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Alder Cove Capital 2015 Market Forecast

and Other Visions of Watch-Spinning Delusion

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An introduction from our Chief Market Strategist

December 26, 2014

Reader,

I thank you for taking the time to read through our report. In order to gain some valuable insight into what 2015 will bring, it's my belief you require the comforting assurance of a used-car salesman combined with the stunning prescience of a palm reader. We hope you find that here. Many, many hours have gone into generating these predictions. Dozens of unpaid interns, daisy-chained together in a complex system of Red Bull IV drips, have tirelessly crunched the numbers in hopes of being the sole survivor to rise through the ranks to become our latest Junior (probationary) Assistant Associate Analyst here at Alder Cove. Please be sure to give us your feedback on your favorite section - the interns' careers depend on it!

Our new CEO, Tyler Linsten, has commandeered full editorial authority over the content that follows in this report. I trust he has only used his editor's pen to slightly correct the interns' grammar and punctuation, for I have put my stamp of approval on the content. That said, and between you and me, I really don't like this guy. I think he's trying to tear down everything I've worked so hard to fabricate.

Forever invested in your future (unless the market tanks),

Richard J Alder, III

Chief Market Strategist

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~~2015 Market Forecast~~

(Content Redacted)

Editor's Note: I'll give you an example for what it's like to be in the business of predicting what a market is supposed to do over a finite period of time: Picture yourself in a crowded theatre. You see the guy next to you in the balcony is holding a fake grenade, he now throws it onto the main floor. In a market we would call this a potentially newsworthy event. What happens? Your guess is as good as mine. Maybe nobody notices it and the show goes on. Maybe it starts an absolute panic and people get trampled as it's a mad dash for the exits. Creating a market forecast is like proclaiming "I think there will be a fake grenade thrown in the theatre tonight and X, Y and Z will happen." It's tough to do that with any precision - or confidence.

The bottom line is that markets are just like crowded theatres when introduced to uncertainty (news events) or significant happenings: completely controlled by unpredictable human emotion. "Bad news" is sometimes just absorbed into a market with no effect, just as the fake grenade could be. Predicting both A) events in the future and B) how a massive crowd is going to react is a pretty pointless venture. Why not just admit that we have very little foresight into the future? Why, because it's been a very profitable venture to pretend to know, of course.

The old Wall Street way of pretending to have deep knowledge of the *short-term* future of an economy or specific asset class is a complete joke. They are smart people, though. They know that as long as people keep buying into the idea that they're providing "value" then they'll keep getting commissions and sales on expensive research reports. So the next time you see an analyst claiming to know a very specific outcome in a very specific time period then it's your duty to take it with a grain of salt and move along.

Baseline belief that human progress will continue to advance economies, therefore markets, therefore specific stocks, is about the only market forecast you can depend or bank on. The rest is up to the animal spirits of market participants over short periods of time. During this slow march higher, wild swings up and down will occur, but we have very little foresight into when exactly they will happen.

~~S&P 500 2015 Year-End Target~~

(Content Redacted)

Editor's Note: Just as it's pointless to predict what an entire asset class will do in only a year's time, it's even more futile to forecast where a specific index will finish a year. There's a reason that the average stock market forecast of analysts is nearly always "cautiously optimistic" with price targets about 10% higher. This is the safest bet to make because what happens, *on average*, is that markets move up and down at various rates of change only to end up, *on average*, about 8-10% higher. Nevermind the fact they rarely return exactly 8-10%.

Pretend you had a handful of Wall Street's best analysts in a group in front of a TV and you asked them to provide a prediction for the always-entertaining game of Plinko, as made famous by The Price is Right.

What do you think the analysts would say? They'd probably scoff and say, "the puck is going to bounce around a bunch and come to rest below where he dropped it." Their stock market predictions are no different than "predicting" what happens in a game of Plinko. Sometimes the puck will land at the corner slot, just as sometimes stocks will collapse in a given year, but it's pointless to try to predict when. They know this so they just take the safe bet and package it in shiny material as valuable information.

Fine, I'll give you my 2015 price target for the S&P 500: I see it landing between 5 and 5000.

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~~Sectors Expected to Outperform~~

(Content Redacted)

Editor's Note: I hope you're getting the point here. Predicting which sectors of the economy will have their stocks surge relative to the broad market is also a pointless venture. I bet you'd say that continued global growth and continued massive monetary stimulus programs would be very bullish for commodities, and especially oil and oil-related equities. Well, we've had continued global growth and massive monetary stimulus, but the price of oil and oil-related equities have cratered in the last two months and many commodity prices have plummeted. If you proclaimed that oil stocks would be major outperformers this year then you've taken it on the chin.

Obamacare was sure to absolutely kill the healthcare sector, right? Well, healthcare stocks as represented by the Healthcare Sector SPDR (ticker: XLV) have advanced 26.52% for the year, versus 15.06% for the S&P 500 (Finviz). Another "no-brainer" debunked.

The simple truth is that sometimes wild and unpredictable events - like the price of oil getting cut in half or Obamacare effects - will ravage certain sectors or cause them to outperform the broad market, but we just don't know which way they will go. Sticking to a diversified portfolio across asset classes, sectors and continents will keep an investor from playing hunches that certain entities will outperform. Be bold - take the boring approach. You'll be surprised at how much more sleep you get.

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Sagittarius Horoscope

Editor's Note: The interns must have accidentally included one of their investment research sources, but I'll allow it because it's at least worth the price (free!), unlike most other reports offered by analysts.

I figure if people are willing to pay for something that's worthless (like a stock market forecast), then they'd be feeling better with something like a horoscope that's worthless but costs nothing - having no value versus negative value.

