www.firestonecapital.com

QtrNotes

Qtr 1 January 2014

FIRESTONE CAPITAL MANAGEMENT

Volume 22 No. 1

In this Issue

Quotes:

Money won't create success: the freedom to make it will.
Nelson Mandela

The function of economic forecasting is to make astrology look respectable.
John Kenneth Galbraith

Making long-term plans based on short-term news is like telling the time by watching the seconds hand on the clock.
Anonymous

If you don't know how to care for money, money will stay away from you.
Robert T. Kiyosaki

The first lesson of economics is scarcity: there is never enough of anything to fully satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.
Thomas Sowell

Economic Recovery Gaining Momentum

Looking back on 2013, we find a year of moderately accelerating economic growth and spectacularly responsive markets. In the US, the markets put in their best performance since 1997. Consecutive days of record market highs were set at the end of December, with the Dow closing out the year at an all-time high.

In strictly economic terms, after a 4.1% third-quarter GDP growth, economists are predicting an even better year for 2014. The Federal Reserve now feels confident enough to start a slow tapering of its policy of Quantative Easing. As the Fed tapers, interest rates are already beginning to rise, but inflation is not expected to get out of hand. Nor are interest rates predicted to rise more than 1%, still a minimal amount compared to today's ten-year Treasury rate at just over 3%.

Consumer confidence reached a four-month high in December, bringing modest gains in holiday sales and a sense of optimism heading into the new year. Congress passed the first bipartisan-produced budget in 27 years, which both cuts the annual deficit and modestly eases the next round of sequestration spending cuts.

The employment picture is brightening: the most recent report showed that jobless claims had declined more than predicted. Companies are holding on to the workers they currently employ and are finally starting to add staff. While the news is encouraging, long-term unemployment is still a prominent issue, especially for the young and for workers without advanced education.

Federal Reserve economists predict the unemployment rate will fall to 6.3% during 2014, but this still won't help middle-class and older workers, whose jobs may never return. Part of the drop in the unemployment rate includes the late-career baby boomers who, nearing retirement age, have been unable to find comparable work and have retired early with reduced prospects. Congress's failure to renew benefits for the long-term unemployed may dampen consumer spending and threaten economic growth.

Index	*12/31/2013*	*YTD*
Dow Industrials	**16,576.66**	**26.6%**
S&P 500 Index	**1,849.44**	**29.5%**
Russell 2000	**1,165.64**	**37.0%**
MSCI EAFE	**1,915.67**	**19.4%**
Global Bond Index	**453.87**	**-2.6%**
10-Year Treasury yld	**3.03%**	

While the US markets are likely to continue to be an attractive place to invest, we can't realistically expect back-to-back years like the one that just ended. However, the coming year is sure to provide opportunities in several asset classes, and we hope to capture returns from those. A smooth ride is too much to expect, but we remain positive on the long-term prospects for our clients and their families.

Market Corrections:

Is the Glass 20% Empty or 100% Normal?

On March 9, 2014, we'll mark the fifth anniversary of the Great Recession's market bottom. If you still cringe at the thought of early 2009, you're not alone: the memory still haunts us today. It's crazy to think that the bottom marked a 57% decline in the S&P 500, when it felt as though it was on its way to zero. Even crazier is that since then, the market is now 177% higher and setting new record highs almost daily.

Thankfully, the five years since 2009 have provided steady market growth and everything seems pretty normal. From 2010 through 2013, the S&P 500 index has risen 64% and there haven't been any market pullbacks of note. Or have there? In actuality, the market had substantial corrections in 2010, 2011, and 2012, yet still finished each year in positive territory. At one point in 2010, the S&P 500 was down 16%; in 2011, it lost nearly 18%; and in 2012, it fell just shy of 10%.

(cont'd next page)

1500 San Remo Ave., Suite 176
Coral Gables, Florida 33146
305.669.2119
www.firestonecapital.com

jack@firestonecapital.com
carol@firestonecapital.com
carlos@firestonecapital.com
anthony@firestonecapital.com

FIRESTONE CAPITAL MANAGEMENT

Safety in Numbers:
The Year's Top Scams

Everything old is new again, especially when new technology offers a different packaging to the same con games that have been around for decades (if not centuries).

