



2014 Q3 Capital Markets Review

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Q3 Capital Markets Review

As markets headed into the third quarter of 2014, initially strong economic data gradually began to weaken. Furthermore, headline risks contributed to overall risk levels, and technical indicators also indicated overextended markets. These volatile conditions corresponded to a volatile market, as the S&P 500 reached record levels but ultimately ended the quarter largely flat and in decline.

Several geopolitical risks carried over into Q3 from Q2; namely, ISIS' rampage through the Middle East, the crisis in Ukraine and sanctions against Russia, and the conflict between Israel and Hamas in Gaza. In the third quarter, Argentina's "selective default" and the spread of Ebola had added to the smorgasbord of headline risks. Heading into Q4, pro-democracy protests in Hong Kong sparked concerns of a negative impact on Asia's economies.

Of note, the sanctions against Russia continued to have a negative impact on European economies; Germany in particular suffered, as the Eurozone country with the largest share of its economy tied to Russia. As Germany is the engine that drives the Eurozone, German weakness rippled through the Eurozone throughout Q3, particularly in Italy and France.

It is important to note that although foreign economic conditions weakened throughout the quarter, in addition to geopolitical risks and indications of a technically overextended market, domestic economic data stayed strong. The US economy remained robust throughout the quarter, providing an important stabilizing note to markets. Nonetheless, by quarter-end, the S&P 500 index had declined once and was in the midst of a second decline, and was headed into Q4 mostly unchanged on the quarter.

The following indicators are representative of the overall economic climate in the first quarter of 2014.

July:

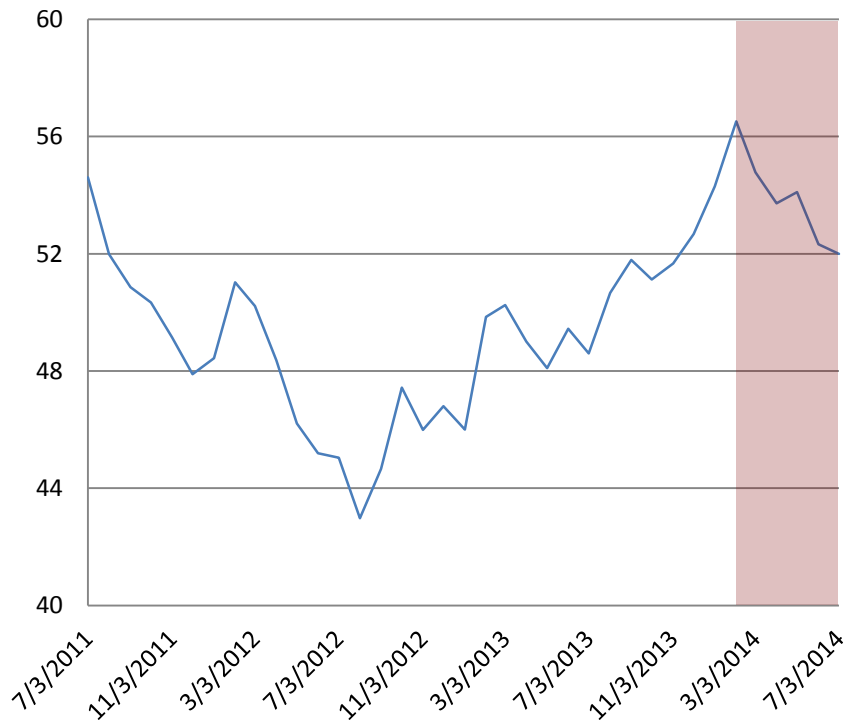
- Heading into July, generally strong global economic data began to weaken, and geopolitical risks remained outstanding. US economic activity was strong, but gradual weakening in Europe as well as rising VIX levels and US Treasury yields contributed to rising risk levels throughout the month.
- The S&P 500 index was flat until the end of the month; heading into August, markets began to decline in light of the aforementioned risks.

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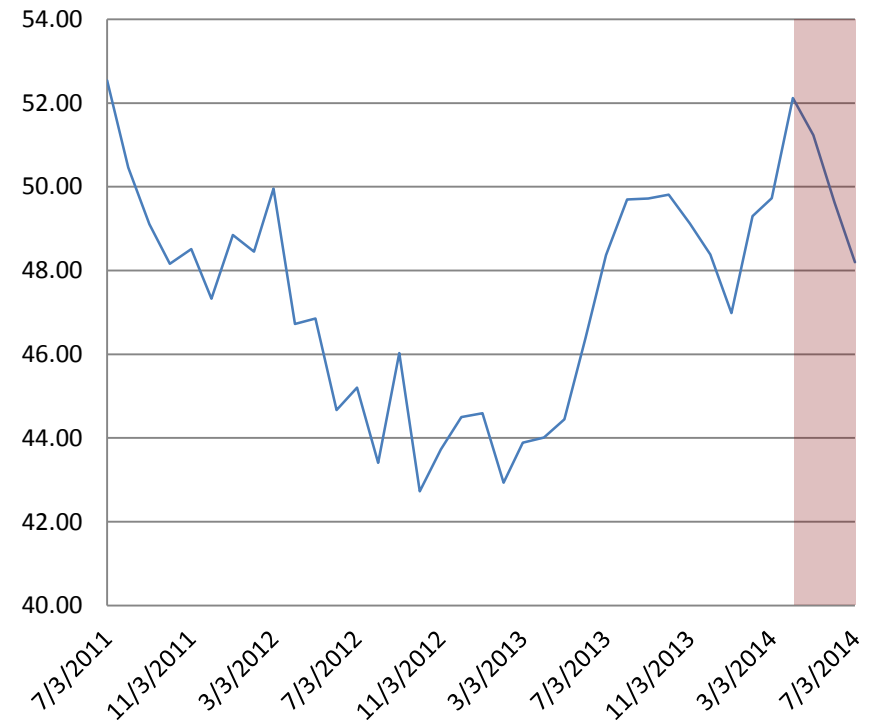
July

- Germany continued to be negatively affected by the Russian sanctions. This weakness rippled out to the rest of the Eurozone, as France and Italy in particular were affected.