If you're a Sagittarius, see how you will fare in 2015 here.

"Saturn will back out of your sign between June and September, creating a break in the action of your ongoing self-reinvention process."

So you've got that going for you, which is nice.

~~Volatility Outlook~~

(Content Redacted)

Editor's Note: In 2015, the stock market will be open for about 250 days. Sometimes the prices of stocks will go up, sometimes down. Sometimes the rates at which they move up or down will be larger than the day before. Stocks may fluctuate less than they did in 2014, or they may oscillate violently until we are all motion sick and bankrupt. The annualized standard deviation of these moves will settle somewhere between one percent and five hundred percent, extrapolating to a VIX index level to somewhere between one and many hundred.

Your guess is as good as mine and they're both the same in that they don't matter to any reasonable, semi-rational investor. Multiple events in 2015 will cause large spikes in volatility while the media and markets will likely overreact and you won't be able to care less if you're an investor with a time horizon of decades instead of the length of a news cycle.

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2015 Recession Probability

(Content Redacted)

Editor's Note: Why analysts and economists want to play this game, too, is beyond me. Predicting recessions accurately has been proven to be another foolish venture. I'm sure you've heard the joke: "This indicator has predicted twelve of the last eight recessions." Remind me, how well did economists predict the 2008 financial crisis and resulting protracted recession? Not very well.

If you must have it, here's my 2015 Recession Prediction: we have a 1% to 99% chance of falling into recession. This will be the same forecast for eternity. Never will expansion be guaranteed (a 0% recession prediction), nor will contraction be assured (a 100% recession prediction).

~~Dividend Plays, 5-Star Stocks and Upgrades/Downgrades~~

Editor's Note: A triple whammy! Oh boy, where to start.

First, the allure of the high dividend yielding stocks never seems to go away. There are many more important factors that go into weighing the merits of an equity investment before the dividend yield is considered. Ever hear of TANSTAAFL? There ain't no such thing as a free lunch! If you fall in love with a stock because it has a hefty dividend yield then you're guilty of thinking that lunch was free. Chances are the high yield reflects an elevated percent chance that the company may end up cutting the dividend because the company's prospects are dimming - subsequently crippling the very reason you bought the stock! How do you think shares will trade if they cut the dividend? Not well, probably. Sorry.

The notion of 5-Star Stocks, and any other similar ranking with a dopey name, is a gimmick from the familiar family of financial verbiage used to convince investors that someone Really Smart must have put in a lot of hard work to bring this exclusive pick to a report. Another offshoot of this tactic is the Fancy Fund phenomenon I've wrote about in the past where fund companies hope you like their sophisticated sounding names. See also: Growth at a Reasonable Price. Closely related: the Super Bowl Indicator, the January Effect, and Presidential Market Cycles. All gimmicks. And backtesting, oh PLEASE don't even get me started on backtesting.

When analysts make upgrades and downgrades, it implies they *think* they know the true intrinsic value of a stock. This is a bold statement. Intrinsic value is a very slippery slope and I'd argue it's more like trying to chart and predict that plastic bag flopping around in the wind during American Beauty, or the feather in Forrest Gump if that's your thing. In other words: hard to do. There have been some great posts on intrinsic value lately: the first by James Osborne of Bason Asset Management as well as the follow-up by pseudonymous blogger Jesse Livermore. Check their posts out - you'll be happy you did.


Bottom line: there is no free lunch and you certainly won't get one by following gimmickry.

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High Tide Is 11:32 AM, What Stock Should I Buy?

(Content Redacted)

Editor's Note: The interns had an answer but I've since deleted their findings. They backtested a twelve week rolling average study of the pattern of migrating killer whale pods in the Puget Sound with the 48th parallel as an x-axis and found that it had a significantly high correlation with Amazon.com stock just before noon, subsequently issuing a "Strong 11:32AM High Tide Buy" for AMZN.

I just can't put my stamp of approval on this kind of work but it was a nice try by the interns. The problem is that this kind of thing happens all the time - you truly will find this kind of research out there. If an analyst can find any kind of correlation to back up a thesis, he will. Claiming causation when correlation is present is the basis for many of the major investing gimmicks. The problem is that it's not a sexy statement to just say "I don't know" constantly and nobody in the old guard of financial advice ever got a huge bonus by avoiding proclamations.

Conclusion

(Original Ridiculous Conclusion Redacted)

Editor's Note: I hope it became obvious I don't hold the habits of traditional investment analysts with high regard. This was only one piece of commentary on a single slice of the large pie dedicated to misinformation, disingenuity and greed within the investment management world. If I could boil it down to one recommendation it is that skepticism is your only true friend when managing a portfolio.

The future is uncertain. It always has been and always will be. Sadly, many "reputable" firms are putting the finishing touches on reports with very similar qualities to the very tongue-in-cheek report I created here, but with real numbers and very real intentions to profit from their prognostications. They have been rewarded for this behavior in the past and they seek to earn more bloated commissions, more insane fund fees and excessive yearly bonuses based on the completely bogus prediction framework I have described.

Jack White could have been describing the game perfectly with lyrics to The White Stripes song "Hypnotize" --

> I wanna spin my little watch
> Right before your eyes
> You're the kind of girl a guy like me
> Could hypnotize

Avoid market predictions - they aren't what their creators want you to believe.

Tyler Linsten
Actual Founder and Sole Advisor
Alder Cove Capital, LLC

P.S.: I fired the "Chief Market Strategist" and the interns have been carefully transported to a safe house for recovery.