

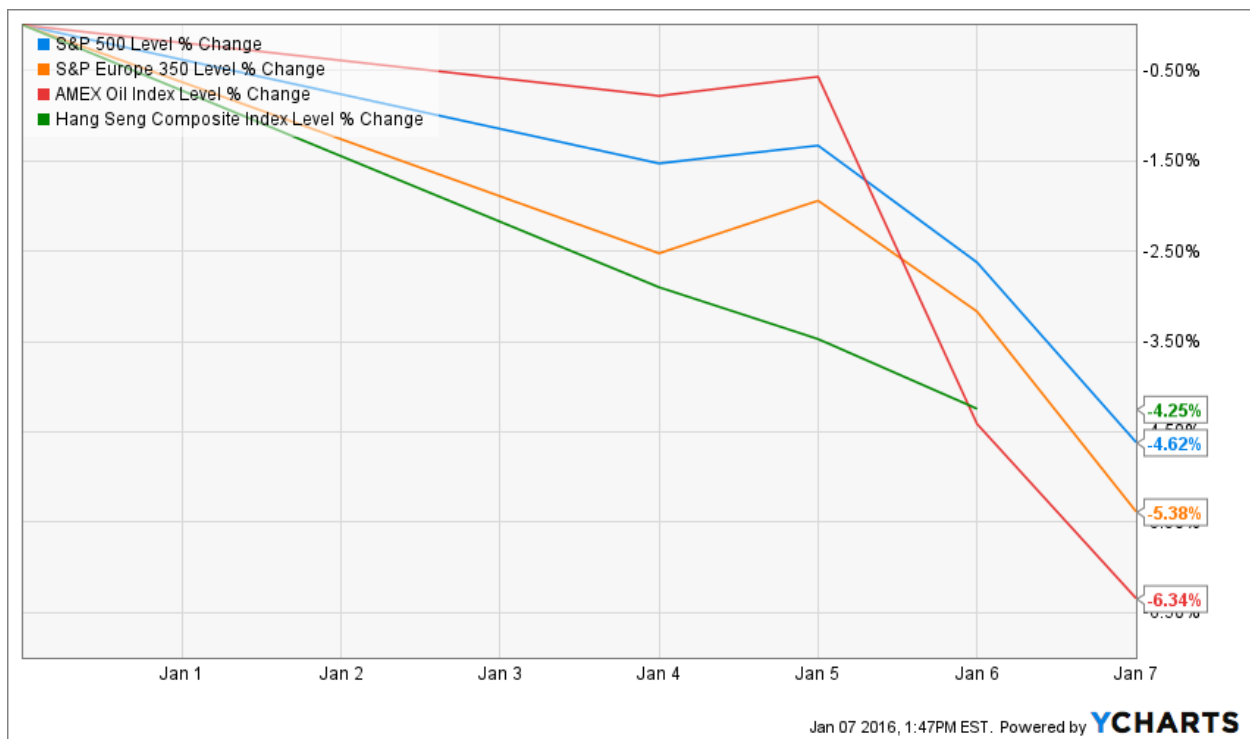
Market Update

January 7, 2016

CHINA, CHINA, CHINA

2016 has started with market selloffs around the world. Why? The overwhelming reason is current issues in Chinese markets and economics. We all understand that to some degree all investment markets are global in nature. Recently, even the most local of all markets (Residential Real Estate) has benefited from globalized markets. For instance, many reports on local Real Estate values point to an influx of foreign capital chasing safer investments in real estate in and around the Los Angeles area. The reason for this is the stability of the economic environment in America and the strength of the U.S. Dollar.

China is battling three issues; slowing/changing economic trends due to the shift from a manufacturing economy to a more services oriented economy, an immature stock market where rules on halting trading for numerous reasons are being changed almost daily by the government and the devaluation of its currency. Most important might be the devaluation of the currency. Normally, this would bode well for a country in many aspects because it makes their goods cheaper and increases their exports. However, as the shift to a more service oriented economy occurs, which is a signal of economic maturation; a weakening currency can imply further economic weakness and potentially hurt production and global demand.



Information in the chart above is taken from resources we believe to be reliable; however we do not guarantee its accuracy or completeness.



PROMINENCE CAPITAL

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Note the Hang Seng Market was closed after opening because of a trading halt from the government on January 7 2016 so data is not available for January 7 2016 in this chart.

Disruptions in global economies like China often trigger selling of assets all over the globe. Currently, the U.S. markets are down to start the year and have not seen the depth of selling that Europe and other global economies have seen. The reason why this happens is very simple. In a global market place, where investors and institutions have investments in other open markets, it is natural to start selling assets in those other markets as a means of protection. Today, Chinese markets opened and closed for the day after a trading halt was implemented by the government, due to steep losses. Although this was designed to stop selling, it actually created more. It does so because people with investments that trade in those markets cannot sell their investments anymore so they go to the next most liquid places they can where they have investments to sell and reduce risk, hence a chain reaction of selling around the world.

At some point, history tells us, China will calm its markets down, real price discovery will occur for investable assets again and things will normalize in their markets. This may take time.

OIL, OIL, OIL

Oil is not to be forgotten and another stress on the global market place as well. The slump in oil prices has caused a great amount of asset value depletion across the global markets, for many of the same mechanical reasons as China. Energy is a major sector of investment exposure for the majority of investors in the equity markets and fixed income markets. The price of oil has come down due to over production globally and the prospects of larger amounts of Iranian oil about to hit the market from recent international negotiations lead by the U.S. and the Obama administration. This market will see continued pressure. The energy industry is a large source of income producing investments for income oriented investors, both equities that produce income and bonds. The issue of supply exceeding demand is very apparent in the current environment. Prices remaining lower and continuing to go lower forces production to be cut back and "Rig Counts" (the facilities that produce oil) have been decreasing as producers are shutting them down. As prices have dropped, anything related to oil and gas has been under selling pressure. In order to protect against this, portfolio managers and investors will go to other sectors and markets to sell, in order to raise cash. History tells us "the best cure for lower oil prices tends to eventually be the lower oil prices" as the producers continue to cut back until supply no longer meets demand and a reversal happens. The latest I have heard is that we are producing 1 million barrels a day more than what is currently demanded. If that number is accurate, it is not the biggest discrepancy in history. We have seen many times where production was significantly higher than this vs. demand.



