Wealth Advisory Group – Market Review and Outlook – Q1 2016

Economic and Market Review

Economy – The US economy continues to trudge forward with modest GDP growth and lukewarm employment gains. Inflation has remained in check and there does not appear to be any areas of the economy which appear overheated. Globally there are some challenges to economic growth, especially in China where a significant slowdown is underway, spooking investors earlier this year. So while not dramatic, the slow, steady pace of US economic activity has enabled the Fed to ever so slowly begin to normalize monetary policy.

Interest rates – Interest rates fell during the first half of the quarter as the equity markets struggled and investors sought safe haven and rates have stabilized as the equity market regained its footing. After increasing short term rates in December of 2015 for the first time in nearly a decade, the Fed has recently signaled a more dovish stance on rates potentially pushing out future rate hikes. While interest rates hover near 50 year lows (10 year Treasury 1.83%), market forces will limit the prospects for any significant increase. Domestically a sluggish US economy with slack in the labor markets and little inflationary pressure will not force the Fed to increase rates rapidly. Global growth is slow or non-existent so foreign central banks continue to cut rates further tying the Feds' hands. High yield bonds continue to faces challenges, especially in the energy sector where lower crude prices have put pressure on the finances of domestic producers.

Equity Markets – The first quarter was a wild ride for US equities. At one point in mid-February, the S&P 500 was down over 10% only to rally back and finish in positive territory (+1.35%). Larger stocks performed better than smaller stocks continuing a trend which has been in place for a number of years. Value stocks did slightly better than Growth, especially in small cap reversing the pattern of the last 10 years, too early to tell if this is the beginning of a leadership change in the US equity markets. Overseas the developed markets fell slightly (MSCI - EAFE -2.88%) while emerging markets did very well (MSCI – EM +5.75%) in stark contrast to the past five years of negative returns. (Sectors)

Crude oil – Down over 7% for the quarter but has bounced off the mid quarter lows and may be poised to stabilize and potentially go higher although long term supply/demand forces (fracking, increasing production in Iraq and Iran)/(weak economic activity and increased efficiency) will keep the price reasonably low with a trading range of 30-60.

Commodities – Commodities showed some strength in the second half of the quarter lead by strong moves in gold and other precious metals and some agricultural products. While too early to predict a reversal of the 5 year slide in commodity prices, a stabilization of commodity prices would be a good sign for global growth and emerging markets in particular.

Dollar - The US Dollar gave up some ground during the quarter but still remained at very high levels. US economic strength, safety and interest differential should keep the dollar relatively strong going forward. Dollar strength does present some challenges for US companies as multinationals suffer when they report overseas results in US dollars and export oriented companies face higher prices for their goods overseas.

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Outlook

Economy – We believe the economy will continue to slowly grind ahead with modest GDP growth in the 1-2% range, modest gains in employment and limited inflationary pressure. This tepid, Goldilocks type of growth is susceptible to slowdown/recession or acceleration and Fed tighten and investors could be hurt in either scenario. We are closely monitoring the important real time indicators of employment, credit and retail sales for signs of any changes in the level of economic activity one way or the other.

Volatility will continue to be part of the investment landscape driven by election developments, Fed policy, world events, and global growth fears. Investor should be prepared to weather periods of market uncertainty and position their portfolio accordingly. Those with a long term horizon can take advantage of market gyrations while investors with more immediate needs should structure their portfolios for protection. Investors should stay close to target asset allocations and use any market volatility to rebalance.

Equity Markets – While the US market has rallied strongly since mid-February, we are still below the highs of May 2015. S&P 500 Earnings have been negatively impacted by the fall of crude oil prices in the Energy sector, while multinationals and exporters have been hurt by impact of a higher dollar. We expect earnings to resume modest growth and when combined with reasonable (but not cheap) valuations should lead to modest gains for the US equity markets. We are closely monitoring the overseas equity markets which may present significant opportunities after 3-5 years of difficulties. While early, we are following developments in commodities and the US Dollar, which may signal renewed confidence in foreign equities, especially the emerging markets.

Fixed Income – While there is little upward pressure on interest rates in the short to intermediate term, investors should be aware of impacts to their portfolio should rates increase. Extending out the yield curve for a modest yield pick is not worth the loss of principal should rates increase significantly. Also investors should be hesitant to reach for yield in lower quality bonds. In this environment, fixed income should act as an anchor to windward for your equity holding and a place holder for reinvestment in a higher interest rate environment.