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Wealth Management

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Quarterly Economic Update

Third Quarter 2016

The third quarter of 2016 was very confusing for investors. Investors were served a variety of economic and financial turmoil amid a backdrop of confusing political concerns yet the bull market continued to move forward. At the quarter's end, the S&P 500 was up 3.31% for the quarter and 6.1% year-to-date. The Dow Jones industrial Average gained 2.11% bringing it to 5.1% so far this year, and the NASDAQ had a large gain of 9.69% bringing its year-to-date total to a 6.1% gain.

The stock market began the quarter with a slight rally in the first two weeks of July, and then stayed quiet until the first week of September. This included a period of lower volatility with the S&P 500 going 42 trading days during that period without moving more than 1%. (The record for low volatility was 62 days occurred in July 2014.)

That streak quickly changed on September 9th when the Dow Jones Industrial Average dropped 400 points, or 2.1%, and the S&P 500 and NASDAQ both dropped 2.5%. The catalyst for this was investor concern over whether the Federal Reserve would raise short-term interest rates at its September 21st meeting.

During that session, the Fed decided to wait, which seemed to please investors, and equity markets mounted a late September rally that offset the month's earlier loss. By the quarter's end, the S&P 500 held to its gains of early July by finishing flat in August and September.

In Brief…

- The 3rd Quarter of 2016 was positive for equities.
- Interest rates remained unchanged and long-term target rates suggest low rates for a long period of time.
- Oil and energy prices increased but remain volatile.
- Presidential debate was one of the most watched of all time.
- The 4th Quarter can bring volatility and investors need to be prepared.
- Call us if you have any changes to your personal situation.

While the quarter ended on an up note, September reminded investors to watch out for the market's volatility. While headlines might read that the equity market closed out the third quarter with modest gains, this result does not reflect the potential risks that could have concerned even the most seasoned of investors.

Deutsche Bank was one of the major drivers of the quarter's final week. Shares of the bank plummeted on Thursday, September 29th pulling markets into a selloff before giving them a massive boost on Friday, September 30th. The German Bank had been twisting and turning since the U.S. Justice Department proposed a $14 billion fine in early September over residential mortgage-backed securities. Reports on September 30th indicate that the bank had settled with the Department of Justice for a fraction of the original fine. A JPMorgan report indicated the penalty could be as low as $5.4 billion.
(Source: www.thestreet.com 9/30/2016)

Oil prices, foreign currency valuations, corporate earnings and the upcoming presidential election are all still major concerns for investors. All of those issues made a lot of headlines, but for investors, interest rate concerns seemed to be the main event. The most news-generating and interesting situation for the upcoming quarter is who will reside in the White House next January. Investors also need to pay careful attention as to which party will control the Senate in 2017. Although the year only has three months left, this last quarter could bring some unrest to the equity markets.

Here are some specific areas investors should continue to watch in 2016:

Interest Rates

The Federal Reserve chose to keep the Federal-Funds target rate at a range of 0.25 to 0.5% during the September session but strongly implied that an increase is on the horizon. Also during this session, several members of the policy committee voted for an immediate increase leading analysts to suggest that a December increase is highly possible.

The key news from the Federal Open Market Committee meeting was another ratcheting down of their target rate projections by 50 basis points for the end of 2017 and 2018 to 1.1% and 1.9%, respectively. This continues a pattern of Fed officials lowering their outlook for future interest rates and indicates that investors need to consider that we probably remain in a period of lower rates for longer.
(Source: Barron's 9/26/2016)

The Bank of Japan left their key short-term interest rate unchanged at minus 10 basis points and said they would target their 10-year Government bond rate at 0% in order to hit its elusive 2% inflation target, rather than allowing this yield to drop to a negative rate.
(Source: Barron's 9/26/2016)

There have been no rate increases this year and there is no reason for investors to get overly concerned; a rate hike is usually aimed at preventing an economy from overheating and that does not seem to be a concern. Economic growth is sluggish and inflation remains low. Housing activity has been disappointing, retail sales are declining and manufacturing activity is slowing. This leaves only one major purpose for a rate hike, the desire to get one done.
(Source: Barron's 9/26/2016)

Fed Chief Janet Yellen suggested that ultra-low interest rates can lead to asset bubbles. Raising rates allows the Fed the power to cut them should we enter a recession. David Rosenberg, Chief Economist and Strategist at Gluskin Sheff says it's important to separate those fears from reality. When it comes to an interest rate hike, he suggests the Fed "hurry up and get it over with."
(Source: Barron's 9/26/2016)

When the Fed raised interest rates last December, their forecasts suggested 2016 would bring four more rate increases, which created a lot of anxiety for investors. Currently, the Fed is suggesting the possibility of two more rate increase next year. JP Morgan strategist Dubravko Lakos-Bujas cites that this could be good news for stocks at least in the short-term.