**Germany Manufacturing PMI Survey,
July 2011 – July 2014**

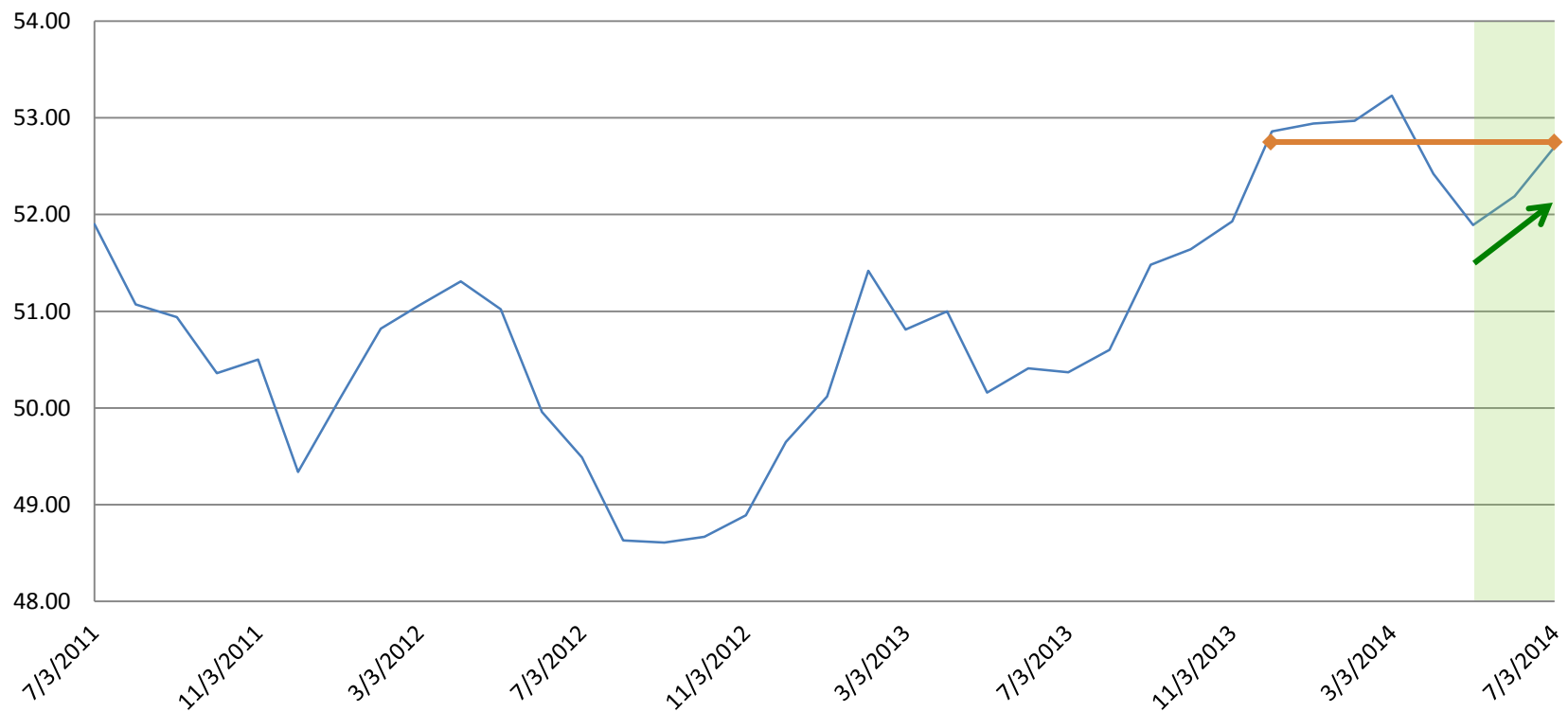


**France Manufacturing PMI Survey,
July 2011 – July 2014**



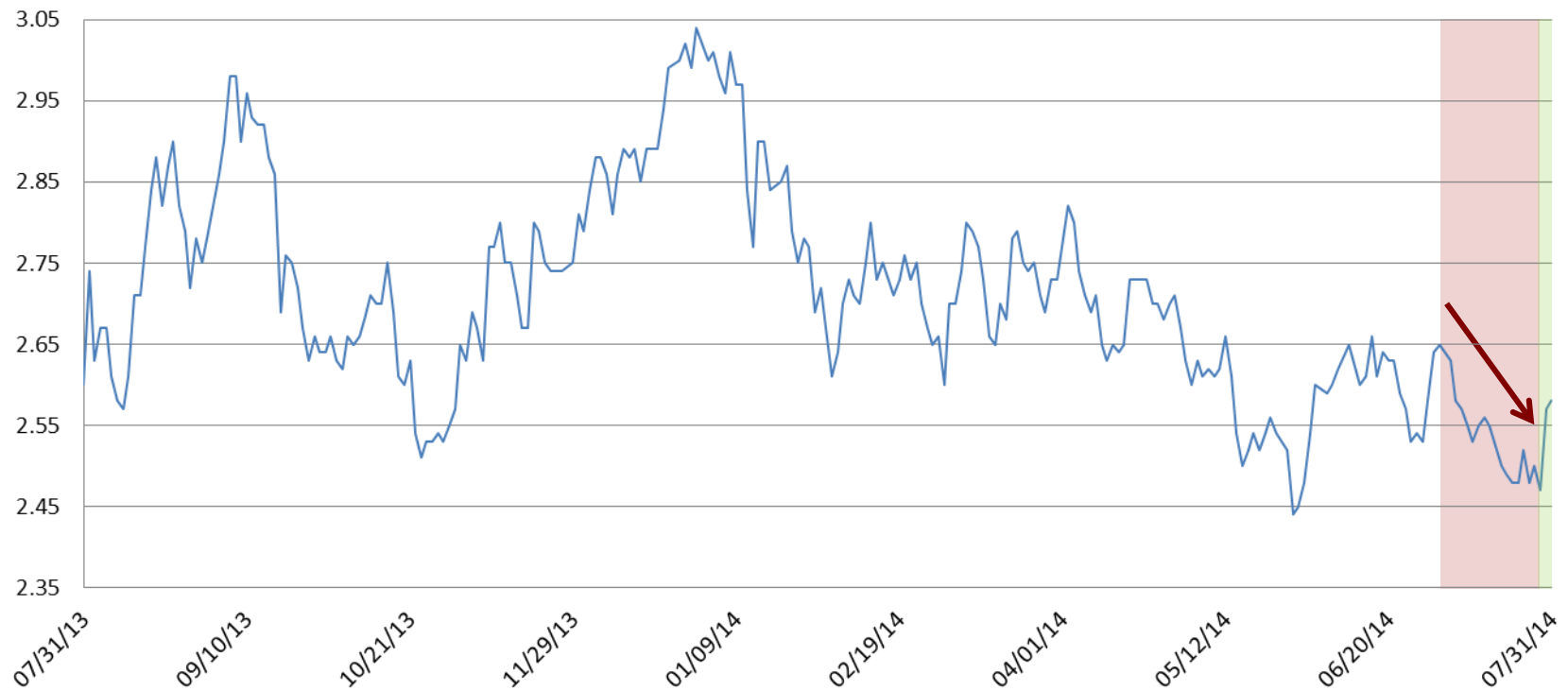
- Weakness in Europe was somewhat offset by economic strength in the US and a measure of stability in China. Consequently, overall global manufacturing was steady in July, remaining near three year highs.

