Market Review and Outlook—July 7, 2016

Just One Exception Everything went well for investors in the past quarter except for one thing. Great Britain's voters went to the polls and by a close margin requested that they leave the European Union (the BrExit vote). The *3 Months* column in the table shows gains in all areas except foreign stocks. This is what we call a self-inflicted wound.

Oil Price Recovery Oil prices are recovering nicely, which brings gains and higher expectations not only to oil companies, but also to emerging markets.

Dollar Returns The US dollar, which had climbed sharply over the past year, has fallen back. Currency extremes are bad for almost everyone, and this recent retreat is good, for US exporting companies, and for investors in foreign stocks.

US Economy Chugs Along JP Morgan's lead analyst Dr. David Kelly describes our economy as a 'healthy tortoise, not a sickly hare.' Another analyst describes it as a 'plow-horse recovery,' slow but hard to push off course. The expected more stable oil prices and US dollar should serve as a modest tailwind to US companies over the next year. The BrExit vote is expected to have minimal direct impact on our economy.

Poor One Year Returns Investors have had a disappointing year. The *12 Months* column is filled with losses. With investing, however, losses are most often closely followed by gains, as losses create cheap prices. For when investors recognize this, those prices are bid upward.

Difficult Rebalancing Regular rebalancing helps portfolios, by systematically selling higher-priced investments and buying lower-priced ones. It is difficult, as you are "cutting the flowers and feeding the weeds." Yet that is the best way to buy low and sell high. Today this means buying foreign stocks, **despite** the BrExit vote. Foreign stocks are the only line in the table below with a quarterly loss. Don't view this as putting good money after bad, but rather as a sale, a blue light special. Commit to regular rebalancing, and try to disregard the headlines.

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
Fidelity Cash Reserves	+0.02%	+0.03%	+0.02%	+0.02%	+1.11%
Intermediate Term Bond	+2.34%	+4.63%	+3.61%	+3.66%	+4.83%
Intermediate Muni Bond	+2.16%	+6.40%	+4.58%	+4.48%	+4.21%
Large-Cap Stock	+1.74%	-0.03%	+9.42%	+10.11%	+6.42%
Mid-Cap Stock	+1.39%	-4.47%	+7.53%	+8.27%	+6.40%
Small-Cap Stock	+2.37%	-5.77%	+6.36%	+7.63%	+5.88%
Foreign Large-Cap Stock	-1.08%	-9.94%	+1.69%	+1.11%	+1.54%
Real Estate	+5.48%	+19.49%	+12.11%	+11.16%	+6.41%
Natural Resources	+8.54%	-9.42%	-3.60%	-4.85%	-0.19%
Technology	+0.26%	-1.15%	+12.78%	+9.37%	+8.39%
Allocation (50-70% stocks)	+2.20%	-0.12%	+5.91%	+6.19%	+5.26%

The data in this table comes from Morningstar and is as of June 30, 2016.

Any Interest? One impact of the BrExit vote is heightened uncertainty. This uncertainty is expected to have global interest rates "lower for longer." Rates are so low that 36% of global government bonds yield less than 0%. In the world of the blind, the one-eyed man is king, and in a world of miniscule interest rates, stocks should be king. The S&P 500 index of large US stocks yields the same as a 30-year treasury bond, 2.3%. Would you rather get 2.3% annual interest for 30 years, or 2.3% annual dividends plus the growth of the US economy for the next thirty years? Historically low interest rates make it hard to not like stocks.

More Uncertainty Investors also have substantial uncertainty over the fall's elections, who will be our next President and which party will control the Senate (the House is almost certain to remain controlled by Republicans). Some certainty will come from the summer conventions, but ultimately we will need to wait until November. Currently, it is expected that neither party will control both the White House and both houses of Congress starting in January. Shared power equates to few dramatic changes. This equates to few surprises, which pleases most investors. Thus, while we have a lot of uncertainty now, we expect certainty to arrive in the coming months, and a relatively smooth path in 2017.

While US stocks are slightly more expensive than normal, bonds are incredibly more expensive than normal, and so US stock prices appear well-justified at this time. Foreign stocks provide more uncertainty, but with it, greater potential returns. Emerging markets provide even more uncertainty, and with this, even greater potential returns. We prefer the 'broadly diversified' approach, to capture some of every good outcome, but avoid undue losses when a few sectors stumble.

It is true that bonds are quite overpriced, however this has continued for several years. If we had abandoned them once they first appeared overpriced, we would have missed some strong gains. Furthermore, when the bond markets fall, overpriced bonds bring far more modest losses than when overpriced stocks correct. Even overpriced bonds provide some safety.

In addition, we separate bonds into quality and opportunity bonds. We have maintained a sizeable allocation to opportunity bonds ever since quality bond yields fell so low, and quality bond prices rose to expensive levels. The opportunity bonds provide exposure to the growing economy. This is the reason we suggest that clients maintain their bonds—they provide more safety than stocks, and we can shift some of our bonds to ones that are not seemingly so expensive.

Stocks are not for the faint-of-heart. They produce stomach-churning losses, and successful investing requires adding to stocks as they fall, and selling stocks as they rise. There are always reasons to be worried about stocks. In fact, when there are no reasons for worry, it is likely time to sell all of your stocks. This is the very reason that you blend your portfolio with stocks and bonds, to regulate the level of stress in your portfolio.

There are many reasons to be concerned with stock investing now—oil prices rising/falling, labor shortage and wage inflation, rising inflation, recession in Great Britain, recession in Europe, conflict in Syria, backlash to massive refugee displacement, Chinese banking crisis, terrorism in the world, terrorism in the US, no end to our military involvement in Afghanistan, etc. Amazingly, this list is neither shorter nor longer than normal. Our world is complicated, and today's media brings it all to us, with neither a delay nor a filter.

There are also many reasons to be excited about stock investing now. What is also with us at all times is a planet filled with people who need each other, for goods and services. This is the global economy, and as Warren Buffett warns that you should never bet against the US economy, you also should not bet against the global economy. There will always be ebbs and flows, but for hundreds of years the global economy has continued to grow, and the best way to benefit from that growth is by including stocks in your portfolio. **May the growth be with you.**