ClearBridge Investments

The ClearBridge View

Hersh Cohen
Co-Chief Investment Officer,
Managing Director, Portfolio Manager

Market Overview and Outlook

We can make this letter simple: Financial markets were challenging during 2015, with each day seeming like an independent event. We expect this will continue until oil prices stabilize. A global economic slowdown is being reflected in collapsing commodity prices, most notably oil. The Federal Reserve backed itself into a corner by overestimating the molasses-like recovery and raising short-term interest rates at the same time that industrial activity is weakening severely. The stock market has seen so many violent reactions to the smallest earnings or revenue misses versus analyst expectations. This turned the market into one of short-term spasms as opposed to rational investing. Yet not all is dire. Housing remains a pocket of strength and consumers are being helped by lower gasoline and heating prices. Retail sales should also begin to reflect the benefit of lower fuel prices.

The single most important factor in helping the markets to stabilize is, in our opinion, stability in oil prices.

After OPEC created a monopolistic structure, we used to cheer for lower oil prices and hope for a sound domestic energy policy. Now we are of the opinion that the collapse in oil prices, while benefitting consumers, is creating havoc in too many industries. We believe the weakness in the industrial economy is far more widespread than simply declining oil prices would suggest. Just as expanded housing creates benefits for suppliers of materials, appliances and furniture manufacturers, plumbers and carpenters, etc., the negative effect of the oil collapse is pounding related industries. Transportation, valve and tubing suppliers, drilling equipment, well-service companies and many others are hurting. Layoffs have been widespread and severe. The single most important factor in helping the markets to stabilize is, in our opinion, stability in oil prices.

With interest rates so low, it is hard to say that a quarter point rise by itself is terribly damaging. But directionally, it is not consistent with comments from so many companies that are struggling to maintain, let alone grow, revenues. There is a global slowdown in progress. The strong dollar, coupled with weakness in so many other countries, makes revenue growth from usual sources very difficult.

In recent days, we have heard of much slower conditions from such economic bellwethers as Union Pacific, 3M, Caterpillar and Nucor Steel. The declines in transportation stocks are indicative of lower demand for the movement of goods. Thus a rise in interest rates, while small, is hardly a prescription for what ails the economy.

A disturbing note came from a recent N.Y. Times survey of New Yorkers. Despite appearances of a stronger economy, half the respondents said they were having trouble making ends meet. We have stated repeatedly that the collapse of 2008 would not be repaired quickly. Unfortunately, the dissatisfaction of too many workers is being

reflected in political campaigns that seem mean-spirited instead of offering pro-growth policies.

At the beginning of 2015, we gave a more sober view of the stock market than we had in the prior six years. It has been a tough year for capital appreciation. Dividends, as expected, continued to rise nicely. A turn of the calendar page does not call for a change in outlook. With revenue growth so hard to come by for so many industries, it is unreasonable to expect important large earnings gains. So many stocks actually experienced their own bear markets over the past year, while the popular averages were sustained by fewer strong performers with good returns. Our view is that the stock market needs time to adjust to the very difficult industrial environment. While we cannot rule out further pain for many stocks, it seems that quite a lot of negative earnings and revenue disappointments have been priced in.

The need for income will remain elevated for many years to come and we cannot think of a better way to generate income than owning a diversified portfolio of high-quality stocks offering attractive dividends. We continue to believe that doing so remains a sound investment strategy for the long-term investor. The companies we own exhibit strong balance sheets and generate ample free cash flow. This underpins our conviction that dividends are not only secure but have more room to grow. Though stocks may face challenges, we do expect healthy dividend increases in the year ahead.

Based on comparative valuations, stocks remain the asset category of choice for longer term returns. Despite all of the volatility and frustrating swings, we keep thinking back to tough years in our careers which seem insignificant when viewed in a bigger picture.

ClearBridge Investments
620 8th Avenue, New York, NY 10018 | 800 691 6960
ClearBridge.com