Global Manufacturing PMI Survey, July 2011 – July 2014



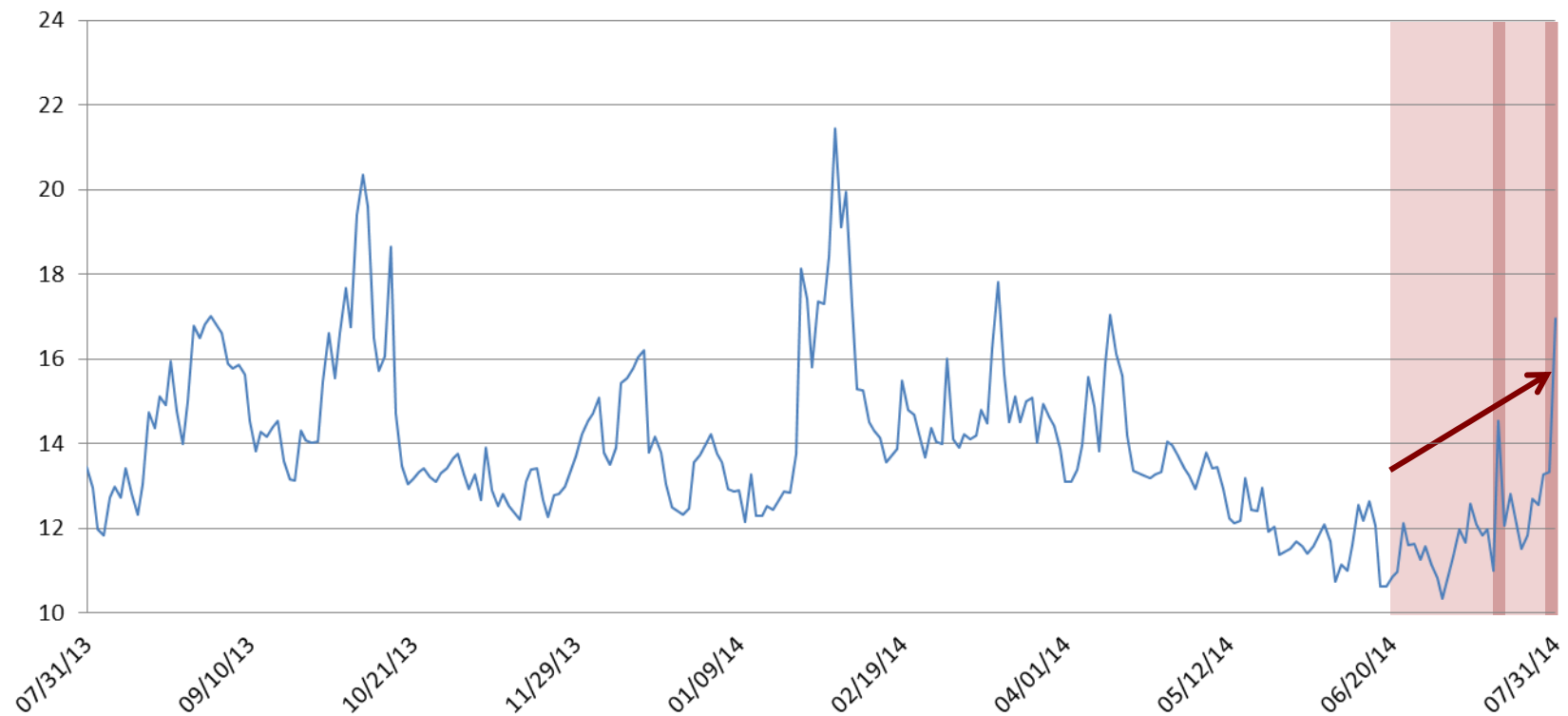
- Despite a moderate jump on the last few days of the month, 10-year US Treasury yields declined throughout July. Traditionally, lower US bond yields indicate decreased appetite for risky stocks and increased appetite for less risky debt instruments.

US 10-Year Treasury Bond Yield, July 2013 – July 2014



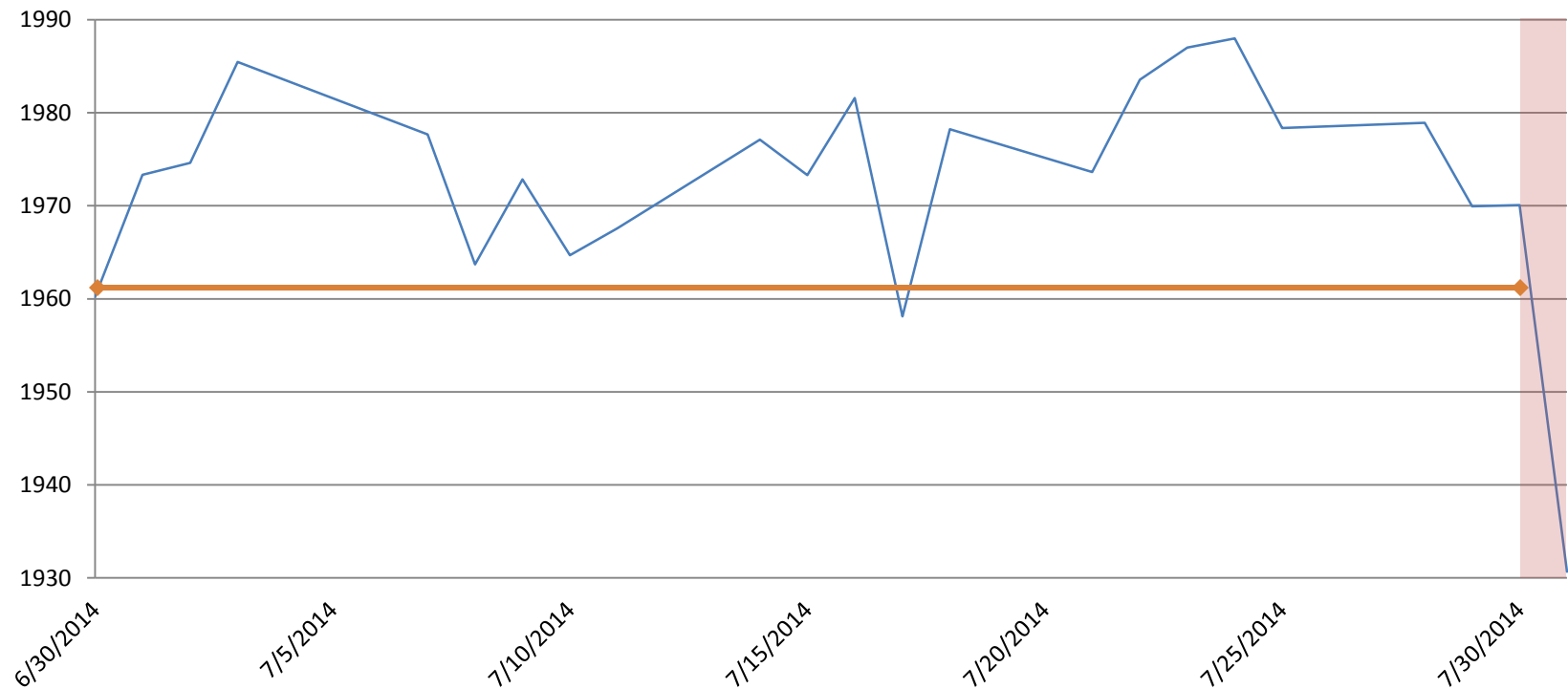
- The volatility index began to move up again in July after several months of relative calm, with small jumps mid-month and at the end of the month.

S&P 500 Volatility Index, July 2013 – July 2014



- Mixed data corresponded with a mixed month, as equities were mostly flat in July; furthermore, heading into August, the S&P 500 was in the midst of a correction.

