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QtrNotes

Qtr 1 January 2015

FIRESTONE CAPITAL MANAGEMENT

Volume 23 No. 1

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Quotes:

There are only two kinds of forecasters – those who don't know and those who don't know they don't know.
John Kenneth Galbraith

Diversification is always working; sometimes you'll like the results and sometimes you won't.
Larry Swedroe

The evidence on investment managers' success with market timing is impressive – and overwhelmingly negative.
Charles D. Ellis

Investing should be like watching paint dry or grass grow. If you want excitement, take $800 and go to Las Vegas.
Paul Samuelson

I was going to make a list of all the things I was wrong about this year, but the Internet ran out of space.
Josh Brown

Not-So-Great Expectations: the Year the Pundits Got It Wrong

2014 was a year full of surprises. Economic crystal balls are always at least partly cloudy, but it's an extraordinary year when so little goes as expected. Predictions and forecasts for the year proved even less accurate than the proverbial stopped clock (which is correct twice a day).

Global turmoil is a given these days, but who expected Russia to start annexing parts of Ukraine, taking the Crimean peninsula and threatening a large part of the rest? Out of the blue, the Islamic State invaded large parts of Iraq and Syria, terrifying the world with videos of barbaric beheadings. Lost airliners and the Ebola outbreak dominated the news for a disproportionate part of the year.

Who could foresee the price of oil dropping nearly in half? None of the pundits predicted the dollar strengthening by 12%. GDP growth was expected to rise another 3% like last year, but a dramatic 2.9% drop in GDP for the first quarter, partially weather-related, kept growth below target at 2.5%. This past quarter featured an encouraging 5% growth rate, giving rise to optimism for the year ahead.

Closer to home, changing decades of policy relative to Cuba portends heightened expectations for South Florida.

In 2013 investors had bid up domestic stock prices, feeding concern that US stocks were overvalued. As money sat on the sidelines, waiting for a market correction that never came, the domestic markets expanded even further in 2014, confounding the experts.

Improving labor markets argued for wages to begin to rise in 2014. After years of failing to provide meaningful raises, with 2013 wage increases of only 1.9% and near-full employment numbers, workers expected stronger wage growth. But wages grew just 2.1% while corporate profits rose faster than ever.

Index	12/31/2014	YTD
Dow Industrials	17,823.07	7.5%
S&P 500 Index	2,058.90	11.4%
Russell 2000	1,204.70	3.4%
MSCI EAFE	1,174.90	-7.4%
Global Bond Index	456.53	0.6%
10-Year Treasury yld	2.17%	

In a Bloomberg survey of economists early in the year, by unanimous consensus, interest rates were expected to rise. Treasury rates on the 10-year bond were likely to be 3.25% at year-end. But what happened instead? Rates fell to 2.2%, causing a surprise increase in longer-term bond prices.

Home prices added another 4.8% to the robust 13% of the prior year, as mortgage rates continued to be attractive to those who could qualify.

After a tepid 2013, when its economies shrank by nearly half a percent, Europe was expected to pull itself out of recession. After lagging the US markets by 10% in 2013, conditions seemed ripe for attractive returns, but with the stronger US dollar, foreign stock markets didn't fare well at all.

Inflation was expected to rise to the Federal Reserve's 2% target. Instead, inflation actually dropped to 1.3% by year's end. Consumers, however, suffered as some food costs rose by 9%, driven in part by record drought in California. Late in the year, the plunging price of energy offset some of the dramatic rise in food costs.

One prediction came through pretty much as expected. The results of the 2014 mid-term elections confirmed that the GOP would control the Senate as well as the House, giving a glimmer of hope that the 114th Congress will be more productive than the last. We could see action on tax reform, which is likely to start with corporate taxation, as well as modest immigration reform.

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Safety in Numbers: the 'Internet of Things'

Pop quiz: how many computers do you own?

If you answered "Dozens," you're correct. A typical home has more computers than ever – from tablets, phones, and peripherals to smart devices (appliances, monitors, alarm systems, Fitbits) and other items (watches, clocks, cameras, TVs, credit cards – even your car.)

