

the Connection

A Quarterly Review

3rd Quarter 2015

The Challenges, The Good, The Future

Large declines in oil and commodity prices caught many people by surprise this year making it difficult for global economies to stabilize. In particular the Chinese, Russian and emerging market economies were hardest hit by this scenario. The U.S. Federal Open Market Committee decision making has been disrupted by this turmoil as well. These concerns have weighed heavily on global stock markets during the third quarter of 2015. The third quarter had the most precipitous decline in stock prices in four years, with the Dow and S&P down more than 6% for the quarter. By comparison, 2011 had an ugly third quarter as well, with major indices declining more than 13%.

The Challenges...China, Oil, Russia and the Emerging Markets.

China is attempting to use fiscal and monetary policy to join the world's free economies. This is new territory for them and the rest of the world is holding its breath. The economic slowdown in China from fever pitch to normal levels continues to have effects across commodity and oil dependent countries. Russia's imperialistic agendas and a take without asking attitude has Europe and the U.S. scrambling. Further complicating oil pricing is OPEC's intentional supply glut. OPEC is likely attempting to put marginal producers in the U.S. out of business. The secondary effect may be to stymie Russian expansionary policies.

The Good...United States consumers can afford to buy.

While the world around us is in economic slowdown, U.S. households are exhibiting their best balance sheets in years. We also face one of the best consumer atmospheres in 35 years. Cheap Oil, cheap technology, cheap goods, cheap vacations; a dollar hasn't bought this much since 2008 and the depths of the financial crisis (mathematically attempting to prove this is beyond my scope).

This is the great balancing effect of having different currencies and countries. The U.S. consumer strength will mean competing economies can offload their deflation and cheap goods to us. Consumers will buy them, and by

nature of purchasing inexpensive imports we will weaken our currency, thus the continual balancing act. This could provide the "inflation target" that the FED wants to see here in the U.S.

U.S. equities are trading at less than 16x forward earnings (cheaper than we have seen in a while). If you negate some high flyers like Google and Amazon, you could make the case that U.S. blue chips are trading below 14x forward earnings.

Looking Ahead...Our future outlook is generally positive.

There are a few major overhangs facing the markets. Most importantly oil pricing must stabilize above \$50. This is important for the U.S. specifically because oil above \$50 means the creation of high paying jobs in oil producing regions. The second overhang, which appears to have bottomed, are commodity prices. A renewed infrastructure buildout in the U.S. and a soft landing for China should lead to stability in commodities. The first two overhangs lead into the last major global problem, the bifurcation of wealth. In developed countries the middle class should be increasing. This has not been the case, and that problem has been exacerbated over the last ten years. One person with \$10 million dollars is substantially less productive economically than 100 people with \$100 thousand dollars to spend. We can't just tax it away and redistribute, we must find a way to allow our lower income strata an avenue to become the middle. Unfortunately, this has nothing to do with markets or monetary policy, we rely on our government to enact the necessary reforms.

The Process...When volatility hits, the first reaction for many is to sell.

This goes for professionals, institutions and individuals. Our job at GenCap is to calm that voice wherever it is heard. We go back to our notes, re-evaluate our initial thesis for investment, on bonds, individuals companies, index investments, and we make a decision on our thesis. If the initial thesis is still sound, we cannot allow market fluctuations to determine our investments. There are two reasons to sell a company; the initial thesis is no longer

sound, or the initial thesis was correct, and the price has moved higher to reflect the initial thesis. Any other reason for selling, outside of tax-loss harvesting and allocation change, is an irrational decision.

The Lesson...stay nimble and within your risk tolerance, as we have been the entire year.

Keep some cash aside for a rainy day. Invest in dips, dollar cost average into major investments, move slowly and carefully. Stock market investing isn't going away, and it will earn money over the long haul. We personally think the market is taking a breather, and digesting the global economy. The U.S. has not been in a position of such strength and growth relative to global markets in a long time. Money is going to keep coming in from overseas, and the dollar may continue to get stronger. So enjoy it, go to Greece, or France, where your dollar hasn't gone this far since they were taking Drachmas or Francs.

GenCap's Contact Information

In celebration of our one year anniversary the partners of GenCap Portfolio Management are pleased to announce that we have taken the final step in creating our independent Registered Investment Advisory Company - Front Row Advisors, LLC.

Beginning November 13, 2015 Front Row Advisors, LLC will be the official SEC Registered Investment Advisor doing business as GenCap Portfolio Management. All of our relationships with clients and custodians (Charles Schwab, TD Ameritrade, & Fidelity) will remain in place as currently established.

The growth GenCap has achieved over the past year would not have been possible without your continued support and trust.

Please update your contact information for us.
(*Note as of 11-13-15 we will no longer use the S.F. address or phone numbers)

Address: 1100 Mar West Street, Suite C
Tiburon, CA 94920

Main Phone: 415-797-6003

The Act of Giving

Below is an updated list of some organizations our clients are helping today. Please let Barbara know the names of organizations you care about and we will include them on list next quarter. Send email to bcorley@gencappm.com

All Local Food Banks

www.sfmfoodbank.org

www.shfb.org

www.foodbankccs.org

Image for Success

www.imageforsuccess.org

Maya's Music Therapy

www.mayasmusic.org

Canal Alliance

www.canalalliance.org

Friends of the Urban Forest

www.fuf.net

Guide Dogs for the Blind

www.guidedogs.com

Doctors without Borders

www.doctorswithoutborders.org

The Nature Conservancy

www.nature.org

National Kidney Foundation

www.kidney.org

Guide Dogs of America

www.guidedogsofamerica.com

Golden Gate National Parks Conservancy

www.parkconservancy.org

Fine Arts Museums of San Francisco

www.famsf.org

Canine Companions for Independence

www.cci.org