far outpacing the benchmark return of 6.6%.

In the Dog House

Energy

Oil prices fell –41%, energy sector equities performed quite poorly lagging the S&P 500 by over –16.50% in the quarter.

Emerging Markets

Hurt by weak currencies and economic growth in the developed world, Emerging markets fell –3.6% in Q4.

Continental Resources (CLR)

Continental CEO Harold Hamm made the brash decision to sell the company's oil price hedges early in oil's retreat. This contributed to the Shale driller falling over –40% in the quarter.

Due to the wide range of risk tolerances of our clients, some topics or asset classes may have more, less, or no importance to your portfolio. For a detailed analysis, give us a call, or request a detailed performance review.

Big Picture Review

The two greatest influences on capital markets in the fourth quarter were falling oil prices and declining treasury rates. While the Fed largely maintained expectations for a mid-2015 rate hike, the 10yr treasury rate retreated from a high of 2.44% to a low of 2.06% (it has since accelerated its decline in the first part of 2015).

Oil prices continued their fall, plummeting over 41% in the quarter. Many economists have speculated over the how and why behind oil's retreat. We believe it boils down to a deliberate decision by Saudi Arabia to maintain production levels in the face of excess supply for two reasons. The first, is an economic decision to push down prices in order to take high cost U.S. Shale producers out of the market. The second, is a geopolitical decision to put pressure on Russia and Iran, who rely on high oil prices to support their national budgets. Whether you believe the decision is more economic or more geopolitical in nature, the implication is that Saudi Arabia is not likely to cut production any time soon. We believe we may see "cheap" oil for an extended period of time.

At first glance, fourth quarter earnings look disappointing at 2.5% growth with about 50% of companies having reported thus far. However, excluding the energy sector brings us to a healthier 5.72% growth, and further excluding the financial sector shows the rest of the economy grew at a fairly robust 8.09%. Labor markets continued their improvement as the unemployment rate dropped to 5.6%. Housing markets and consumer confidence continue to improve as well. Overall, it was a fairly positive quarter for the U.S. economy and the momentum should follow us into 2015.

Looking Ahead Outlook

Going into 2015 we are most focused on three macro-economic themes, a strong dollar, low interest rates, and cheap energy. Central bank policy continues to be the main driver of global capital markets.

In the U.S. we expect the Fed to maintain their data-dependent stance when it comes to normalizing policy. Lately however, we have seen notable strength in the economy, especially in labor markets, which should begin contributing to the Fed's inflation target and supports a mid-2015 rate hike. Despite expectations of the Fed raising short-term rates, absent strong economic acceleration, or significant inflation, intermediate to long-term rates are likely to remain relatively low for the foreseeable future. For stocks this means that above average multiples may remain justifiable. Low rates also encourage spending vs. investing, provide cheap debt financing for expanding companies, and stimulate the housing and auto industries with low mortgage/auto loan rates.

In Non-US Developed markets, specifically the Eurozone and Japan, central banks are beginning easing programs of their own. While these programs may spur economic growth they will likely lead to a weaker Euro/Yen and a stronger dollar. That leads us to focus on U.S. companies that derive a large portion of their value

Links and Articles

- **Website redesign goes live!**
- **3 Ways a Strong Dollar Impacts the Global Economy**
- **Cheaper Oil: Winners and Losers**
- **Is 2015 the Year for Rising Interest Rates?**

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Looking Ahead cont.

Outlook

from domestic revenues. A strong dollar also supports foreign exporters and U.S. companies making foreign investments.

A strong dollar, low return on savings, cheaper gas prices, low unemployment, and rising wages (coming soon) all point to a US consumer ready to spend. While maintaining a diversified portfolio, we are particularly focused on finding US companies that derive their revenues from domestic sales and provide goods and services that may benefit from additional spending money (clothing, home goods, premium foods, tech, media, etc.). We will be keeping a particular eye on companies relating to the housing market as a combination of strong labor markets and rates beginning to rise may be a strong catalyst for increased home sales volume.

We have held an overweight position in the energy sector for quite a while now. While the expansion of shale production in the US has provided solid returns over the years, these companies were hurt by the recent fall in oil prices. As we have written, we believe that Saudi Arabia's decision to allow prices to fall was strategic. Whether you believe in the geopolitical argument, or the economic argument, Saudi Arabia would need to keep prices low for an extended period of time to achieve their implied goals. Thus, we no longer believe that the Energy sector looks particularly attractive and will continue to unwind our overweight position and transition those assets into more attractive investments.

Looking ahead we expect another good year for U.S. equities. While the hyper dynamic nature of global capital markets means expectations can change on a dime, we are largely maintaining our overweight position in U.S. equities, minimizing exposure to rising rates by keeping fixed income allocations down, and focusing on credit, rather than duration, risk when we do find opportunities in the bond market. Europe and Japan are continuing aggressive measures to kick start their recoveries and, while early, their efforts show real promise. It may still be too early to rally behind European stocks, but we will be watching the market closely. We are optimistic regarding the U.S. consumer and will be searching for opportunities in housing, technology, health care, and consumer oriented businesses that should benefit from consumers with attractive employment opportunities, growing wages, and gas bills that have nearly been cut in half.