The ever-expanding list of devices that can be equipped with a computer chip and some access to network connectivity has been dubbed "the internet of things." It includes some unlikely items: the coffeepot, the microwave, the bathroom scale. Each one offers convenience, or added features, or some other benefit. But eventually, the question has to be asked: who's got access to all this information?

Recent demonstrations by security experts showed disquieting examples of unexpected hacking. Any camera or recorder can be used for surveillance. And any item with a USB plug can deliver malware to your home system.

What's the solution? For now, a little awareness goes a long way. Keep chip-enabled credit cards in a special blocking wallet. Put a password on your home wi-fi network. And the simplest security measure of all: put a sticker over the camera lens of your laptop.

Not-So-Great Expectations

(cont'd from page 1)

There might also be some movement on infrastructure spending. With the highway bill expiring in May, an expanded proposal for more than just highways might make an attractive package. A bill to move forward on the Keystone Pipeline is also a priority for the Congressional majority.

Asset allocators have been frustrated with the fact that a single asset class, US stocks, drove returns for the entire year, with everything else detracting from them. As of the end of November, hedge fund managers, purportedly the smartest minds in the business, were showing only an average 2% positive return, with far too many managers suffering negative annual performance.

We have faith in and are committed to diversification, which over extended periods provides the joint benefits of risk management and more sustainable returns. But we understand that clients can become both concerned and frustrated in an era with 24/7 financial news talking heads and pundits, not to mention 140-character commentary and two-minute videos predicting what will happen in the markets in the next 15 minutes. We're more interested in the next 15 years, even though it's hard to stay focused amid the short-term clamor.

Predictions

Take this all with a grain of salt, but what do strategists see for 2015? Predictions include the first interest rate increases from the Fed in 8½ years, and continuing strength in the US dollar. We expect to see improving wages, continuing decrease in unemployment, and increased participation in the workforce.

After the disappointments in international markets over the past several years, we expect those markets to finally turn. Long-term growth prospects in developing and emerging markets, however volatile, continue to look attractive.

In alternatives, multi-strategy and hedge fund managers didn't get stupid all of a sudden: we expect their long-term strategies to once again provide benefit and value to portfolios.

What's Going On With Oil?

As you've undoubtedly noticed, filling up your tank has gotten much cheaper. That's because the price of oil sits at a 5-year low. Light crude oil, one of the main pricing markers, was trading just over $56 a barrel as we ended 2014, reflecting a price drop of nearly half from the $110/ barrel just six months earlier. Goldman Sachs estimates the economic effect on US consumers is equivalent to a $125 billion tax cut. A lower price at the gas pump frees up much-needed dollars, to put towards other discretionary purchases or to add to savings.

Why the price collapse? Weak demand due to anemic world-wide economic growth, a surge in US production made possible by new fracking technology, growing conservation efforts to use energy more efficiently, and OPEC's surprise decision not to cut production in an attempt to stabilize (and manipulate) prices. In short: supply is high, demand low, and oil in search of an equilibrium price. What does all this mean?

Lower prices are already having devastating effects on countries that produce, export, and rely on oil revenue to fund their economies – countries including Brazil, Canada, Indonesia, and Saudi Arabia. Iran, Iraq, Venezuela, and Russia will be the worst off, because they rely heavily on higher oil prices to fund their budgets.

Oil producers will be hurt by lower prices and will be forced to adjust. Smaller companies in the industry may find survival difficult, as they try to service their debt and continue to operate. This could force consolidation in the industry.

But more countries are oil consumers than producers. The fall in oil prices is a positive for consumers in countries that import oil. Europe, the United States, China, India, Japan, and Korea (among others) should all benefit from lower oil prices. Higher consumer spending in the US should boost real GDP growth, although lower US energy production will partly offset this benefit.

We won't know what the market will do with the future price of oil, but we do know that cheaper oil is a net positive for the global economy. In the meanwhile, until supply and demand are in balance, investors will continue to experience price volatility.