S&P 500 Index, July 2014

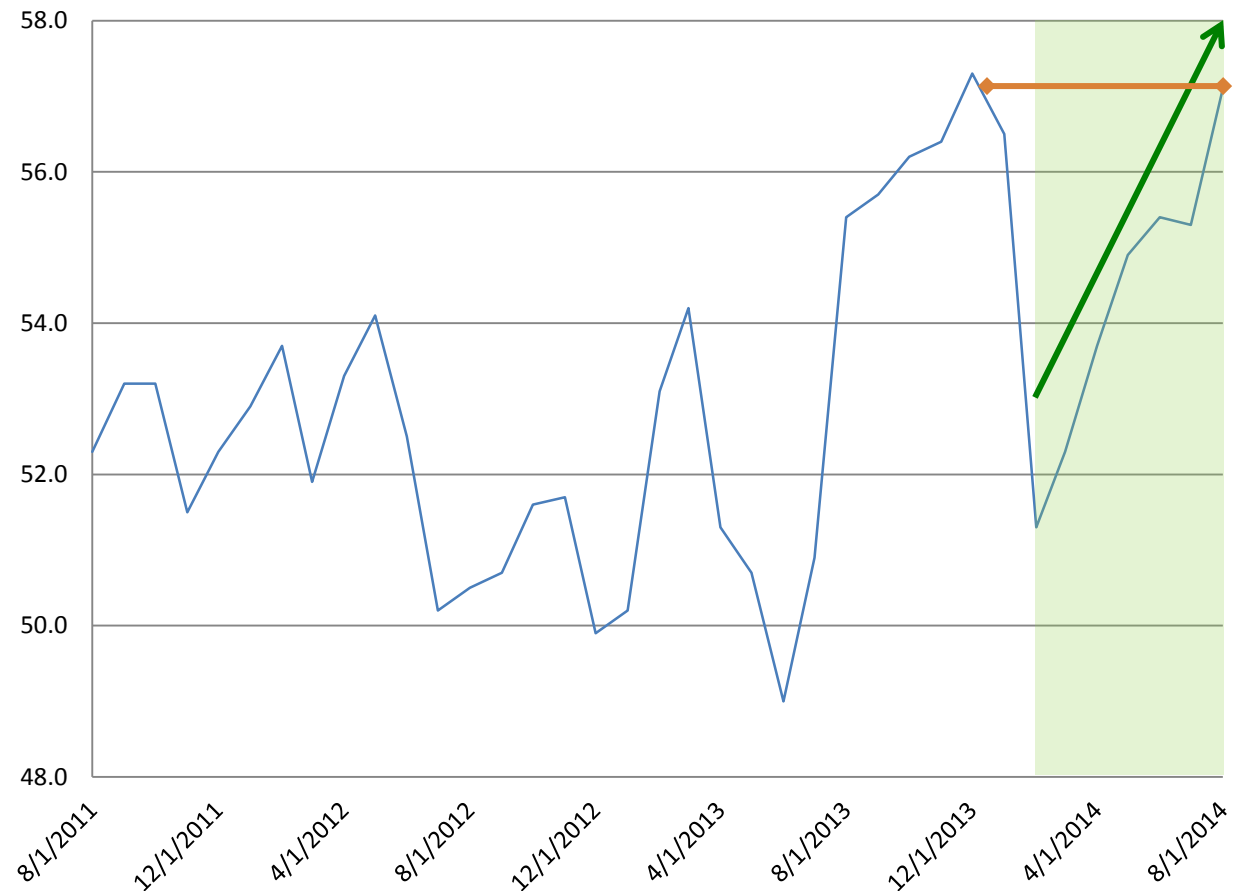


August:

- Though international economic and geopolitical risks did not lessen in August, exceptional US economic data and dovish EU and Federal Reserve monetary policy boosted markets to the upside. A measure of stability in the credit markets also contributed to market strength.
- Though we were wary of the market strength as a potentially transitory shot in the arm, especially following a very volatile start to August, we gradually increased our equity exposure to take advantage of the upward move.

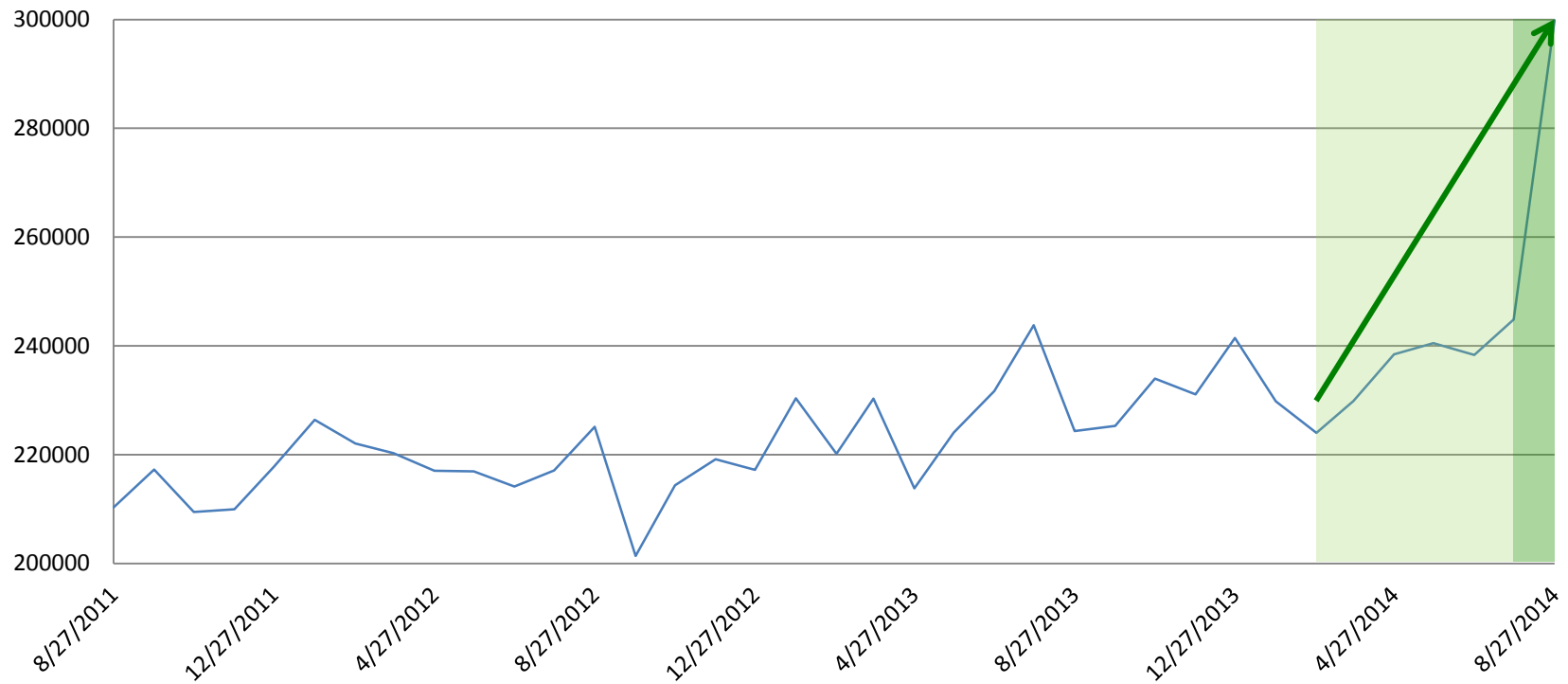
ISM Manufacturing Index, August 2013 – August 2014

- US manufacturing continued to improve, reaching levels near three-year highs.
- The ISM's gradual ascent over several months added a sense of stability to the growth.



- Orders for US-manufactured durable goods spiked in August, recording the largest increase MoM on record. Unusual activity aside, orders for durable goods continued the 6-month upward trend, reflecting steady US economic growth.