You've probably already been targeted by the "Nigerian 419" scam: an unsolicited email from a mysterious person in trouble in another country, the widow or heir or trusted friend of a wealthy philanthropist. Millions will be yours, if you'll only help – help that always involves increasingly large sums wired overseas. This vintage con game is nearly a century old, and is still finding new victims.

The latest frauds of 2013 include cons masquerading as employment offers, credit offers, disaster relief, friends in trouble, computer support, Medicare assistance, and identity theft scams capitalizing on confusion over health insurance. Meanwhile, hackers are targeting the computer records of the world's increasingly interconnected financial network.

The presentation of the cons is new, but the game is still the same, and so is the defense. Is the deal too good to be true? It's probably not true. An ounce of skepticism can be worth thousands of dollars when it keeps you safe from fraud.

Market Corrections

(cont'd from page 1)

Looking at each figure in isolation, those are pretty scary numbers. But in the grand scheme of investing, the last four years are looking pretty normal.

So what's ahead for investors' portfolios in the coming year? Will there be a correction in stocks? Almost certainly. There was no significant correction in 2013; the S&P 500 just kept on going up. Our crystal ball can't tell us when a correction may happen, but markets do not go straight up forever.

When – not if – a correction does occur, we have to remember that not every pullback derails the bull or signifies a recession. After a long climb, even the best mountaineer has to pause and take a breath.

The Many Sides of the Market

Nearly everyone asks, "How did the market do today?" When the media or most investors talk about the market, they are almost always referring to the Dow Jones Industrial Average. Did the Dow finish the day up or down? An occasional investor will ask about the S&P 500, a broader index. The Dow includes only 30 stocks, while the S&P tracks 500. Both rosters are chosen to represent the overall US economy, viewed from slightly different perspectives. Both are mainstream, US large-company, blue-chip indexes. Generally, the index that is having the better year gets more attention.

Despite this, the market is much larger and more complex than any single index. There are about 15,000 publicly traded stocks in the U.S. alone: small-company stocks, commodity plays, real estate investment trusts, gold funds, master limited partnerships, and the list goes on. There's also the enormous US bond market, with its various slivers. Most investors think of bonds as static investments, but bonds form a market too, subject to volatility and risk.

Looking beyond the US, we find that most large and developed countries have their own comparable markets, with their own rosters of companies traded on their own stock exchanges and often on world exchanges as well. The initials "ADR" after the name of a stock designate the holding as an American Depository Receipt, a non-US company traded on the US stock exchanges.

There is a broad spectrum of markets that run the gamut of risk and reward. Developed countries and regions with more stable economies, like the US, Japan, Europe, and Australia, provide diversified growth rates and economic differentiation. Emerging markets offer potential for higher return, but with increased risk. To diversify a portfolio, prudent investors look beyond their home market for opportunities as well as downside protection provided by a mix of currencies, governments, and business cycles.

Foreign or domestic, emerging or developed, large or small, all markets experience volatility. Real estate, commodities, emerging markets, gold, and master limited partnerships, although individually aggressive as investment types, can actually add stability and reduce volatility in a portfolio by adding not only diversification, but also correlation benefits.

Correlation – specifically, inverse correlation – is the measurable extent to which investments can move in opposition to each other. It seems unfortunate that not all markets enjoyed the same success as the US market did in 2013, just as not all segments of the market performed with the same energy. But it's actually a good thing that the various markets don't move in lockstep – because they shouldn't. If they did, each falling tide would sink all boats.

We also expect the US markets to continue moving forward, but not at the same rate we just experienced in this last year. We want to remain disciplined and not fall victim to chasing last year's returns. We expect commodities to rebound at the slightest hint of inflation or increase in consumer demand. We expect real estate to have better returns in the future than the 1.2% that this year gave us. We expect bonds not to be negative every year, but rather to provide stability and income to the portfolios.

We believe that emerging markets are likely to outperform the US; not every year, but we expect them to outperform over the next 5-10 years. Emerging markets are gaining more promise and potential from their improving demographics, industrialization, and modernization. We believe international stocks are more attractive than US stocks based on valuation measures.

Given these expectations, we remain comfortable investing in "the market" – the domestic US market, both large-cap and small – as well as across the various other markets around the world.