Bottoming is a Process: February 11, 2016

On January 20th, the day following our last letter, we saw almost 1400 new lows in stocks which is a classic sign of capitulation (i.e. "panic selling" – sharp declines on high volume). This is the type of market action that we as technical analysts look for when searching for a market bottom. Today as the Dow is down triple digits, it is important to note that we are at bearish sentiment levels last seen in March 2009 at the height of the last recession.

Leading up to that period in '09, falling home prices had caused escalating foreclosures, creating huge losses for banks and hedge funds that had purchased mortgage-backed securities on the secondary market. Today we feel the state of the economy just don't add up to a recessionary type environment like we witnessed in 2008. Eventually low oil prices will encourage global growth, turning from a headwind to a tailwind. U.S. interest rates remain low, as Janet Yellen's speech yesterday indicated that they will be raising rates very slowly if at all this year. While U.S. GDP growth ticked down in the fourth quarter, growth is still positive (+.7%). U.S. wages are also rising as unemployment fell to an eight year low of 4.9% last month. These are all tailwinds for the U.S. economy.

In lock step, energy is also currently going through a bottoming process as evidenced by the extreme daily volatility in crude prices this year. MLPs are typically the last to feel the pain when prices tumble, which we are currently seeing. Bankruptcies are part of the bottoming process as well, which have starting to increase in frequency. It is a painful process, but one which must be completed. At this point, we are just waiting to see the weak producers wash out, excess supply decline, and fundamentals recover. One bright spot to note is that capital ratios of both US & European banks are much better than 2008, and even 2010 & 2011. Thus, they should be able to weather the current environment, especially given that their exposure to energy companies is much lower than their exposure to sub-prime mortgage loans in 2008.

We believe the markets are oversold right now and these levels of market pessimism have over shot the mark. Although we might not have seen the bottom yet, based on recent trading activity, we feel we are getting much closer to the end of this market selloff.

As always, we thank you all for your continued support and look forward to discussing any or all of our thoughts at your convenience.

Best regards,

Richard A. Funk, CFP®
Senior Vice President

Jenny G. Davis, CFA®
Senior Investment Portfolio Specialist