US Durable Goods Orders, August 2013 – August 2014

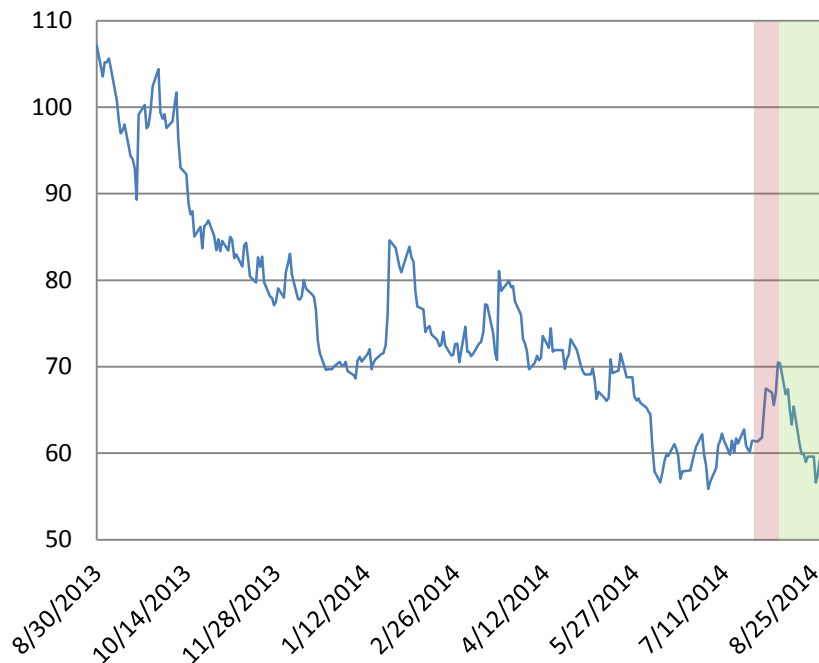


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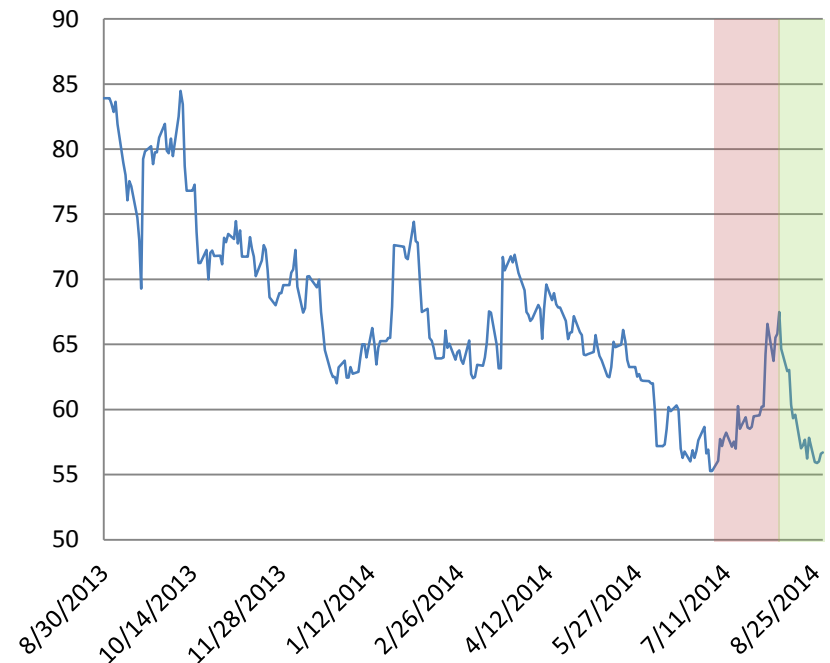
August

- After a brief increase in risk at the beginning of August, credit markets stabilized throughout the month as credit default swap spreads contracted.

