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QtrNotes

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FIRESTONE CAPITAL MANAGEMENT

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The Lighter Side

Noah was the best investor in ancient history. He floated stock while everything around him went into liquidation.

The market is weird. Every time one person sells, another one buys, and they both think they're smart.

A market analyst is an expert who will know tomorrow why the things he predicted yesterday didn't happen today.

I saw a bank that said it offered 24-Hour Banking. But I didn't go in. I didn't have that much time.

If you can count your money, you don't have a billion dollars.

The pessimist sees the glass as half empty. The optimist sees the glass half full . . . and the stock market day trader just adds whiskey.

Thawing Out in Spite of the Polar Vortex

The "Polar Vortex" swept through the nation, putting a temporary freeze on consumer spending and construction, and dampening economic activity overall. The foul weather affected all parts of the economy, from decreased productivity caused by lost workdays, to a multitude of cancelled flights, deferred travel plans, and lowered car and restaurant sales. Although the Dow recovered some gains in late March, it still ended the quarter fractionally lower; overall, returns for the quarter were not impressive. Corporate earnings are likely to be affected going forward, as we have seen downward revision of analysts' estimates. But despite the challenges, the S&P 500 still managed to produce its longest winning streak since 2007, gaining 1.3% to close its fifth consecutive winning quarter near its March 6 all-time high.

Index	3/31/2014	YTD
Dow Industrials	16,457.66	-0.7%
S&P 500 Index	1,872.34	1.3%
Russell 2000	1,173.04	0.8%
MSCI EAFE	1,915.69	0.0%
Global Bond Index	464.78	2.4%
10-Year Treasury yld	2.73%	

The economy, though not on fire, still managed to add 175,000 jobs in February, while new unemployment claims continued to drop. Consumer confidence is starting to heat up and reached a six-year high in March, as expectations grew for a more prosperous trend in 2014.

Although Europe is still dealing with austerity and weak credit conditions, it is also showing signs of growth. With global economic activity picking up, it still seems odd to note that inflation remains so subdued in major developed markets. US inflation is just above 1%, while European inflation is barely positive at 0.5%.

Compared with Europe, the US financial system is farther along in its recovery and our economy is healthier. The improving labor market will eventually push wages higher. We expect the official inflation reading to edge back over 2% by the end of the year. Even that is still low by historical standards. However, the upward trend is important and informs our long-term portfolio positioning.

The crisis in Ukraine, growing concerns over the health of the Chinese economy, hyperinflation in Venezuela, and the Fed's tapering continue to diminish investors' appetite for venturing abroad. As a result, emerging market stocks and bonds remain under pressure.

This is not an emerging market crisis like the one in the 1990s, which was triggered by currency and debt issues. Today's troubles primarily reflect a slowdown in global growth, which caused a reduction in emerging market country exports and appreciation of the US dollar against foreign currencies. Emerging market bonds are at their cheapest level in nine years relative to US Treasuries. Investors are pulling funds out of emerging markets at a pace last seen during the financial crisis. We remain committed to these markets, as the valuation case is very compelling here: history suggest that when fear drives others to flee an asset class, we should be buying.

Even with these headwinds, we continue to feel positive. A number of factors contribute to our optimism: low interest rates into the foreseeable future, an improving economy, fiscal restraint in Washington, and growing energy independence. Anything could trigger a short-term shock to the system and cause a market correction, but conditions are ripe for an extended period of productivity and growth.

A New Federal Reserve Chair Steps Up

Janet Yellen became chairman of the Federal Reserve on February 3rd, officially replacing Ben Bernanke. Yellen has served with Bernanke since 2010, and her public comments and past voting

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New Fed Chair

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history suggest she is likely to continue the Federal Reserve's current policies.

To date, Yellen has mostly met market expectations by announcing the Fed's intention to further reduce the pace of monthly bond purchases and to maintain current monetary policy as long as necessary to support economic growth. In a minor gaffe, she went so far as to hint that interest rates might begin to rise some time in mid-2015. The bond market reacted, sending prices down on most bonds. The market stabilized a few days later, but just to make sure no one misread her intentions, on the last day of March Yellen gave the markets a pat on the back by repeating her plans to preserve the easy money policy for an extended period of time. The stock market immediately responded with another jump to new highs.

Commodities

In today's environment of low inflation and low interest rates, clients may wonder why we continue to hold commodity positions. Generally, commodities were a drag on portfolio performance in 2013. Commodities perform best when inflation is high and demand is brisk. Inflation numbers in most economies remain tame, and slowing growth in China and elsewhere has caused demand to sag.

The primary reason to hold commodities is the diversification that they add to portfolios. Even more than fixed income or real estate, commodity funds historically show little correlation to stock or bond markets. Thus, they decrease overall portfolio risk.

Additionally, commodities represent a hedge against future inflation. Although inflation has been low in recent years, the tremendous amount of worldwide monetary stimulus could cause inflation to return with a vengeance in the not too distant future. At present, commodities are pessimistically priced, which means gains could result from an uptick in inflation expectations.

Even without the resurgence of inflationary fears, commodities are a long-term play on the globalization of world markets. Current world population of just under seven billion is expected to top nine billion by 2050. Increased commodity demand should certainly be fueled by this population growth, as well as by the economic expansion occurring in the emerging market countries.

Although there has been a small rally since the beginning of 2014, commodities are strikingly behind the rally that's been lifting equities since 2009. Diversification will always make some assets look ugly . . . until they look spectacular.

Leadership Change at PIMCO

PIMCO, the world's largest and best-known bond fund management company, is no stranger to publicity. Founded by Bill Gross in 1971, the firm has seen exponential growth and now manages nearly $1.5 trillion.

It came as a surprise when in January, co-Chief Investment Officer Mohamed El-Erian announced his departure from PIMCO. El-Erian, who formerly managed Harvard's endowment fund, is widely regarded as a thoughtful and eloquent global economic thinker. A key leadership change in a major mutual fund company must always be considered seriously when our client portfolios are exposed to potential fallout.

We are disappointed to see El-Erian leave, but we do not view his departure as having material impact on our specific PIMCO holdings. PIMCO retains an extremely deep pool of talented individuals with extended tenure, who lead the day-to-day trading and investing of portfolios. We will continue to monitor the situation to assess whether any action should be taken, but we continue to regard PIMCO's primary portfolio managers as effective, reliable professional partners.

Form ADV Annual Offer

Each year, the SEC requires that we notify clients when we have updated our disclosure brochure, known as the Form ADV Part II. You can download the updated document from our website by entering the following URL into a browser:

firestonecapital.com/docs/FCM Form ADV Part II.pdf

If you would like a copy sent to you directly, please call our office. We will be happy to mail or email you one.

Safety in Numbers:
The IRS Has Your Number

Most people know that their bank doesn't email them to verify their personal information, and that the Social Security Office doesn't call them at home to ask for their Social Security Numbers, and the government will neither call or email you to ask if you've signed up for health insurance. When you get any of these calls or emails (if you get them), you know it's fraud . . . especially if they want personal information, or money, or both.

Another group that won't call you at home is the IRS. But one of the newer scams this tax season is based on the hope that you don't know it -- and that you'll panic when a supposed IRS agent threatens you with criminal penalties if you don't pay up on the spot, by credit card or wire transfer.

Over 20,000 reports of this scam have already reached the IRS, and many more have gone unreported. Yes, the IRS does want your money (at least some of it), but they aren't going to call you at home if they have any questions: they still rely on old-fashioned physical mailed notices.

They also will not contact you by email, text, or social media. The IRS asks that any such messages purporting to come from them be forwarded to phishing@irs.gov.