For now, investors need to keep a watchful eye on both the Fed and interest rates. If you have any concerns about how this affects your investments then call us or ask at your next financial review.

Oil and Energy Prices

The trend for higher oil and gas prices has continued and a report from the Dallas Federal Reserve branch in the week of September 30 showed that the energy sector's activity rose in the third quarter. In the quarter's final report, the Dallas Fed Energy Survey showed that oil and gas executives have responded positively to higher activities in the energy space.
(Source: www.247wallstreet.com 0/30/2016)

Crude oil ended September with a monthly gain of nearly 8% and helped push crude to a one-month high after the Organization of Petroleum Exporting Countries (OPEC) came to a production freeze agreement. Even though members had shown reluctance to agree to any deal and cede market share, OPEC agreed to limit oil production to 32.5 million barrels a day.

As we head into the final quarter of the year, OPEC has provided the market with uncertainty. Until the final week of the quarter, the cartel had been consistent in their inaction when it came to any policy that would support the price of oil and OPEC nations had increased daily production wherever possible. However, words from their recent session signal a change in that policy but we will have to wait until November 30th to find out if the membership carries through on their promise to cap production. We remain watchful as there are many factors that could send the price of oil higher or lower in a flash over the coming three months. ***(Source: Seeking Alpha 10/3/2016)***

Presidential Election 2016

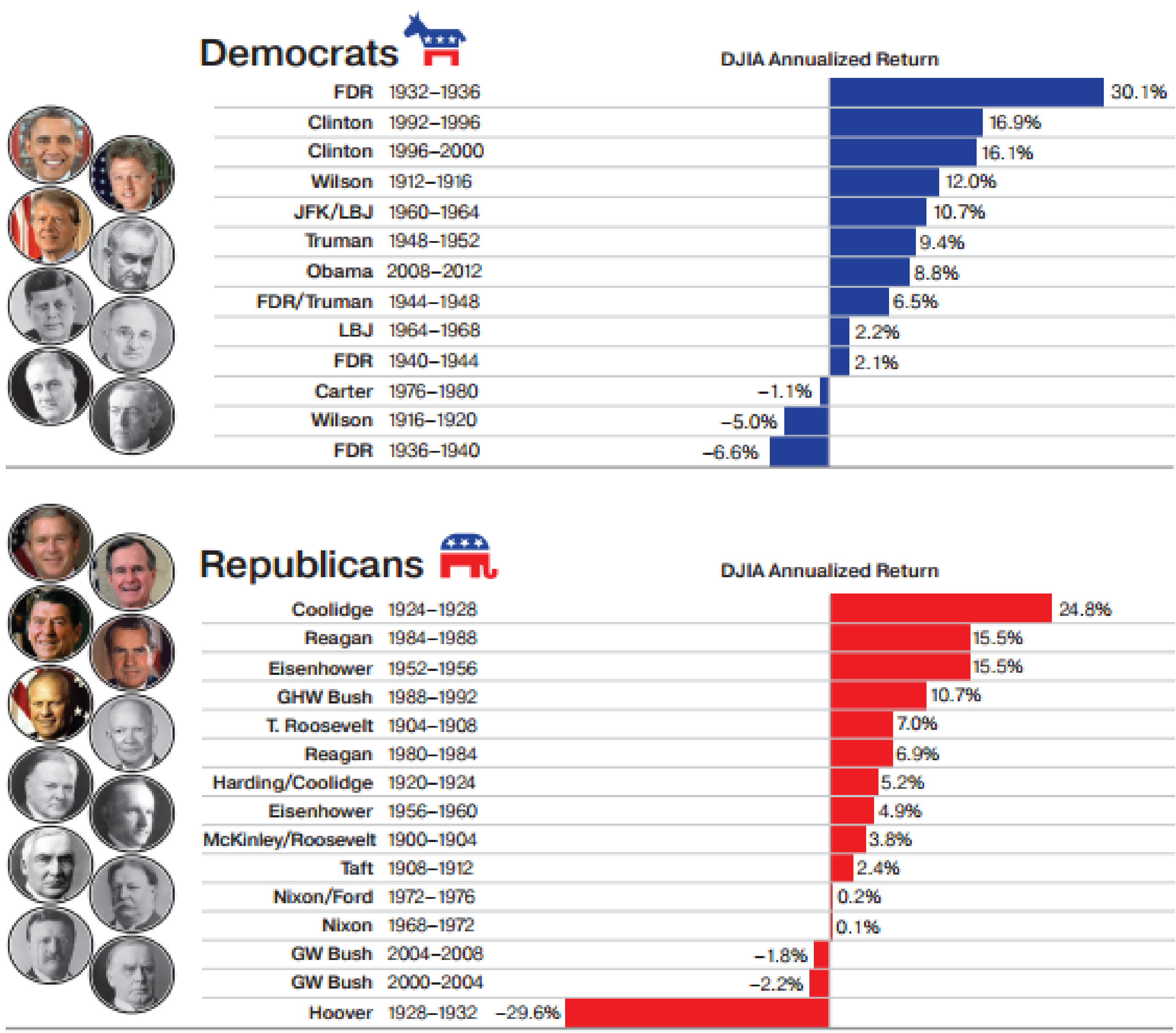
This year features one of the most interesting and controversial political landscapes of all time. The first debate between Hilary Clinton and Donald Trump was compared to the famous Muhammad Ali "Rumble in the Jungle" fight as the two candidates squared off at Hofstra University in Long Island, New York.

