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INVESTMENT Q&A

Editor's note: The Investment Q&A feature appears regularly in the Banking & Wealth Management special reports of *The Central New York Business Journal*, spotlighting area investment professionals and their views on the financial markets and investments. In this issue, Alan Leist provides his outlook.

Leist

Alan R. Leist III, CFA, chief investment officer at Strategic Financial Services in Utica.

CNYBJ: What is your view on where the financial markets are headed in the coming months?

Leist: On my first day in the investment business, I received a particularly bad piece of unsolicited advice: "Always be bullish, no matter what!" This stance has always struck me as dangerous, a product of the Wall Street sales machine. I was reminded of that long-ago conversation at the start of this year when reading a popular survey of leading market strategists. *All* of these "experts" were calling for the market to be up again in 2014. I couldn't help but laugh. Everyone was bullish.

The market may very well be up this year. We don't know. Over the short-term, no one ever really knows for sure. At Strategic, we simply employ a disciplined, repeatable process to make sound decisions in protecting and advancing client capital over the long-term across market cycles. On occasion, we may even recognize that the bull deserves a short rest.

U.S. Stocks: With a weather-related pause in the domestic economic recovery, an escalation of geopolitical risk, and the Federal Reserve in transition mode, equity investors were patient to start the year and refused to chase stocks after 2013's historic rally. Nevertheless, a familiar theme quickly returned. As soon as the market showed any sign of weakness, buyers stepped in to put a floor under U.S. stocks in the absence of attractive alternatives elsewhere. This pattern has been repeated consistently for the past several years, instilling an imprudent sense of complacency among investors.

Market sentiment and valuation tend to swing like a pendulum, occasionally moving to the outer edges, but rarely pausing in the middle. Five years after the final washout in 2009, the momentum remains on the side of the bulls in a low-interest-rate world that supports ever-higher prices for stocks and other risk assets. However, the market has recently shown some signs of exhaustion, most notably in the type of speculative stocks that often emerge at tops. A reacceleration of economic growth is needed to drive corporate sales and to justify current valuations. As we wait for fundamentals to catch up to stock prices, the market likely will mark time within the recent range, occasionally retesting lows and flirting with new highs.

Bonds: A sell-off in the bond market was all but guaranteed at the start of 2014. As is often the case, however, the market moved against popular opinion. A rally ensued as the economy showed some signs of weakness and the Russian-Ukraine conflict drove investors toward safety. Yes, fixed-income investing will be a challenge for the next few years, but bonds are the ballast in a well-diversified portfolio, allowing for prudent risk to be taken elsewhere. A high quality, laddered, relatively short-duration strategy will help protect investor capital until better values emerge in other segments of the capital market and interest rates inch closer to levels that are more normal.

CNYBJ: Provide specific recommendations for investments that clients should be making right now.

Leist: At Strategic, we have been net sellers of small and mid-cap stocks in recent months despite the persistent calls of the bulls. Client portfolios have been rebalanced back to targets in domestic equities in order to capitalize on better values elsewhere in the market. Sales proceeds were directed toward international stocks, including emerging markets, commodities, and even cash. A note on emerging markets: valuation and demographic trends support attractive longer-term returns. Investors should expect bouts of near-term volatility that present an opportunity for entry at favorable levels.

CNYBJ: What do you see as the greatest risks investors need to be aware of and seek to avoid in the coming months?

Leist: A disorganized unraveling of Federal Reserve policy, corporate-margin compression, and a still-fragile global recovery remain among the key risks for 2014. Until there is a pick-up in the pace of top-line growth, segments of the market appear to be fully valued, if not outright pricey, at current levels. With valuation no longer a cushion, we are due for a healthy correction that tests the conviction of investors and sets the stage for the next leg higher in the bull market.

Acting as an offset to dysfunctional policy making in Washington, the Federal Reserve's monetary stimulus program has distorted asset prices across the entire investment spectrum. Investors must resist the temptation to reach for returns. Protecting capital is the first rule of successful investing. Insist on quality with a margin of safety in every investment decision. ❑