SEASCAPE
CAPITAL MANAGEMENT

Q2 2015 MARKET RECAP AND A LOOK AT THE MONTHS AHEAD

July 2015

Most of us remember the clown car at the circus. Stuffed just shy of the bursting point, it spilled out an astonishing number of comical passengers who scrambled around the car accomplishing little, only to swallow them back up leaving the stage unchanged.

Market activity in recent quarters has not been much different. Most types of bonds had a positive first quarter, followed by a bigger negative second quarter. US equities, as measured by the S&P 500 have barely budged all year. Developed international markets bested domestic equities in the first quarter but hardly moved in the second quarter. After an admirable first quarter, REITS of all stripes fell sharply this past quarter—albeit those holding global properties lost less ground than those in the US. Finally, after a brief respite in the first half, emerging markets are on track to continue their multi-year slump.

So, what's going on? And, how do we position portfolios to benefit longer term given that growth is scarce, geopolitics scary, and most types of assets have been trapped in a trading range?

We started the year with the view that certain broad categories of US equities were a little expensive and preserving capital should move up on the priority list. We also held that the Fed's eventual increase in interest rates—the first in nine years-would be small and slow in arriving. Thus, we added to bonds with higher credit ratings and held onto REIT positions. (Recall the volatility associated with Ben Bernanke's comments in May of 2013. REITs sold off sharply but took all of a month to gain back the loss.) We also shifted some US equity investments to more attractive, less expensive equities in European and other developed international markets. Within our US equity holdings, the overriding theme was to reduce holdings that had done well but were likely to suffer in a slower growth, strong US dollar environment. Our caution detracted from returns this quarter as the slip in bond prices overwhelmed the tiny advance in equity prices, and our REIT holdings brought returns down.

We are disappointed in the short term, but we strongly believe both the caution and the shift to more international holdings will pan out. Here's why:

- While the US is in better shape than the vast majority of countries in the world, our growth prospects for the intermediate term are subdued. Slow growth from trading partners, a strong dollar, and restrained spending from most consumers will keep a lid on corporate earnings. These challenges are not reflected in the prices of many US companies so we've taken profits where it made sense. Financial, Health Care, and certain Technology companies offer an attractive exception to that rule so we have increased holdings there.

- Hazarding a pile-on in "Greek fatigue", we will simply note that the EU appears on the way to containing Greece's debt crisis and therefore preventing the domino effect of other southern European countries seeking populist solutions to debt reform. For now, Europe is still cheap versus its growth rate.
- We bet on Prime Minister Abe in Japan a few years ago. The country has 20+ years of catching up to do. We are keeping our chips on the table here.
- After watching the Chinese market fall for a month, we added a position here. While early, we added more after it appeared to have established a bottom. The new Five Year Plan of the Chinese government will likely include doubling the average income of the Chinese worker. There are 1.4 billion Chinese. Capital market manhandling aside, we are confident they will get there. After all, they have accomplished most of the goals of the 2011-2015 plan.
- Bonds. We have been underweighted on bonds for a couple years now. We still are, but not as much. Though increasing bond holdings via higher credit issues was obviously premature, we see interest rates settling in at levels not much higher than they are now. Inflation is hard to find. Economic contraction and unemployment are not.

As always, we appreciate your business and continued trust. Please call if you would like to discuss your investments. We are happy to review your financial situation and offer some preliminary ideas to improve your wealth management plan.

Warm regards,

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