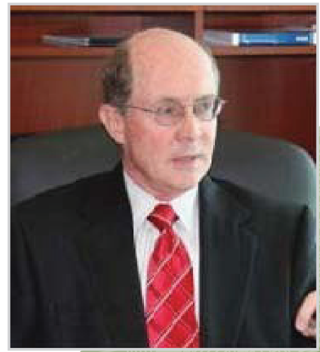
VERITY
Asset Management

Commentary

Tactical All Asset Strategy

December 31, 2014

The Impact of Oil



Gordon T. Wegwart
President and Chief Investment Officer

Since early fourth quarter, 2014, the plummeting price of oil has been a lead story in both the popular and the financial press.

The most prominent view is that savings at the pump will funnel through the hands of consumers into other areas of the economy, boosting growth.

On the other side of the equation, the decline is undermining the profits of energy producers, threatening the job creation and capital spending of the recent shale energy boom, a significant contributor to the economic recovery.

Also prominent are the credit concerns. The high yield bond market has financed a material component of the expanding energy production, at progressively lower rates. If low energy prices persist, a wave of defaults seems almost inevitable.

Ultimately, whatever the pros and cons, a move of this magnitude in a commodity this vital is profoundly disruptive, with a scope and complexity which defy conclusive analysis.

- Consider as one example the potential repercussions of the revenue loss to countries who are major oil producers – from already politically volatile producers, such as Russia, Venezuela, and Iran – to major U.S. trading partners such as Mexico and Canada.

- Consider the global currency impact. Though indirect, it would appear that the deflationary effect of oil's dramatic slide has contributed to a powerful rally in the U.S. dollar, affecting capital flows from Russia, Europe and many emerging markets, each already struggling with other very challenging issues. And the strengthening dollar will negatively affect U.S. exports and the foreign profits of our large multinational corporations.

As we consider the market's path forward, we must also be aware that falling interest rates have become an additional indication of significant deflationary pressures worldwide. The global concerns expressed in our previous quarterly commentary remain very much in play. Japan is contracting and has slipped into recession, Europe remains a structural nightmare which is also flirting with recession, China's rate of growth remains strong but is clearly slowing, and export-dependent emerging countries watch nervously as economies weaken in many of their foreign markets. Further, many emerging countries face the dual disadvantage of declining prices on their export commodities and the negative effect of a rising dollar on the debt they have financed in U.S. dollars.

Comparatively at least, the U.S. appears the one strong presence. Our economy, though well short of booming, has gained strength. Very importantly from a market perspective, there are no material indicators of a shift toward recession. While valuations have become elevated, they are not near extremes, and an array of conditions remain favorable:

- Interest rates are exceedingly low.
- Low energy prices are a benefit to many sectors.
- Consumer confidence is strong.
- Employers are hiring.
- Corporate balance sheets are strong.
- And not insignificantly, U.S. stocks seem almost like the only game in town. With an awful lot of money still on the sidelines impatiently looking for someplace productive to go, one simply cannot discount the possibility that the expansion still has room to run.

But we must remain aware that it will have to do so in an environment fraught with risk. As noted in last quarter's commentary, the world seems like a pretty scary place right now, and "even in purely economic terms, it is hard to imagine that the U.S. market remains unaffected if the rest of the world's major economies continue to falter."

With oil and other catalysts making 4th quarter perhaps the most volatile quarter since the summer of 2011, the Tactical All Asset strategy performed well, continuing the solid overall pattern since we reorganized the investment team five months ago. Significant positions in biotechnology, utilities, and homebuilders were the biggest winners, as all posted double digit gains. Positions designed to help buffer volatility did so effectively, particularly when the market reversed sharply in early October. We took advantage of the decline in oil prices to gradually develop a small position in energy stocks, nibbling as prices fell. This was the biggest drag to fourth quarter performance, but shares were acquired at prices significantly below the market peak and may offer strong upside once the price of oil stabilizes.

For now, it seems, the band plays on, so we are positioned for growth while continuing to manage for the ubiquitous potential of significant market turmoil.

This material contains forward looking statements; there is no guarantee these outcomes will be achieved. All investing involves risk of loss, and there is no guarantee that strategies which may have been successful in the past will be similarly successful in the future.