Cove Views

January 21, 2016

Dear Client,

Happy New Year! We hope everyone had an enjoyable holiday season and we wish you all a very healthy and happy 2016. The markets are off to a rough start both globally and domestically and we would like to update you on some of the positions and views that we presented in our last newsletter as some of our positions have changed.

General Market:

Many prognosticators are blaming this weakness on China, which we agree with to some extent. Overall however, Chinese equity and currency weakness is not necessarily a net negative for the U.S. A weak Chinese Yuan is good for American companies having things manufactured in China. Capacity underutilization in China is also a net positive for these types of U.S companies. Generally, we believe there is some sort of overall economic weakness developing, beyond the Chinese situation, which is currently manifesting itself in global equity markets. **We continue to believe that U.S. equities are reasonably valued and we continue to advocate holding them over the long term.**

Energy Prices:

In our previous newsletter we said we expect energy prices to stay low for a long time. We did not, however, expect the near capitulation which we seem to now have. Our opinion is unchanged that it is going to be many years before we see $100 oil again but we believe we may be witnessing a bottoming out process in the energy markets. **We continue to like industries and securities that benefit from an extended moderation of energy prices such as; refiners, auto and auto parts manufacturers, airlines and tire manufacturers.**

Medical Devices and Pharma:

In our last newsletter we were bullish about medical device and pharmaceutical companies and have recently become less enthusiastic regarding their prospects. **Drug and medical device pricing has become so front and center in the election rhetoric that regardless of who wins, prices will be under intense scrutiny and companies' pricing power may be diminished.** There are some medical related securities that have been under so much pressure that we would still consider owning them but our overall level of caution in this industry has increased.

Interest Rates - Banks and Insurance Companies:

Interest rates have been soft, which furthers our belief that, on a relative value basis, American equities should play an important role in client portfolios. In our last newsletter we spoke about our fondness for life insurance company and bank stocks. Since then these two industries have been much weaker than the general market. With the equity weakness, and ensuing bond strength it has caused, we suppose that investors are becoming impatient and are not willing to hold them waiting for rates to rise. We continue to like these types of companies, particularly at their current discounts to book value. Additionally, we are beginning to see evidence that **some of these giant financial institutions may be about to break up**, which would help realize their substantial asset values. We believe that that would be a gift to shareholders.

High Yield Bonds:

We continue to watch the high yield (HY) bond market come undone and yet we continue to hold our bonds. There have been large investor redemptions from open-end high yield bond mutual funds as investors are scrambling to reduce overall risk. Many of the accounts we manage own individual HY bonds as well as closed-end HY bond funds. **Closed-end bond funds are selling at significant discounts to their net asset value and we continue to believe they provide significant value given their diversified portfolios and large discounts.**

Our tone is cautious. We continue to seek value and find it in the markets. In situations like these, where there is systemic weakness in the global marketplace, we tend to focus on fundamentals instead of getting caught up in the noise. In our experience, eventually value gets realized once it all shakes out. We believe the U.S. markets will be at the forefront coming out of this patch of weakness and want clients to be positioned to take advantage of that.

If you have any questions about any of your positions, or want to have a more in-depth conversation about any of these topics, we are always available. And, of course, please feel free to share these views with anyone who may find them of interest. Anyone is welcome to subscribe to this newsletter on our website.

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