European Credit Market Risk, August 2013 – August 2014

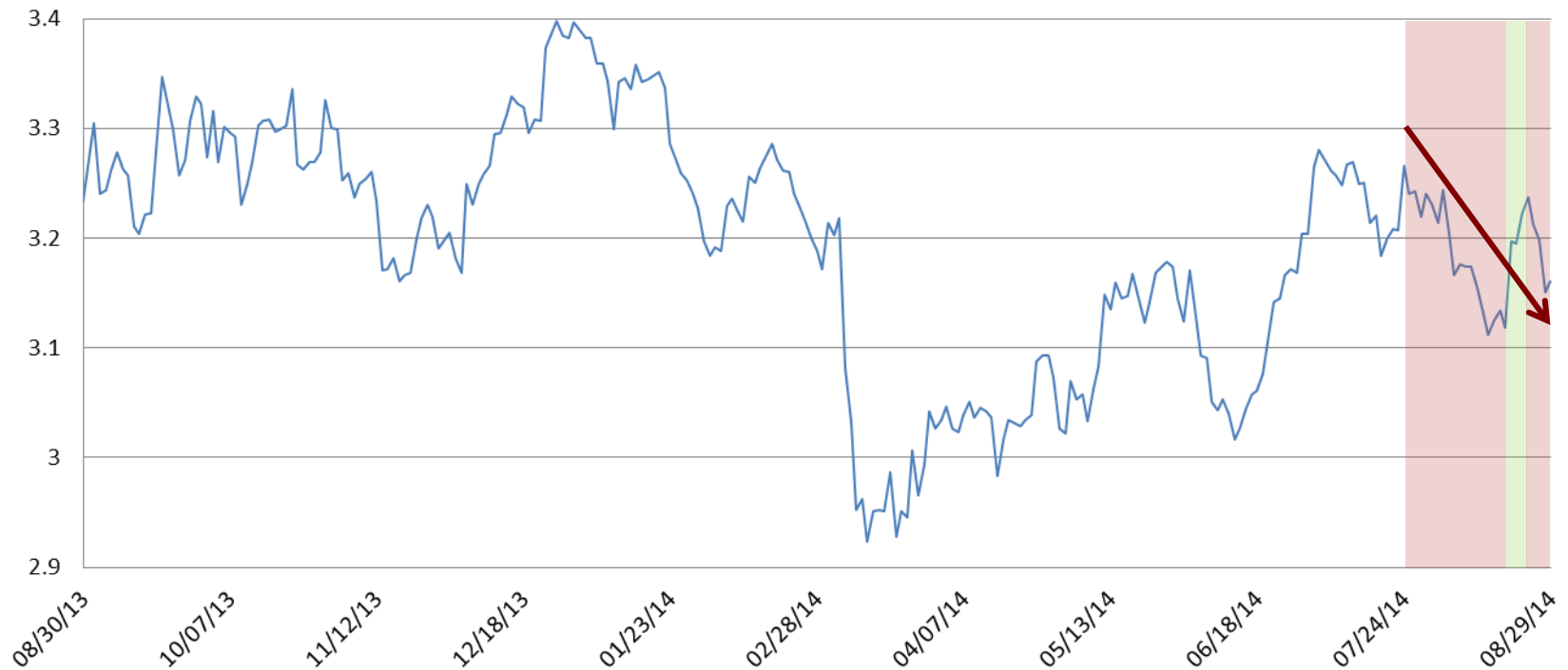


North American Credit Market Risk, August 2013 – August 2014

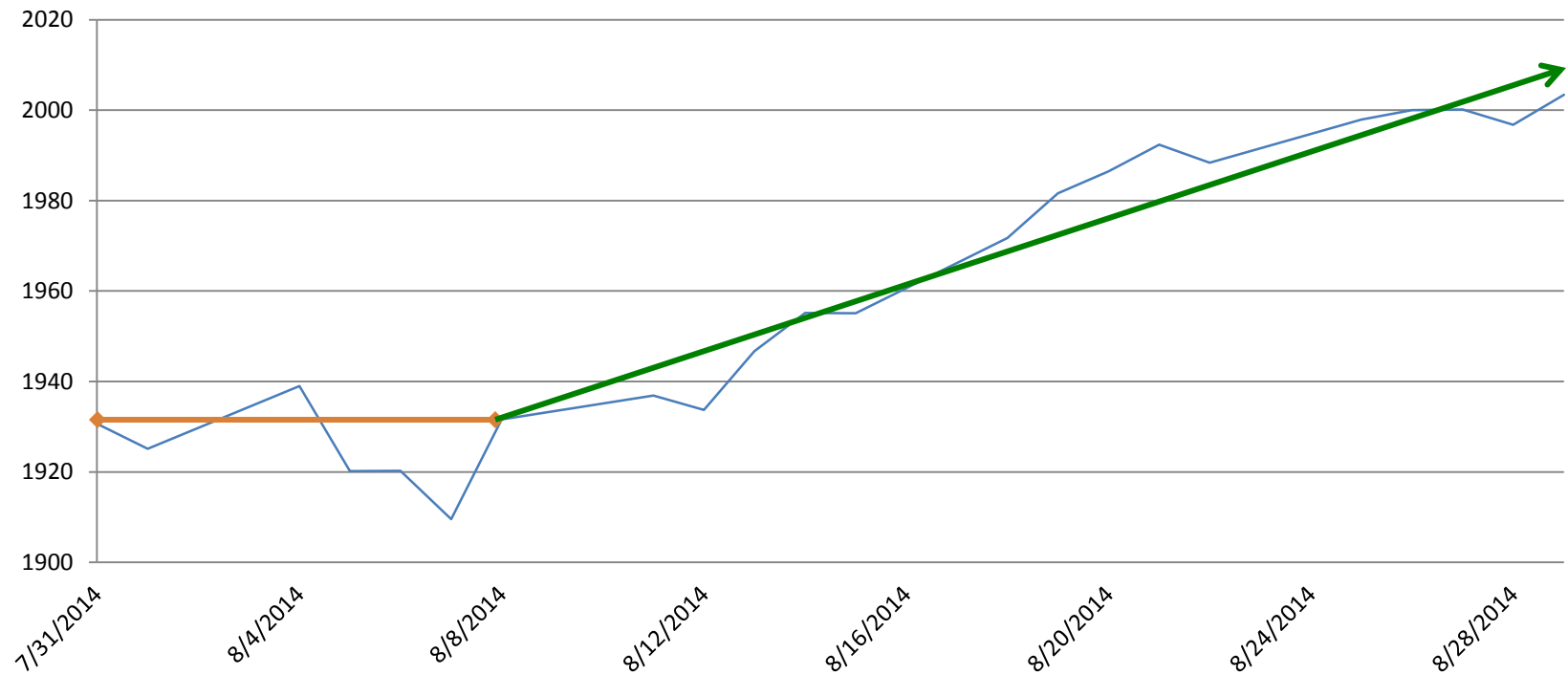


- After a weak July and start to August, commodity prices jumped temporarily before coming back down at the end of the month. Commodity prices presented a less optimistic outlook in the face of an otherwise bullish August.

Price of Copper, August 2013 – August 2014



S&P 500 Index, August 2014



- After a rough start to August, dovish monetary policy out of central banks as well as credit market and US economic stability provided a boost to equity markets.

September:

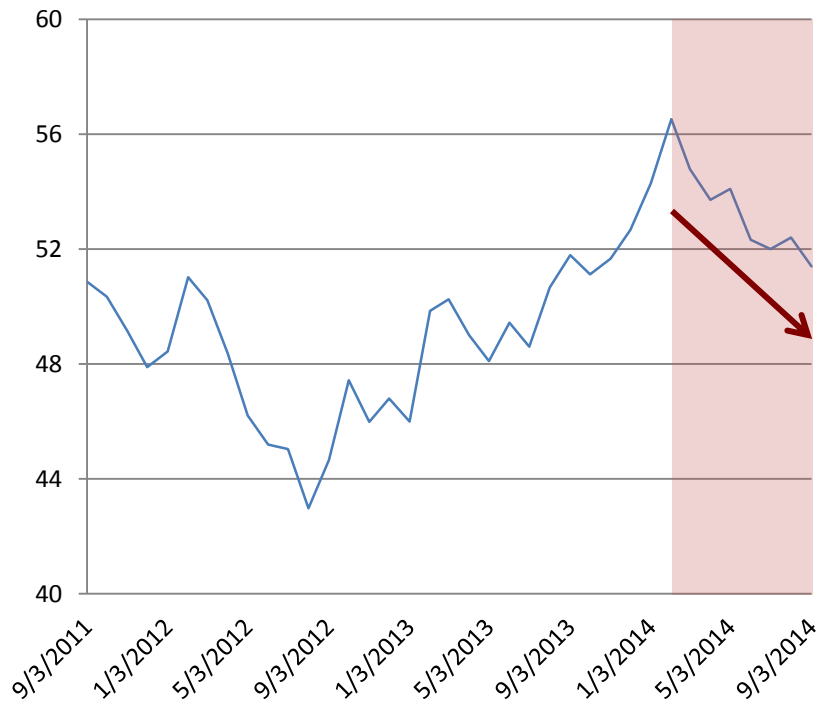
- By September, it became increasingly more apparent that the strength in August had not been supported by corresponding underlying economic strength. Though US economic conditions were strong, foreign economic conditions deteriorated somewhat, and technical indicators signaled an overextended market.
- Throughout September, we restricted our equity exposure in light of the aforementioned risks. The S&P 500 index was negative for the month, and headed into Q4 in the midst of a decline.

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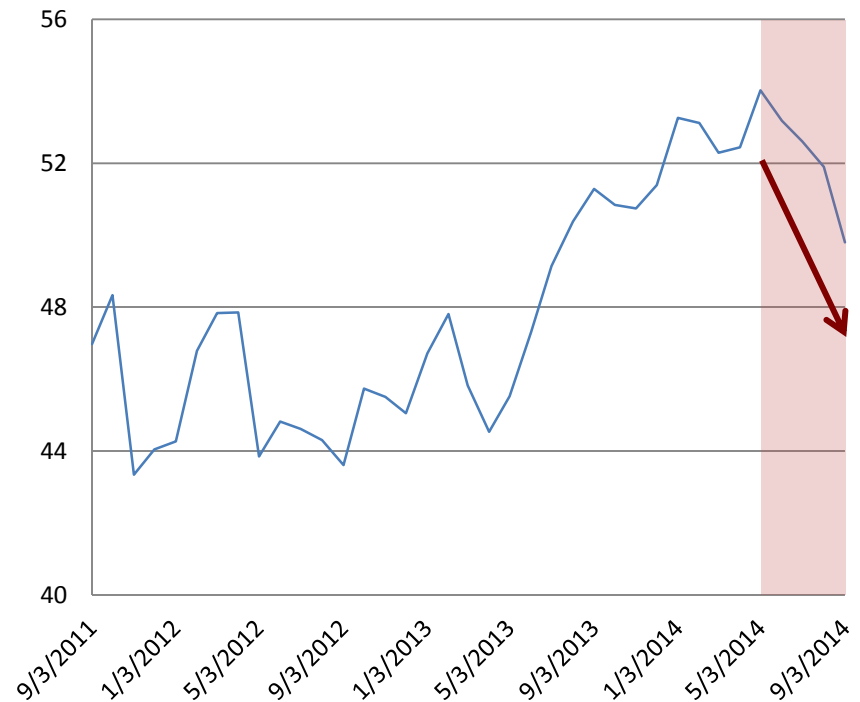
September

- Though US economic conditions continued to grow, economic conditions abroad – specifically, in Europe – continued to deteriorate.

