Prepared Comments from 7/15/2016 Conference Call

Despite a two-day plunge last month, the S&P 500 is up 4% from mid-April, up about 7% so far this year, and is over three times its level from its low in March 2009.

Markets across the globe plunged in late June, after the British voters approved a referendum requesting Great Britain's exit from the European Union, the EU. The market reaction was swiftly judged to be a gross overreaction, and positive economic news has fueled a strong market recovery ever since.

In the second quarter, almost everything did well. Bonds delivered gains of over 2%, as interest rates fell to absurdly low levels. US stocks gained about 2%, helped by natural resources, real estate, and utilities which each rose 5½% or more. Foreign stocks, however, fell about 1%, despite strength in emerging market stocks. While foreign stocks have risen over 2% so far this month, they remain in the red for the year-to-date by about ½%.

Value stocks had another good quarter, versus growth stocks, again helped by strength in natural resource and utility stocks.

Bonds had a solid quarter, while opportunity bonds did even better (high yield bonds rising about 4%). Duration was your friend with quality bonds, as long-term corporate bonds returned almost 6% and short term only 1%.

The **S&P 500's earnings** for the 1st quarter were, finally, greater than the prior quarter, but well short of the 1st quarter of 2015. Analysts expect sharply improved earnings for the next several quarters, as energy stocks stop posting painful losses, and sinking the S&P's earnings in the process. An end to the rising US dollar is also expected to help the S&P earnings to rise this year and next.

Since the last call, the **price of oil** has risen from just over $40 to about $48½. It has been extremely volatile since 2007, and sharp moves have generally coincided with weak stock markets. It appears to be stabilizing in the $40-$55 range, and any range is better than the extremes we have suffered over the past 9 years. It appears that energy will provide a modest tailwind to US and foreign economies and markets for the next few quarters.

Similarly, the **US dollar** appears to be stabilizing after a sharp rise which hurt most investors. As with oil, the US dollar's expected lack of movement is expected to provide a modest tailwind for economies and stocks for a few quarters.

The January China and oil fears, coupled with the summer's BrExit vote appears to have affirmed the view that the Fed will leave overnight rates largely untouched for the rest of the year. The new tag line is: **Lower for Longer, Get Used To It.**

Core **inflation** has been very steady for twenty years, dependably under 3%. In June it came in 2.3% above last June's figures. Headline inflation came in much lower, at 1.0%, due to 9.4% lower energy prices. My top concern for inflation over the next year is wage inflation, which has in May measured 2.4%.

A good inflation hedge is stocks—the S&P 500 provides a dividend yield of 2.3%, the same as inflation, but you also get the likelihood of earnings (and therefore price) growth. You could lock up money in a 30-year US government bond and get that same 2.3% income stream, but zero price growth. If you purchase a 5-year government bond, you only get half the income, 1.15%.

The Conference Board maintains a **Leading Economic Index**, and after inching upward in March, it rose strongly in April, but fell back in May. It remains up about ½% over the past three months. This is a good sign, of the US economy over the next year. This provides the best perspective, as a leading indicator. It matches how investors should be looking—out the windshield, not the rear-view mirror. This index has risen pretty steadily since early 2009, and the economy has, too.

The Consumer Sentiment Index, from the University of Michigan, has also recovered very well since late 2008 (and mid-2011 when a 'double dip recession' scare seized the nation). As almost 70% of our economy comes from consumption, happy consumers lead to a happy economy.

There are more signs of a healthy US economy. Housing prices are almost back to their 2006 high, housing starts continue to climb, light vehicle sales remain above average, and housing affordability remains extremely attractive.

Globally, the economy is still on a slow-growth track. I don't have any data yet that reflects impact from the BrExit vote on economic expectations. The data we have shows strength in Europe, especially Germany, Italy, and Ireland, but weakness from Brazil, and some from Japan and China.

Concerns remain over **China**, as is appropriate for such an important economy. In the plus column, we have a central bank and government with a very deep tool box, and we have an economy which, despite slowing, remains growing at a much better pace than the rest of the world. Debt, especially in their banks and non-financial lenders, is a real concern, however at this point the challenge appears to be controllable.

While our federal government gives us much to complain about, our recovering economy has helped to drive down the annual budget deficit, as a percent of the GDP, for six straight years.

We have been positive on investing in European stocks for many quarters. Their unemployment has been falling steadily for four years, and they have also experienced rising bank loan demand. Importantly for investors, however, the earnings have not recovered in Europe they way that they have in the US, so we see substantially stronger potential returns for European stocks (versus weaker, but more reliable, returns for US stocks).

Earlier this month JP Morgan's chief global strategies Dr. David Kelly described the photographer tasked with taking a kindergarten class picture. Ever the professional, he sought to have everyone just right, no blinking, everyone looking at the camera, etc. With a class of kindergarteners this will never happen.

Similarly, investors often are waiting for conditions to get 'just right,' to await the right time to get into the markets. Frankly, the best recent time to get into the markets was right after the BrExit vote, when markets were tumbling. Despite two sharp sell-offs, through yesterday the average moderate allocation mutual fund has gained over 5%.

Stock markets and stock investing will never feel safe, nor ever be safe. There are always risks, known and unknown, knowable and unknowable. The key point is that long term investors can and likely should disregard the noise, and discard the notion that there is a good time to invest.

US stocks seem very slightly overvalued versus their history at this time. Of course alternatives, cash and bonds, appear grossly overvalued at this time, which makes US stocks look good. Foreign developed stock markets offer greater upside, but with less certainty than US stocks, and emerging markets extend this upside/uncertainty.

Rather than finding a safe time to invest, or the 'right thing' to invest in, we favor all-weather global balanced portfolios, with cash, bonds, and stocks. We also are very strong proponents of regular rebalancing, as this helps you trim your profits and pick up some bargains. While volatility can produce stress, it also provides some great opportunities.

Several of our clients were able to automatically purchase stocks during the two day market decline last month, through their use of our **Drop and Give Me Five™** program. This program is best suited for conditions that we have had thus far in 2016, sharp drops that reverse and fully recover pretty quickly.

More importantly, long-term investors should see volatility as largely noise, and when it lasts more than a few days, an opportunity to pick up some bargains at the next portfolio rebalance.

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 102% of target levels (down from 104% in April). 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 healthcare, but we no longer emphasize financials. We are maintaining real estate at a special 4% level, and natural resources/energy at 2%.

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 20/35/5/5 short-term, intermediate-term, long-term, and cash (a big shift from short- to intermediate-term bonds). Opportunity bonds are 10/10/6/5/4 high yield/multi-sector/preferred/unconstrained/bank loan (a reduction of high yield and introduction of bank loan funds).

As the party conventions are upon us, remember that this fall's anxiety will be followed by certainty in November. Remember that the media is rarely tasked with helping to inform you, about politics, economics, or about investing. We find that a long-term perspective is the best to keep blood pressure down and portfolio values up.

Questions?

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