Prepared Comments from 4/15/2016 Conference Call

What a difference three months make. The S&P 500 is up over 10% from mid-January, and is three times its level from its low a bit over seven years ago.

Despite a painful January, **US stocks** ended the quarter with a modest gain, with mid-caps faring the best. Financials fell 5%, healthcare tumbled over 13%, natural resource funds gained 5%, real estate gained over 4%, while technology fell 2%. The most notable of these results was the 5% gain in natural resource funds, which had been on a one-way trip to the basement through January.

Value stocks uncharacteristically outperformed (for large, mid-caps, and small-caps), aided by the gain in energy stocks and the gain of over 15% for utility stocks.

Foreign stocks weren't able to fully recover, and ended the quarter down 2%, however there were some bright spots. Smaller foreign stocks posted a very scant loss, but emerging market stocks gained almost 4%.

Bonds had a mixed quarter. Taxable quality bonds did well, with long-term bonds gaining over 6%, intermediates earning 2%, and short terms up 1%. Quality municipal bonds gained 1½% for long- and intermediate-terms, and ½% for short-term bonds. High yield bonds, both taxable and municipal, earned 2%, while multisector bonds earned a little less than 2%.

The **S&P 500's earnings** for 4Q15 were lower than the prior quarter, and lower than 4Q14, and year-on-year growth is not expected until 2Q16 or 3Q16. The culprit has been the energy sector. Think back to your school days, and the impact that a zero on one test has on your final grade. Energy is only one sector of the S&P 500, with about a 7% weight in the S&P 500. Energy in 2015 did worse than scoring a zero—as a sector it posted a loss for each quarter, a sizeable loss in the 4th quarter. The (thankfully) stabilizing price of oil is enabling energy sector earnings to stabilize, and with that stability, enabling the S&P 500 earnings to recover. The 3Q16 earnings are expected to set an all-time quarterly record, and the 2016 calendar year earnings are expected to set an all-time full-year record. We appear to be firmly on an earnings-recovery path, once that zero has left the grade book.

Since the last call, the **price of oil** has risen from just under $30 a barrel to just over $40. It remains more than 50% below its level from this time last year. After the steady decline of 2015, sideways price movement is a victory. A rise is incredibly good. Oil prices are now high enough to avoid energy sector losses, but low enough to help economies (ours and many of our global neighbors).

The **US dollar's rise** finally reversed, falling 2.8% during the quarter, and largely unchanged from a year ago, the point following a VERY sharp rise (30% from its 2011 low). Economic stability is the investor's friend, and I am hoping that the dollar does not resume its upward climb.

The January fears prevented the Fed from acting so far this year, and at this time only 2 rate hikes are expected in 2016, down from an expectation of four as of late 2015. This has led to the tag line for US interest rates: **Lower for Longer**.

Core **inflation** has been very steady, despite the volatile headline inflation, which includes energy prices. Core inflation is now at 2.3%, while 10-year treasury bonds currently yield only 1¾%. Fortunately, the S&P 500 is currently producing 2.3% in dividend yields.

The Conference Board maintains a **Leading Economic Index**, and it inched upward in March. After a very strong climb since 2009, it appears to be flattening out, however in the past two recessions it turned down several calendar quarters before the stock markets began to decline. There is no clear evidence of the US economy running out of steam anytime soon, although of course this is partially due to the extremely slow pace of this recovery.

Globally, the economy is pretty steady. The US, UK, and Euro area are solid, with surprising strength from the problem-children of old—Ireland, Italy, and Spain. Australia and Mexico are also doing quite well.

China, which was the nightmare in January, is no longer viewed as the tipping point to trouble. Their economy has indeed slowed down, but appears to be in zero danger of crashing. Furthermore, the Chinese central bank has its tool belt overflowing with steps to protect against a hard landing. There are still plenty of areas to worry with China, but it no longer is headlining, in a bad way, every economic news story.

One of the newer items causing concern are **negative interest rates**, from European and Japanese central banks. This is new territory, and complicates the US Fed's path to more normal interest rates in the US. This is likely one of many reasons for the Lower for Longer, slower path to normal rates.

We can work with Lower for Longer, and are a bit more comfortable with longer-term bonds, however Lower for Longer strengthens the case for reasonably-priced stocks. And stocks are reasonably priced.

US stocks are reasonably priced, foreign stocks from developed markets are attractive, and stocks from emerging markets appear cheap. When this is coupled with limited-upside bonds, stocks offer unusually attraction for investors today.

So what are we doing? Our investment committee met earlier this month. We are continuing to favor stocks over bonds, and hold client stocks at 104% of target levels. We continue to use a 56/44% balance of US/foreign stocks, and a 72/18/10 balance of large/mid/small-caps. Despite recent weakness, we continue to favor large-growth stocks a little. Also, despite recent weakness, we are favoring technology, and to a lesser extent, finance and healthcare. We are maintaining real estate at a special 4% level, and natural resources/energy at 2% (which figure had been higher in prior years).

For foreign stocks, we have a 63/17/20% balance of large caps in developed markets (including a Europe focus, although we eliminated our Japan focus due to disappointing results), foreign smaller companies, and stocks in emerging markets.

Bonds are little changed, with 65/35 quality/opportunity, and with quality bonds at 30/25/5/5 short-term, intermediate-term, long-term, and cash. Opportunity bonds are 14/10/6/5 high yield/multi-sector/preferred/unconstrained.

We continue to work on quarter reports, including those for clients who are using our **Drop and Give Me Five™** program. This year provided the opportunity to use the program, and to examine the results. We have made improvements/adjustments to the program based on this examination/analysis. We are pleased that the market path during the past quarter has enabled clients in the program to benefit, by buying low and rebalancing and selling higher.

It is very nice that, despite a painful January, the US stock market is up about 2½% so far this year, and deservedly so. Investors received another lesson in economics, and investor fear. Investors who stuck to their guns, and bought into January's decline, have been the most successful. We find that the best way to take advantage of these normal volatile times, is to have a written plan, and to execute it faithfully.

The Presidential Primary season, and the fall elections will continue to bring much anxiety to our nation, and to our investors. The past quarter has shown the value to tuning out the media, and focusing on long-term economics. We hope that we are helpful in this endeavor.

Questions?

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