**Germany Manufacturing PMI Survey,
September 2011 – September 2014**

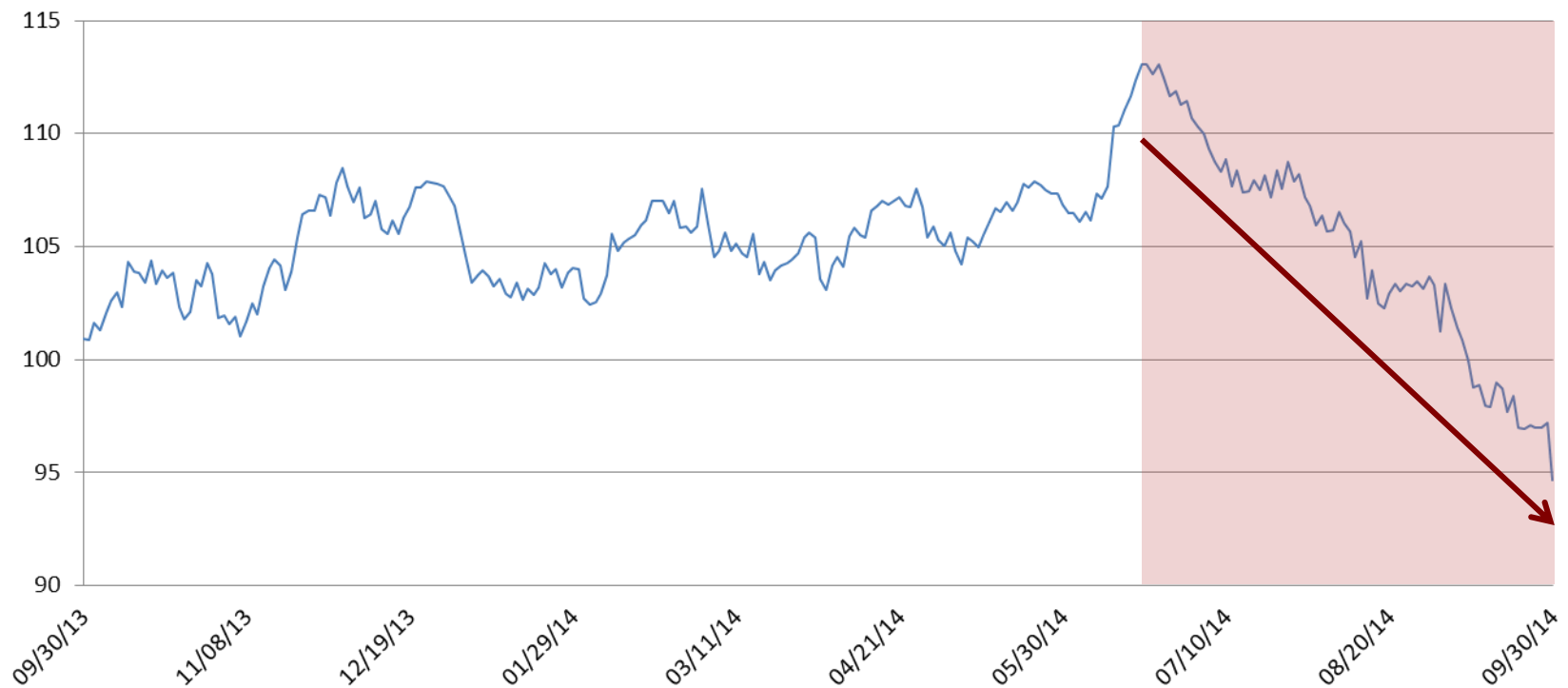


**Italy Manufacturing PMI Survey,
September 2011 – September 2014**



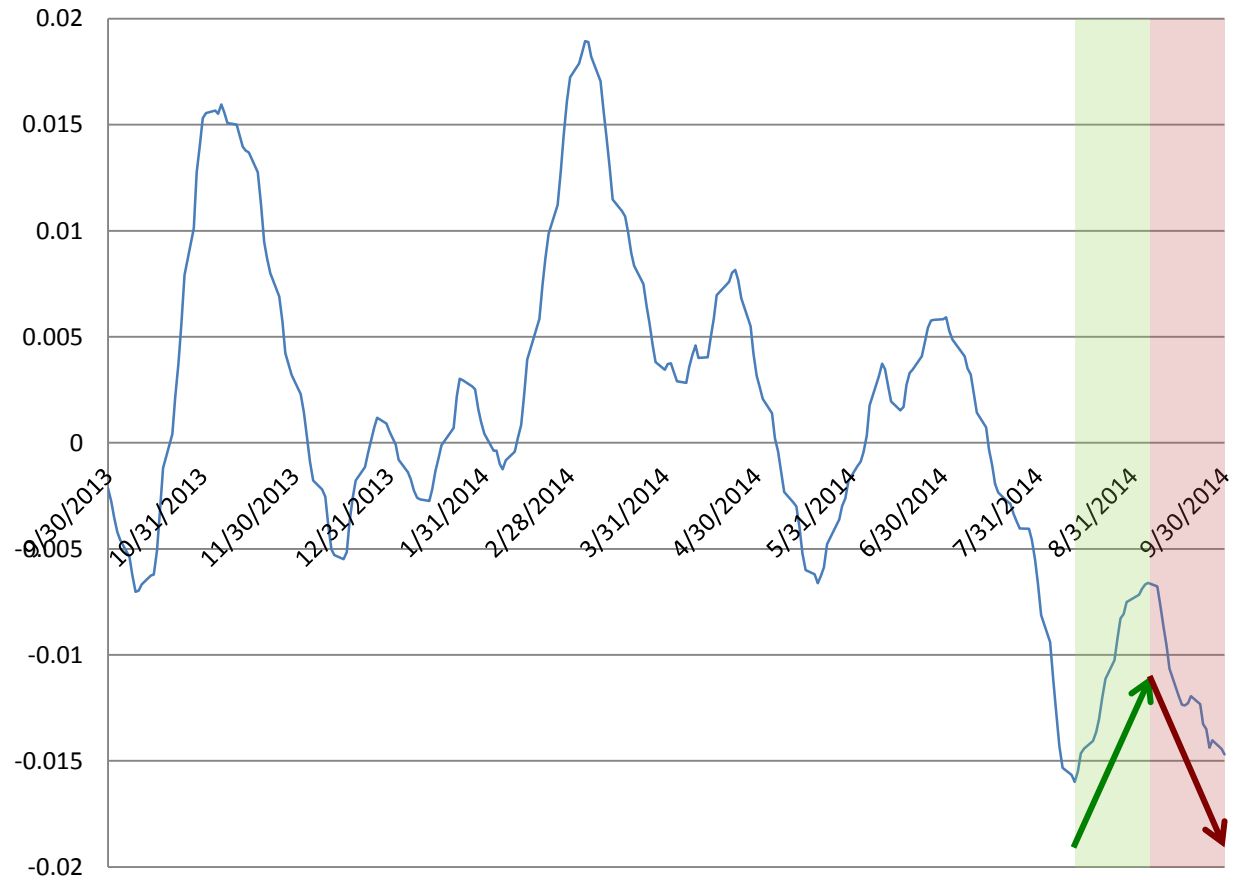
- Brent crude oil continued its alarming decline, despite ongoing tensions in the Middle East. Such weakness in spite of the threat to supply implies a potential weakening of demand for crude oil, corresponding to potential underlying global economic weakness.

Price of Brent Crude Oil, September 2013 – September 2014



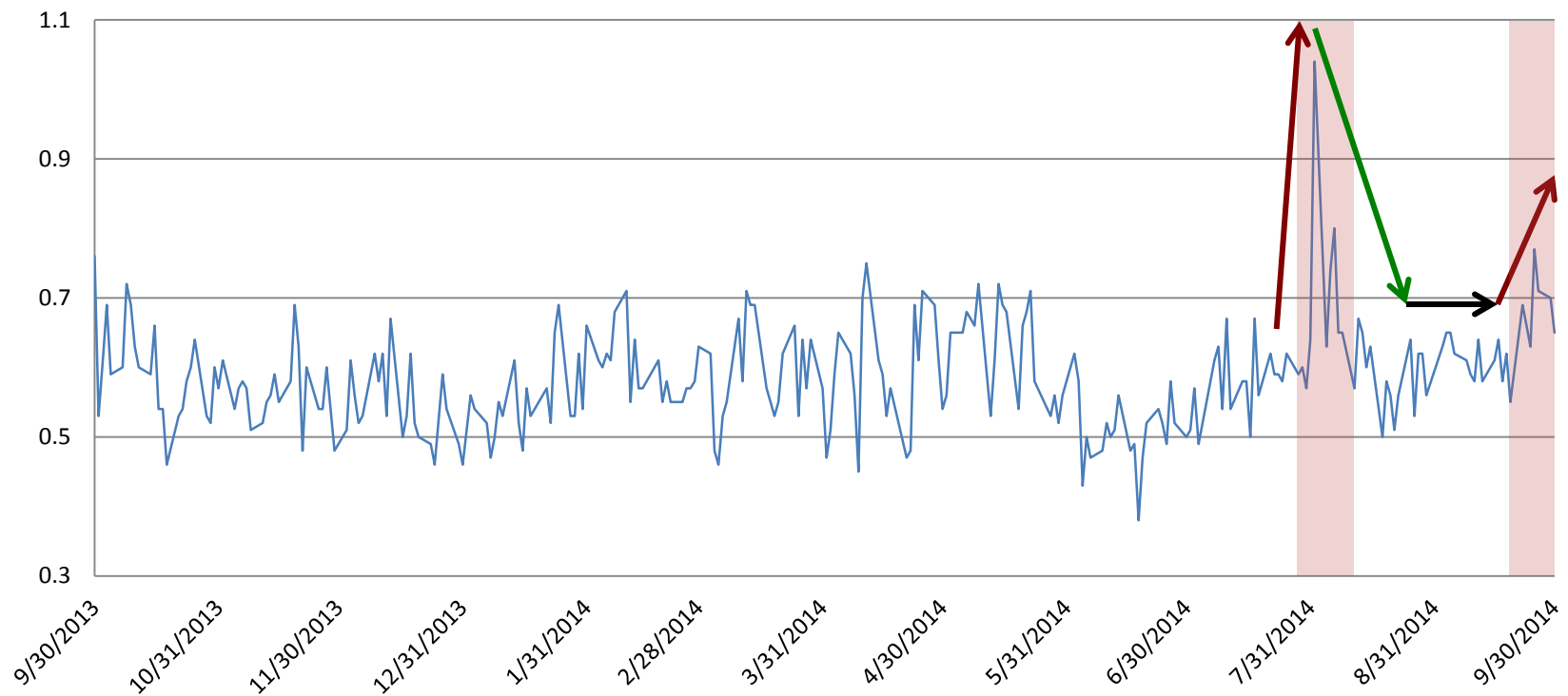
- After a brief uptick in August, the NYSE oscillator began to decline steadily through September.
- The oscillator measures momentum on the NYSE. As the oscillator moves lower, momentum turns negative.

