

# MARKETVIEW

FOURTH QUARTER 2014



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## GS INVESTMENTS, INC.

LARGEST STOCK HOLDINGS

09/30/2014

<u>SECURITIES</u>	<u>PCT.</u>
APPLE INCORPORATED	2.12%
BERKSHIRE HATHAWAY CLASS B	2.05%
WELLS FARGO AND COMPANY	2.04%
DOW CHEMICAL COMPANY	2.04%
INTEL CORPORATION	2.03%
HONEYWELL INTERNATIONAL	1.82%
BOEING COMPANY	1.77%
EXXON MOBIL CORPORATION	1.76%
QUALCOMM INCORPORATED	1.74%
WILLIAMS COMPANIES	1.67%

## FALLING OIL PRICES

On a recent trip to Costco we couldn't help but notice that the price of a gallon of unleaded regular gas priced at \$2.86, a significant change from prices approaching the \$3.75 level earlier this year. The lower price of gasoline stems from the recent downward spiral in the price of a barrel of domestic oil to near \$81 from about \$107 not long ago. Our thought is that we may see lower oil and gas prices for some time to come.

Due to an economic slow down in Europe and some Asian markets, the International Energy Agency projects that, "oil demand will expand this year at the slowest pace since 2009". At the same time, increased production from U.S. shale oil and the Libyan fields coming back on line, has resulted in excess supply. In an effort to maintain market share, Saudi Arabia recently dropped the price of its oil. We find this interesting given that the more typical approach is to cut production in order to prop up prices. Finally, Russian oil is failing to find its expected market in Asia. As a result, it is ending up in our West Coast ports.

Speaking of Russia, there is reported discord between Putin-backed statists and the corporate oligarchs. This is due to Putin's rather impulsive effort to nationalize private Russian oil companies. We believe that Mr. Putin needs government revenues to support his expansionist aspirations. As one writer opined, President Putin will have to take an extra shot of vodka to settle his nerves.

In addition, we have seen a dramatic decline in the price for corn, soybeans, cotton and other commodities. With

prices of key commodities declining, U.S. production costs for manufacturing should benefit. Consumers should benefit as well as food and gas prices decline, they will have more money to spend on other goods and services. Taken together, these may provide a needed boost to our economy just as the important holiday shopping period approaches.

## CORPORATE PROFITABILITY

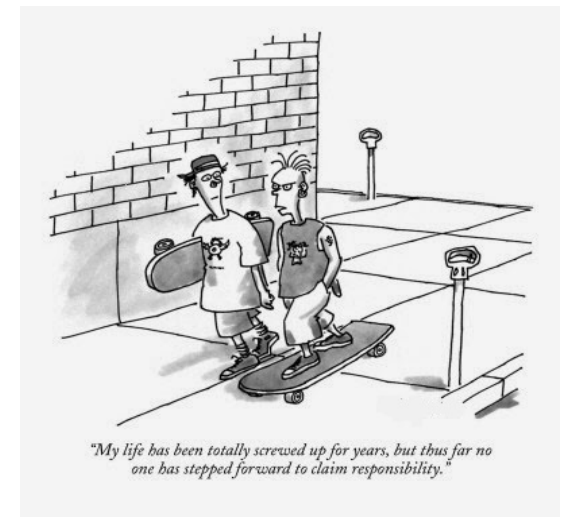
Since the beginning of the economic upturn in 2009, a slow one at that, corporate earnings, and subsequently stock prices, have moved ahead nicely. Much of this advance however, was due to



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cost cutting measures, something that cannot continue to be the primary “driver” for earnings expansion over time. We believe that the key to further expansion in both the economy and stock prices is revenue growth. Without this, both corporate earnings and stock prices will suffer. What intrigues us however, is the potential for an economic boost that could come from a prolonged period of lower energy and other commodity input prices as we have discussed.

We began the year with negative, weather-related, GDP growth. However, the second quarter expanded at a lofty 4.6% rate. Corporate earnings followed, expanding at a 10.7% rate, above the forecast of 7%. A recent publication of Standard and Poor’s “The Outlook,” suggests that corporate earnings could continue to expand at the 10% plus rate for the third and “several additional quarters.” Not everyone shares this feeling however. A recent forecast put forth by the statistical research firm, FactSet, estimated that corporate earnings would only expand at a 4.7% rate for the third quarter. Certainly, differences in opinion are what makes a market. We tend to favor the higher forecast as actual increases have consistently exceeded analysts’ expectations. Alcoa, one of the first large companies to report third quarter earnings, exceeded analysts’ expectations by a wide margin. Intel and Johnson and Johnson each had strong earnings reports, also beating expectations and increasing guidance for the next quarter. Wells Fargo’s earnings report was in-line with expectations, a decent result given their heavy dependence on the slowing mortgage market. Finally, energy companies earnings will depend on changes in the price of oil which, as noted above, continues to move down.