Performance

The quarterly performance for each asset class is shown below. Further emphasizing the main capital market drivers in the fourth quarter, REITs had the highest return of 15.0% (benefiting from falling treasury rates), while Commodities had the worst return at -12.0%. Other notable points are the outperformance of small caps vs. large, reversing the opposite trend seen through the first three quarters of 2014, and the continued underperformance of Non-U.S. investments.

On a relative basis these returns were fairly in line with our expectations. We continue to favor U.S. Equities and maintain our low expectations for fixed income.

Segments	Benchmark	Return
Cash	Barclays 3 Month T-Bill	0.0%
Government	Barclays US Aggregate Government	1.4%
Inflation Protected	Barclays US TIPS	-0.8%
Corporate	Barclays US Aggregate Credit	1.1%
High Yield Corporate	Barclays High Yield - Corporate	-1.2%
Non-US Fixed Income	Barclays Global Bond excl. US	-3.0%
Large Cap Growth	S&P 500 Growth	6.6%
Large Cap Value	S&P 500 Value	6.0%
Mid Cap Growth	Russell Midcap Growth	7.6%
Mid Cap Value	Russell Midcap Value	7.3%
Small Cap Growth	Russell 2000 Growth	12.0%
Small Cap Value	Russell 2000 Value	10.7%
Non-US Developed	MSCI EAFE	-2.7%
Emerging Markets	MSCI Emerging Markets	-3.6%
Real Estate	DJ US Select REIT	15.0%
Commodities	Bloomberg Commodity Index	-12.0%

While performance will vary from model to model and investor to investor, our largest strategic moves across models remained a large overweight position to U.S. equities with an emphasis on large cap stocks.

We maintained zero direct exposure to commodities, once again benefitting our portfolios as commodities were the worst performing asset class for a second straight quarter. We also maintained a general underweight to fixed income with an emphasis on credit, rather than duration, risk where we did hold fixed income.

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Benchmark	Description
Barclays US Treasury Bill 1-3 Month	Measures the performance of government bonds issued by the US Treasury. The index includes only those bonds near to their original term. Maturities between 30 and 90 days.
Barclays US Aggregate Government	Comprised of U.S. Treasury and U.S. Agency indices. The index includes treasuries and U.S. agency debentures.
Barclays US Treasury US TIPS	Measures the performance of the US Treasury Inflation Protected Securities (TIPS) market. Federal Reserve holdings of US TIPS are not index eligible. The US TIPS Index was launched in March 1997.
Barclays US Corp. Investment Grade	Measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.
Barclays US Corporate High Yield	Measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Issuers with an emerging markets country of risk are excluded.
Barclays Global Agg Hedged USD	Measure of global investment grade debt from twenty-three different local currency markets. This multi-currency benchmark includes fixed-rate treasury, government-related, corporate and securitized bonds from both developed and emerging markets issuers.
S&P 500	Market-cap weighted index. Includes 500 leading US companies and captures approximately 80% coverage of available US market capitalization.
S&P 500 Growth	Growth segment of S&P 500. Measures growth stocks using three factors: sales growth, the ratio of earnings change to price, and momentum.
S&P 500 Value	Value segment of S&P 500. Measures value stocks using three factors: the ratios of book value, earnings and sales to price.
Russell Midcap Growth	Measures performance of the mid-cap growth segment of the U.S. equity universe. Growth is defined as those companies with higher price-to-book ratios and higher forecasted growth values.
Russell Midcap Value	Measures performance of the mid-cap value segment of the U.S. equity universe. Value is defined as those companies with lower price-to-book ratios and lower forecasted growth values.
Russell 2000 Growth	Measures performance of the small-cap growth segment of the U.S. equity universe. Includes those Russell 2000 companies with higher price-to-value ratios and higher forecasted growth values.
Russell 2000 Value	Measures performance of the small-cap value segment of the U.S. equity universe. Includes those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.
STOXX 600	Derived from the STOXX Europe Total Market Index, this index has a fixed number of 600 components representing large, mid and small cap companies across 18 countries of the European region.
MSCI EAFE	Equity index that captures large and mid cap representation across Developed Markets countries around the world, excluding the US and Canada.
MSCI Emerging Markets	Captures large and mid cap representation across 23 Emerging Markets countries. Contains 836 constituents and covers approximately 85% of the free float-adjusted market cap in each country.
DJ US Select REIT	A subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities. Excluding mortgage REITs, net-lease REITs, timber REITs, and others.
Bloomberg Commodity Index	Made of 22 exchange-traded futures on physical commodities. Represents 20 commodities that are weighted to account for economic significance and market liquidity.
Credit Suisse Liquid Alternative Beta	Reflects the return of a dynamic basket of liquid, investable market factors selected and weighted ina ccordance with an algorithm that aims to approximate the aggregate returns of the universe of hedge fund managers as represented by the Credit Suisse Hedge Fund Index.
ICE Dollar Index	A fixed weight basket of 6 foreign currency values in relation to the US dollar. Includes Euro, Yen, British Pound, Canadian Dollar, Swedish Krona, and Swiss Franc.