Quarterly Newsletter
Walnut Hill Advisors, LLC
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Maniacal!

I also note that the end of 2014 saw quite an expansion in the shares outstanding of the SPY ETF and many of the sector ETFs. (Data from State Street). That's been a pretty good sentiment gauge over the years: demand for stocks expands the supply of ETF shares and bearish sentiment leads to a contraction of shares outstanding. In the past 10 days, we've seen a rise of almost 14% in the shares outstanding for SPY. Going back to 2006, when shares outstanding for SPY have been up by 10% or more over a 10-day period, the next 20 days in SPY have averaged a loss of -2.18%. That compares to an average 20-day gain of +.77% for the rest of the sample. When ETF demand soars, that enthusiasm has not led to good returns in the past, and 2015 thus far has been consistent with that.

~Brett Steenbarger, PhD - professor and trading coach (1/5/2015 blog post)

1. **Manic Behavior of Markets**
2. **Opportunities and Concerns in Global Markets**
3. **Notes**

1. How a Risk-Managed Investing System Looks

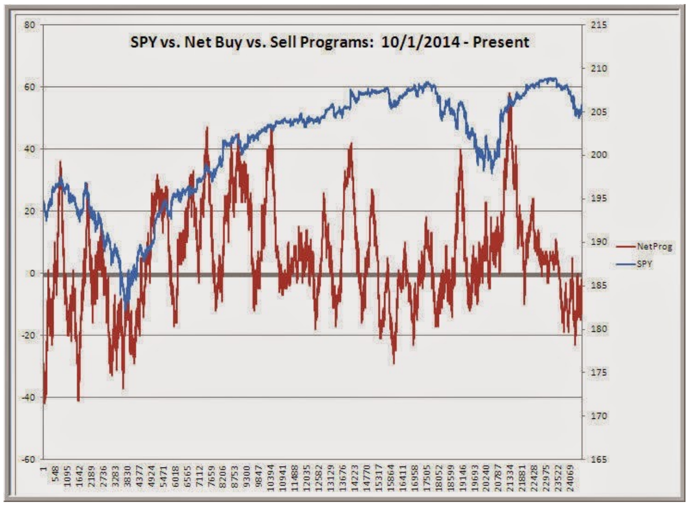
In the past 12 months, and especially the past 4 months, markets have been vacillating between expressions of impending *doom* and "*FOMO*" - "fear of missing out." And the gyrations in the market caused by these mood swings are rather large and happening over what I feel are very short intervals.

Readers of my email newsletter will note that I was somewhat convinced that the October 2014 drop was the top of the US markets for this cycle. The sentiment indicators, the volume traded and the steep drop in price, all impressed me as a serious warning. And even though I have been cautious for a while (view the recent oil market fall for what can happen to a market that's over leveraged and "ahead" of its fundamentals), I have never officially "called a top" - so in October, I thought something was different and got as close as I've gotten to saying such words.

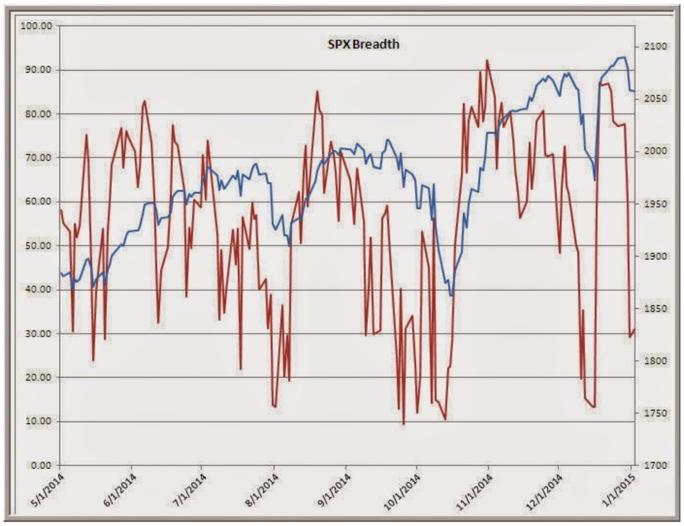
Apparently I was wrong. Since October we've had 2 quick, small, but sudden corrections that although they were not as deep as October's correction, did hit the doom and fear scales rather strongly. Look at the charts on the next page (both courtesy of Brett Steenbarger, Ph.D. via his site: www.traderfeed.blogspot.com):

Here are Brett's explanations from the charts:

"The (chart below) is a measure of breadth for SPX stocks. It represents the percentage of shares trading above their 3, 5, and 10-day moving averages. (Data from Index Indicators). You can see how this breadth measure reliably tops out ahead of price during market cycles; it's also done a reasonable job of bottoming ahead of price at cycle troughs. We've come off quite sharply in this measure; more so than is typical in a market cycle. This invites the hypothesis that we've already seen a momentum peak for the current cycle."



"the (chart below) tracks a basket of stocks that are institutional favorites and the upticking versus downticking in those stocks. When the majority of stocks in the basket uptick simultaneously, that is deemed to be evidence of the presence of institutional buying programs; when they downtick simultaneously, that is counted as the presence of selling programs. We can see that buying programs dominate early in a market's cycle history and give way to selling programs as markets make cyclical peaks. Note how we showed very strong buying program activity off the December lows and now have moved to a dominance of sell programs."