## INTEREST RATES

A recent fear of market participants is rising interest rates. For more than a year this warning flag has dogged the stock market as the issue is raised by the bearish crowd every time the Federal Reserve Board meets. Our belief is that interest rates will eventually increase but will

do so gradually, over time. Our takeaway from this may be best summarized by the a recent study done by the independent financial research firm, Argus. In this study, Argus examined the stock market, in both 6 and 12 month intervals, during periods of rising interest rates. They found that rising rates are generally associated with an improving economy and falling rates with a weakening economy. They also found that an improving economy produces stronger corporate earnings and higher stock prices. We have seen this play out before. During the 1980's and 1990's, when Alan Greenspan was Federal Reserve chief, short-term interest rates moved between three and six percent; the latter halted an economic uptrend and the former started one. The point here is that short-term interest rates are currently near 0%, much lower than the lows of the 80s and 90s. When short-term interest rates begin to rise, given they rise gradually, the impact on the stock market could be minimal following the initial shock. The major negative impact in this case would be on the long-term bond market.



ISIS and turmoil in the Middle East, economic weakness in Europe, and continued Russia/Ukraine conflict have heightened the fear of disruption in the marketplace. Add to these the fear of an Ebola epidemic and an “October effect,” and one has a recipe for what we are currently seeing, a market sell-off.

The initial reaction has been negative. Stocks are down and money flows have moved into safe-haven, U.S. sovereign securities, causing interest rates to decline with the 10-year treasury again briefly moving below 2%. According to the Wall Street Journal, expectations for an increase in the Fed Funds rate to rise by the summer of 2015, has dropped from 66% to 24%. While rates are sure to rise eventually, they are expected to remain relatively low for a longer period of time.

## NOTABLE QUOTES

“The inherent vice of capitalism is the unequal sharing of blessings. The inherent virtue of socialism is the equal sharing of miseries.”

Winston Churchill

“There is nothing so useless as doing efficiently that which should not be done at all.”

Peter Drucker

“Nowadays, people know the price of everything and the value of nothing.”

Oscar Wilde

“Investing is simple but not easy.”

Warren Buffet

“Great minds discuss ideas, average minds discuss events. Small minds discuss people.”

Theodore Roosevelt

“How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case.”

Robert G. Allen

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We will be closely monitoring developments in the marketplace, making changes where appropriate. At this point however, we feel that where some account changes may be justified, major changes in portfolio structure or holdings are not warranted.

***“OUR GREATEST COMPLIMENT  
IS YOUR REFERRAL.”***



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## GSI TENETS

GS Investments, Inc. is an investment management company specializing in individual and institutional asset management. Privately owned and operated, GS Investments, Inc. is run by its owners, Glenn H. Steinke, C.F.A., John G. Steinke, M.B.A. and Greg Cunningham.

**GLENN STEINKE, CFA** brings over 45 years of investment management experience to the business. Previous capacities include Vice President and Senior Investment Officer with a major pension fund (\$1.8 billion under management) and Senior Vice President with a major Minneapolis-based financial institution (\$3 billion under management). Glenn is a graduate of the University of Minnesota.

**JOHN STEINKE MBA** offers a broad financial services background with 20 years of portfolio management experience and 7 years of banking experience including capacities as a Vice President of a \$50 million bank and as a private banking officer for a large, Minneapolis-based financial institution. John received his BA from Concordia College (Moorhead) and his MBA from the University of Minnesota.

**GREG CUNNINGHAM** Prior to joining GS Investments, Greg spent 15 years at Minneapolis-based Ameriprise Financial, a national leader in financial planning with over 2 million retail clients and \$300 billion in assets. Here he worked with the Chief Investment Officer in support of the international and domestic hedge funds and with the President and General Manager of RiverSource mutual funds. Greg is a graduate of Gustavus Adolphus College in St. Peter, MN.

**SHERI RITCHIE** brings over 20 years of financial services experience to the business. Previous capacities include client service and support positions with Dean Witter and Kemper brokerage firms and a Minneapolis-based investment management firm. Sheri is a graduate of the University of St. Thomas.

### GSI INVESTMENT PHILOSOPHY

GS Investments, Inc. utilizes a balanced approach for the majority of its accounts although each account is tailored to the individual needs of each client. Taxable or tax-exempt bonds are used along with a common stock component. The division between bonds and stocks is determined by the personal objectives of each client. A need for income and a willingness to assume risk are also determinants of an account's bond/stock mix.

GS Investments, Inc. emphasizes the purchase of quality securities and employs a long-term investment style, as market timing, frequent shifts in asset allocation and interest rate forecasting are not consistent with the firm's philosophy. In-depth market analysis and many years of experience support this approach.

### GSI FIXED INCOME STRATEGY

GS Investments, Inc. emphasizes a staggered maturity approach when purchasing bonds. Individual security investment grades and call protection are considered when making these investments. Quality grades of "A" or higher are favored with tax-exempt issues. Government bonds are dominant among taxable securities.

### GSI EQUITY STRATEGY

GS Investments, Inc. favors stocks emphasizing quality and growth. Appropriate cyclical growth stocks and small capitalization growth stocks are used periodically as well. Additionally, GS Investments, Inc. believes that a growth oriented philosophy tends to result in less frequent trading and lower tax payments (for taxable accounts) on realized capital gains. This provides a lower cost approach for the client.

### CLIENT COMMUNICATION

GS Investments, Inc. emphasizes client communication. Written investment objectives as well as periodic oral and written reports are used to heighten the understanding between the client and investment manager. In addition, easy to read, detailed reporting is provided by state-of-the-art investment software in order to inform the client of portfolio progress.