THE ROSE
Investment Management & Research

Compass Points

CONTENTS

Market Correction

October witnessed increased volatility and down days in the stock market as measured by various indexes: Dow Jones, S&P 500, NASDAQ. Some days have been down hard as defined by triple digits or more. In some of those same days the swings up and down before the close was measured in hundreds of points. Is this the 'end?'

We do not think this is the end of what has been a great bull market. We do think it is a correction as defined by a pullback of 10% or more on market value (again, as measured by the Indexes). Given the long run up in market values, is seems reasonable to expect some form of correction.

In all the years we've worked in this field the only certitude is, 'things will change.' We've encountered some learned and credible research from multiple sources suggesting that financial markets have some degree of predictive accuracy. This view holds that when markets work well they are less an indicator about the past or even present and more a forecast of things to come. This view, of course, can only be evidenced with the wisdom of hindsight.

If the October sell-off is a forecast of things to come, where is the bad news? More specifically, where is the economic 'bad news?' We know that the global economy is slowing. In the EU the French and German economies show signs of weakening. There is a lot to read about growth slowing in China.

The story is different in the US. We are actually exporting petroleum products for the first time in decades. Thanks largely to the practice of hydraulic 'fracking' we are experiencing a growing surplus of petroleum products and natural gas. Gas prices are lower heading into the winter at a time when they normally would increase.

What else is 'wrong?' On a related note, demand for petroleum products is down at the same time we are experiencing a surplus. That qualifies as a double positive. Higher mpg automobiles, increased deployment of renewable energies sources and improved transit options are beginning to bear some fruit as it relates to demand for petroleum products.

Unemployment is below 6% — good news! Housing is showing increased strength as measured in existing and pending home sales, prices, etc. New construction as measured by permit issuance is strengthening.

The Federal Reserve is preparing to end the practice of driving down interest rates with massive, systematic debt purchases in the fixed income markets. Inflation is well below the worry level on the economic radar detector. With only a few, minor exceptions corporate earnings are coming in on target or with positive, upside surprises. More good news!

As various sectors of the global economy outside the US contract or slow down, the US dollar has strengthened relative to other currencies. Still more good news!

Record corn and soybean harvests across the grain belt are driving down prices. Freight rail capacity is overwhelmed by demand to the point where most of the corn sold for March (2014) delivery is still in the bins. With much of the 2013 crop still in storage there is not enough capacity to store the 2014 harvest.

Consumer sentiment is increasingly positive. Once again, there is more good news.

Ebola Virus

There is plenty of 'bad' news on the international front. The evening news is a constant reminder of all that is wrong. Pick your favorite handhold on the international 'wall' of worry: Russia and Ukraine, US and EU sanctions against Russia, Israeli/Palestinian conflict, ISIS in Syria (and everywhere else), Turkey's failure to support Kurds, Iraq's failure to fight (anyone) and of course the outbreak of the Ebola virus in Africa.

Early missteps in handling the Ebola outbreak here and in Africa provided fuel for the flames of panic. News services fanned the flames. There were a few days in the middle of October when headlines about 'market declines' and 'Ebola spreading' seemed equally panicked and fear laden.

The November election cycle overlays more 'noise' as candidates and parties jockey for position and advantage over any issue the news brings before the public. October has provided a rich political harvest ripe with opportunities to cast blame and/or claim credit.

We sometimes wonder if anyone will remember or note the fact that the United States Army, the Gates Foundation and the Zuckerberg Family Foundation were among the very first to send substantial Ebola aide to Africa. We certainly note and will remember those among our clients who supported the American Red Cross and Doctors without Borders in their Ebola efforts.

What's Next?

Who knows? We expect to see some more pull back in prices and continued volatility in market indexes for the remainder of the year. We intend to take advantage of those opportunities using available cash to invest in existing or new positions.

Generally, we expect to see the US economic recovery continue. The trend-line of 'good news' items will continue. We are not so optimistic as to expect geometric growth in the trend lines. Incremental, linear growth is what we expect. Stated differently, this is in fact the season of harvest. In spite of all the causes for worry, we are blessed with abundance. We'll be the first to admit that sometimes it is hard to put that abundance in perspective.

It is clear that the wars and worries of international import could have adverse economic consequences for the US recovery. We'll cross that bridge, if and when it comes.

As always we are grateful for your support and confidence.

Stephen & Susan

"Past performance is no guarantee of future returns." This statement applies equally to the portfolios we manage as well as any mutual fund or individual security discussed in this publication. *Compass Points* newsletter is published for informational purposes as periodic communication with clients of The Rose Inc. Investment Management & Research. Discussions of particular investments do not constitute recommendations to buy, sell or hold such investments. Some content is drawn from other sources that are presumed, but not guaranteed, to be accurate. Nothing in this publication should be construed as professional advice recommending any particular course of action to a reader.