A large audience of viewers were entertained by both contestants taking personal shots at each other but as for investors some of the differences in the two candidates remain clear but were not discussed in great detail. Although both candidates have suggested changing both income tax and estate tax rates, the success of either plan would still be determined by Congress.

Many investors ask which party is better for investors. Oppenheimer Funds, in a summary piece, suggested that, “It’s probably best not to let your reaction to which candidate wins shape your investment decisions.” While both parties try to offer reasons for optimism and despair, the graphic in Exhibit 1 might provide some insights. As history shows, neither party can lay a claim to providing better market performance. As always, investors must once again remember that historical performance is not an indication of future performance.

For now, investors should continue to watch and see how the election plays out and after the results are in, we can update our clients with some suggested strategies.

Exhibit 1: Neither Party Can Lay a Claim to Delivering Better Market Performance



Source: *The New York Times*. As of 10/26/12. DJIA is an acronym for the Dow Jones Industrial Average. **Past performance does not guarantee future results.**

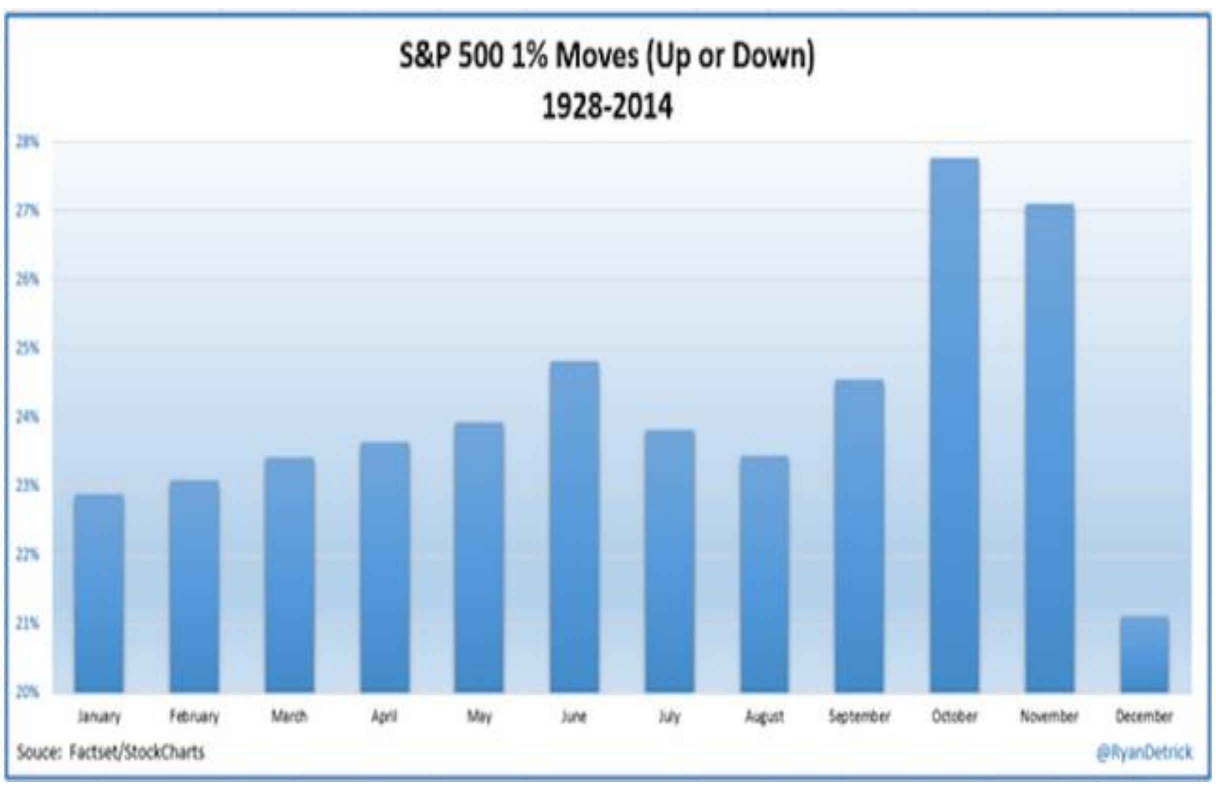
Should I Stay Invested?