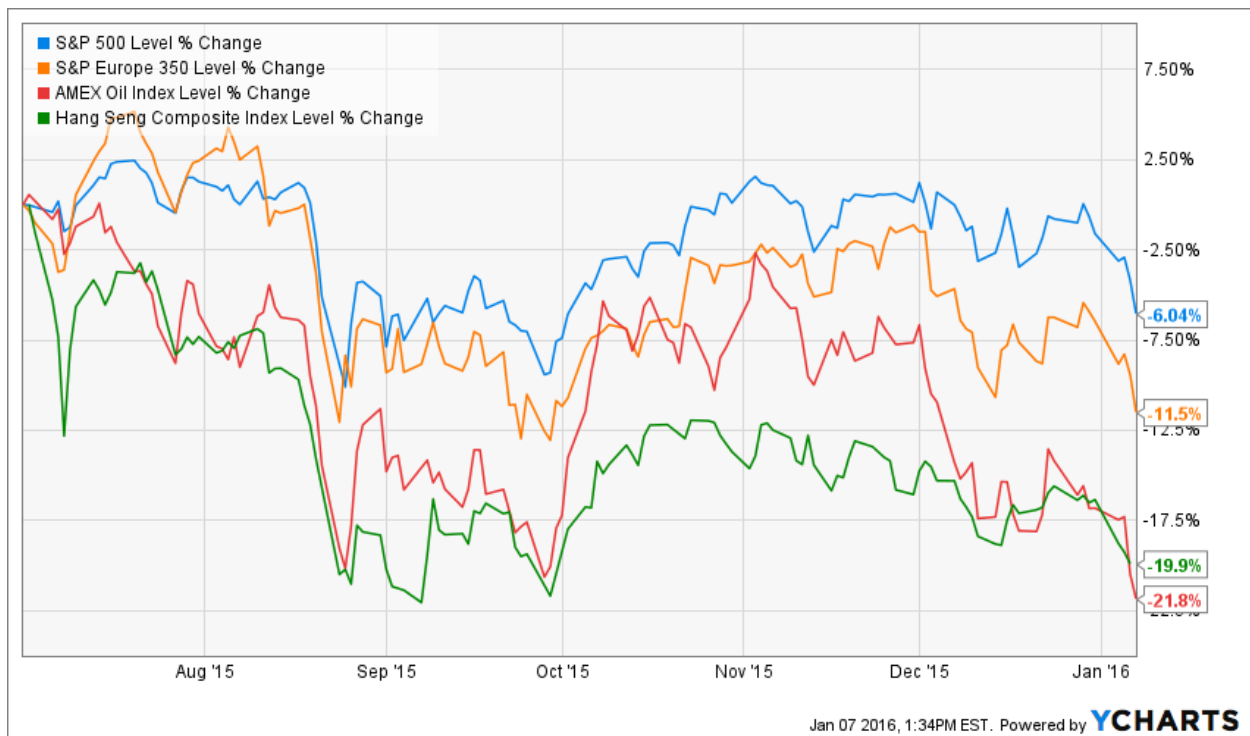
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Lastly, we cannot mention the low prices of oil without pointing out that lower oil prices tend to reduce costs for the consumer putting more buying power in their pockets. This tends to be good for an economy but may take time to get through the system.

WHAT DOES THIS MEAN AND WHAT DO I DO ABOUT THIS?

My view on this is that a short term bear market has already started. It started toward the end of Q2 (Second Quarter) in 2015, see chart below, when stock markets here in the U.S. had hit highs. Bear Markets come in varying shapes and sizes. I do not believe this will be a major bear market. Here are two important factors on why: 1) we do not have the credit default issues we had during the recent great recession. Although debt levels are rising a bit by some measures, individuals and businesses are not as leveraged as they were right before the great recession. That environment does not exist. 2) Although we have some flattening of the yield curve (difference between short term interest rates and long term interest rates) we do not have an inverted yield curve where short term rates are higher than long term rates. This is a classic sign of a potential long term protracted bear market and recession.



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I believe what we have is a shorter term bear market. If issues such as China and the Oil price problem work themselves out, we will be somewhat uncomfortable for a bit. Ultimately the U.S. economy and U.S. investors will weather through like all previous shorter term bear markets.

As an investor and a portfolio manager I believe long term strategic investment plans are still very well intact. Knowing that the money invested in these portfolios is not all needed today making longer term strategic portfolio changes is not warranted. From a shorter term investment plan, a prudent investor should have at least 3 to 6 months cash reserves built up in non-investment accounts such as a bank savings account to cover shorter term needs. Tactically as a portfolio manager and investor, this is a great time to look at rebalancing ones portfolio to make sure that the percentages in each investment class are aligned with their long term strategic goals. If you truly feel uncomfortable about the immediate markets environment which will likely see a bit more selling pressure in the near term, we may want to look at raising a bit of extra cash from some of the more risky areas of your investment portfolio.

If you have questions or would like to discuss this further with regard to your personal portfolio please contact me at 310-433-5378.



James M. Liotta
President
Prominence Capital GP, LLC.
jliotta@prominencecapital.com
www.prominencecapital.com