NYSE Oscillator (Short-Term Smoothing), September 2013 – September 2014



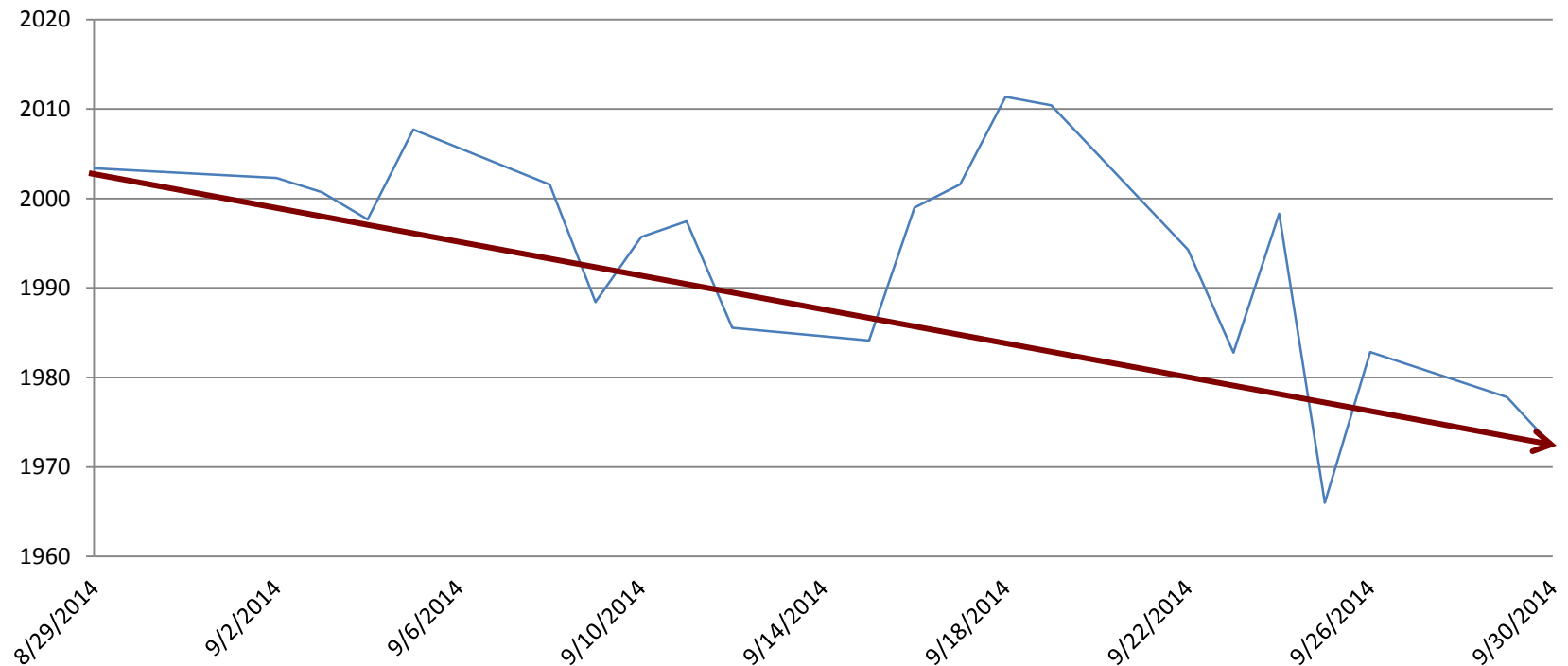
- Volatility in the equity options markets following a period of relative calm hinted at a potential corresponding volatility in the equity markets, which were relatively calm in August.

CBOE Equity Put/Call Ratio, September 2013 – September 2014



- The August optimism wore off as market focus shifted to economic data and technical market indicators that had never really improved; accordingly, the S&P 500 index declined in a volatile September, ending the month in decline and the quarter flat.

S&P 500 Index, September 2014



Global Economic Indicator Descriptions

The ISM Manufacturing Index is a survey-based measure of manufacturing conditions in the United States.

The Germany Manufacturing PMI Survey is a survey-based measure of manufacturing conditions in Germany.

The France Manufacturing PMI Survey is a survey-based measure of manufacturing conditions in France.

The Italy Manufacturing PMI Survey is a survey-based measure of manufacturing conditions in Italy.

The Global Manufacturing PMI Survey is a survey-based measure of manufacturing conditions around the world.

The S&P 500 is a value-weighted index of 500 widely held common stocks, whose performance reflects changes in stock market conditions.

The NYSE Oscillator is a measure of momentum on the NYSE given the number of advancing and declining stocks.

The CBOE Equity Put/Call Ratio is the ratio of puts to calls traded on the CBOE.

Global Economic Indicator Descriptions

The Price of Brent Crude Oil is a benchmark that measures global crude oil prices.

The Price of Copper is a benchmark that measures global copper prices.

The North American Credit Market Risk is a measure of the cost to insure North American credit derivative instruments.

The European Credit Market Risk is a measure of the cost to insure European credit derivative instruments.

The US 10-Year Treasury Bond Yield is the interest rate on the bond issued by the United States government that matures in 10 years.

The US Durable Goods Orders is a measure of the demand for durable goods manufactured in the US.

The S&P 500 Volatility Index (VIX) is a measure of the implied volatility of S&P 500 index options, commonly used to gauge general stock market volatility.

Disclosure

L&S Advisors, Inc. is a privately owned corporation headquartered in Los Angeles, CA. L&S Advisors was originally founded in 1979 and dissolved in 1996. The two founders, Sy Lippman and Ralph R. Scott, continued managing portfolios together and reformed the corporation in May 2006. The firm registered as an investment adviser with the U.S. Securities and Exchange Commission in June 2006. L&S Advisors performance results prior to the reformation of the firm were achieved by the portfolio managers at a prior entity and have been linked to the performance history of L&S Advisors. These results should not be interpreted as the actual historical performance of L&S Advisors.

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All data for global economic indicators has been provided by Thompson Reuters. Data for the S&P 500 index has been provided by the Federal Reserve Bank of St. Louis.