October is known for fall weather, pumpkins and playoff baseball but traditionally, October has had a bad reputation among investors. That's because some of the biggest market crashes in history took place during this month. In 1929, there were three record slides in October that are remembered as the Black Thursday of October 24 (when stocks retreated 11%), the Black Monday of October 28 (when the Dow lost 13%) and the Black Tuesday of October 29 (when markets closed 12% lower). In 1987, the Dow dropped over 22% in one single day on October 19, then noted as the new Black Monday. In fact, October is historically the second month of the year with more market crashes after September.

However, the October Effect theory that stocks tend to decline during the month of October is false. In fact, since 1928, the median stock market return in October is 1%, the average gain is 0.4% and stocks tend to finish the month higher 60% of the time.

Despite the positive median returns in October, equities on average tend to perform poorly during election years and have finished the month slightly lower during election years since 1932.

A long range study from 1928 to 2014 found that October is also the month of the year with the biggest share of 1% day moves (up or down) in the S&P 500. In fact, 28% of the trading days in October see over 1% moves (up or down) in the overall index. ***(Source: Seeking Alpha 10/1/2016)***



According to a detailed report prepared by McKinsey and Co., the forces that have driven exceptional investment returns over the past 30 years are weakening and even reversing. Given the waves of turbulence that have swept through financial markets in recent years, including the 2000 dot-com meltdown and the 2008 financial crisis, it may sound odd to describe the past three decades as a golden age for investors but the reality is that total returns on equities and bonds in the United States and Western Europe from 1985 to 2014 were significantly higher than the long-term average. These returns were driven by an extraordinary confluence of favorable economic and business fundamentals. Inflation and interest rates declined sharply from peaks in the late 1970s and 1980s. Global economic growth was strong, fueled by positive demographics, productivity gains, and rapid growth in China. During this period, corporate-profit growth was even stronger. ***(Source: McKinsey.com 4/2016)***

The report concludes that investors should lower their equity return expectation. Today's equity market will require patience for investors and your portfolio needs to be one that is adjusted to your specific situation.

Experts agree that investors always need to consider the risks of investing when making decisions and should always be prepared. No one can fully predict the future and past performance is no assurance of any type of financial return but a well-defined investment plan tailored to your goals and financial situation that considers the chance of normal ups and downs of the market can help investors during volatile times.

If you have any questions about your investments call us or bring these concerns up at your next review.

CONCLUSION

Volatility might return for investors and therefore we need to proceed with caution. We are carefully monitoring equity markets and interest rates so we can communicate with clients. Market volatility is a part of investing and instead of being worried by volatility, try to be prepared.

Today's fixed rate returns will not help most investors reach their financial goals so they probably need to include equities in portfolios and be prepared to take a long-term approach when looking at returns. As the 1 year CD rate chart from Bankrate.com shows, through September of 2016, the national rate for 1 Year CD's remained around 0.57% (far less than 1%). Your time horizon, goals, and tolerance for risk are key factors we consider in helping to ensure that you have an investment strategy that is tailored for you.

Three questions you should ask yourself:

1. ***Have my time horizons or needs changed?***
2. ***What are my investment cash flow needs for the next few years?***
3. ***Am I comfortable if my investment returns fluctuate?***

Instead of focusing on the markets, focus on your specific situation. Your answers to these questions will govern how we recommend investment vehicles for you to consider. We can help you determine which investments to avoid and how long to hold each of your investment categories before making major adjustments. We continually review economic, tax and investment issues and draw on that knowledge to offer direction and strategies to our clients.

We pride ourselves in offering:

- Consistent and strong communication
- A schedule of regular client meetings
- Continuing education for our team on the issues that affect our clients.

A skilled financial advisor can help make your journey easier. Our goal is to understand our clients' needs and then try to create a plan to address those needs.

We continually monitor your portfolio. While we cannot control financial markets or interest rates, we keep a watchful eye on them.

No one can predict the future with complete accuracy, so we keep the lines of communication open with our clients. Our primary objective is to take the emotions out of investing for our clients.

We can discuss your specific situation at your next review meeting, or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial matters.

George Washington was the only American President not representing a political party and also the only one to be unanimously elected.

His inauguration speech - the shortest on record - was only 133 words and less than 2 minutes.

Help us grow in 2016!

This year, one of our goals is to offer our services to several other people just like you! Many of our best relationships have come from introductions from our clients. Do you know someone who could benefit from our services?

We would be honored if you would:

- ✓ Add a name to our mailing list,
- ✓ Bring a guest to a workshop,
- ✓ Have someone come in for a complimentary financial checkup.

Please call **Chris Hartrich** or **Eric Rechtin** at **(314) 394-2354** and we will be happy to assist you!

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