What Brett is saying is that we've had some big swings in the past few months! He also mentions elsewhere (on his blog: that the market looks strong to him right now based on some other measures, but the rapid and strong moves to the downside have been surprising to him. The charts also show the extremes in sentiment over such small time periods and moves in the market. It tells me that there are many more players swinging big for shorter term gains than one would realize (**professional investors aren't always "in it" for the "long term" - not when markets swing like this and they keep taking the opposite side of retail investors - they buy when retail investors sell and vice versa**).

My tactic of choice to mitigate these extreme moves has been to replace stocks with options as a "placeholder" (thanks to my client Jim for recommending that term) to get exposure to stocks without committing the full capital. The only problem with this has been that the rallies haven't gone too far without correcting strongly the last 2 times as noted above. Which means that if you're the type to just hold your stocks, you earned a few percent. If you used a risk-managed approach like I use, you haven't earned a few percent as the gyrations have burned up the money used to buy the options. However, the risk managed strategy will show its stuff once the market resumes a general trend.

That being said, the market could continue this manic behavior all year I suppose, and in that case, risk management strategies would not yield much fruit. But if the market really starts trending up, we will have excellent exposure following this plan. And if the market decides to tank, our risk will be small. I do expect this market to resolve itself one way or another (maybe after a "real" correction of 15-20%). In the meantime, parts of the market have trended well as have other markets (bonds for example have trended up nicely all year, as has real estate). China is making new 52 week highs and may be on the way to a new trend. My opinions on China would support that.

I have written about this in the past where I expect a massive WPA type program in China as the country realizes they can't just sell us cheap manufactured goods forever. They will switch to using their excess reserves to funding public work projects in the areas of clean water, pollution control, mass transit, more roadways and other internal improvements. This will put more blue collar Chinese to work and also spur more internal tourism which is already booming, and mobility of labor. See more on trends below.

So we don't need to just think about US stocks. We also have futures markets - commodities, bonds, currencies - which have been distorted over the past 5 years due to Fed interest rate policy and money printing, starting to trend again. Trend following strategies are coming off an excellent year after 4-5 flat years. And if the Fed does start raising rates even slightly, we may have more clear trending markets.

2. Opportunities and Concerns in Global Markets

Speaking of trends, there has been an annoying trend in my letters. Every individual idea I have highlighted has peaked soon after I had written about it here (*Altius Minerals*, *Reeds Soda* and *The Japan Hedged Equity Fund* come to mind). So I am not going to mention any positions that we current own! I will highlight some themes for this year that I am watching that could yield investment ideas. For those of you that don't remember, we break portfolio management down to components:

1. Static allocations (usually a managed money idea such as currency)
2. Major markets and sector allocations following a trend trading strategy with stop points to minimize potential losses and protect capital
3. Individual investment ideas - fundamental ideas that we develop and then enter the trades with stop loss points to protect capital
4. Miscellaneous

The themes could encompass any of the 4 above components. So here are some themes:

1. Global growth is not strong - therefore more countries across the globe will turn to printing money and borrowing to fund **WPA type infrastructure projects** in order to put blue collar people to work and to try to stimulate economic activity. We are seeing this in China and I bet we will see it throughout Asia and in Europe. South America could use some of this too but they don't have the fiscal reputation to get away with borrowing funds and deficit spending.

2. Internet security continues to be an enormous topic of concern. As more and more people move away from simply browsing and put more and more of their personal stuff on social websites, and banking sites, security issues will continue to pop up globally.

3. Software will continue to "eat up the world." We can do everything virtually now. In fact, I can run Walnut Hill Advisors from anywhere in the world due to our secure internet based phone system, CRM system, and document storage system. Furthermore, we can run virtual meetings via Skype and FaceTime and hold presentations with *Joinme* or *Gotomeeting*. Everything from retail stores to medical consults are on the web ready to do business with you (I personally favor the web + personal combination but that's my bias:).

4. Food security and purity - more and more mainstream consumers desire organic and non GMO foods (not just "all natural" foods, whatever that means). Companies that offer and verify natural foods will grow. Traditional grocers are offering a large selection of organics now opening up more space for organic food micro-entrepreneurs as many stores now seek out local producers (I wrote about food entrepreneurship in California 2 years ago on my ChrisGrande.com blog).

5. Healthcare breakthroughs - biotech contract research organizations have made it easier for development biotech companies of all sizes to run tests on compounds and ideas. The rate at which new drugs and therapies are being brought to human trials and to final market approval has been very large. And it's been exciting.

6. Personal security - I expect small scale one on one terrorist attacks and other security breaches to increase. It's impossible in my opinion to completely stop this and those who think that law enforcement can are delusional. The idea of self independence and security will be a growing theme - home independent on energy, food, and resources is a small but rapidly growing sector.

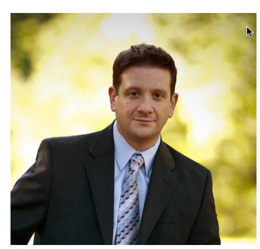
There are other themes of course - but for now, this is a good starting list of what I see happening out there. Lets see how they develop in 2015.

3. Notes...

Baby #2 arrived on December 29. Kimiko Hyejin Grande is home happy and relaxed with mom. Both are doing fine. We hope you can all meet her sometime. Here she is posing for the camera:

Thanks to all of our clients for their support and for those of you that needed me the last week of December to first week of January, thanks for your patience.

Warmly,



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