2016
First Quarter Comments

The first quarter of 2016 is firmly in the rear view mirror, thankfully. We started the year with the worst three weeks for the S&P 500 on record, falling more than eight percent. The carnage did not end there, dropping to more than a negative ten percent by February 11th. At that point Jamie Dimon, CEO of JPMorgan, stepped up to the plate and said he had had enough. Putting his money where his mouth was, he announced the purchase of 500,000 shares of his company stock. That trade seemed to shake the market out of its funk and marked the low point for the quarter. By the time we reached March 31, 2016, the S&P 500 had fully recovered and ended up 1.3% for the quarter on a total return basis. In what will prove to be either a change in trend or a shorter-term mean reversion rally, value out-performed growth for the first time in at least five quarters. Small cap continued to struggle against large cap as the Russell 2000 ended the quarter down 1.5% versus the S&P 100 Mega Cap at a plus 0.8%. The Fed became more dovish in their 2016 outlook. After increasing the Fed Funds Rate a quarter of a point at their December meeting and a forecast of four rate increases in 2016, they tempered their outlook with a pass in March and a forecast of two or three increases for the balance of the year. As we will discuss a little later, the softness in a number of the economic numbers has prompted them to lower the longer-term interest rate outlook. We also saw a number of foreign markets flip performance from where they ended in 2015. Brazil's Bovespa ended last year down 13.3% but rallied in the first quarter and closed up 14.5%. Canada flipped from a minus 11.1% to a positive 3.7%. At the other end of the spectrum, Japan went from plus 9.1% to a minus 12.0% in the first quarter, and China's Shenzhen went from up 63.4% in 2015 to a negative 17.2% for Q1. Dramamine, anyone?

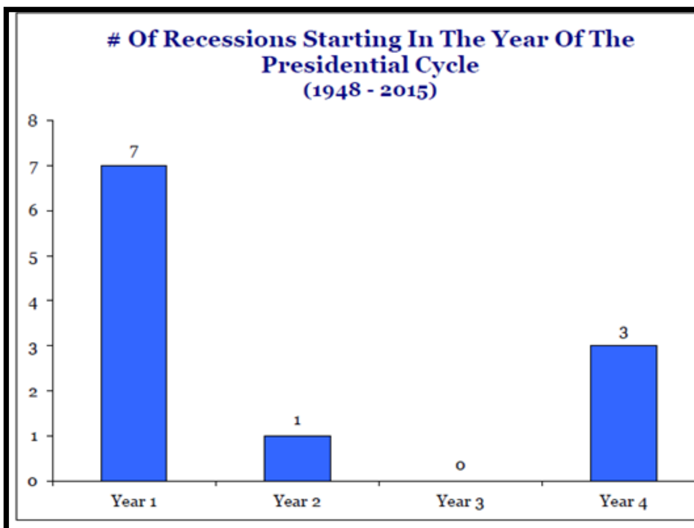
Recently we have been noticing some disturbing similarities in the trend of several economic indices and their directions entering the previous two recessions. It seems especially pronounced in the industrial side of the economy versus the consumer. There certainly isn't anything that would indicate a recession is imminent. After all, the unemployment rate is hovering around 5%, and oil prices have just gone through a major decline, freeing up significant consumer spending capacity. Auto sales are at near record levels and home sales, while not robust, are holding up reasonably well with the help of record low mortgage rates. And the recently completed federal budget should provide fiscal stimulus estimated to add a back-end loaded 0.6% to 2016 GDP.

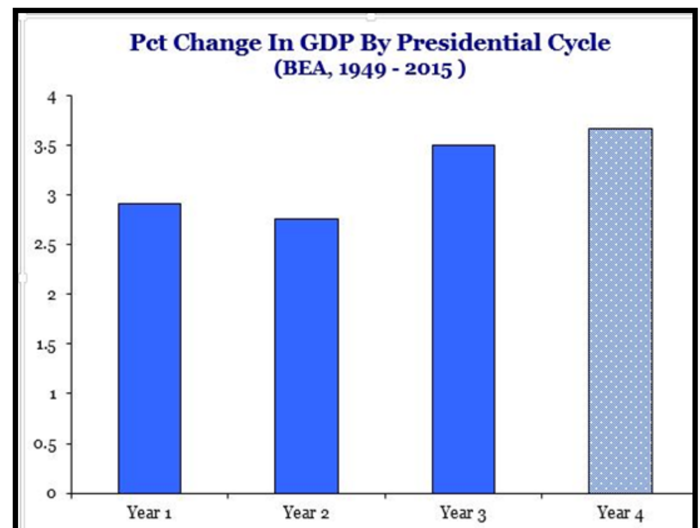
Corporate earnings have been a sore spot for some time. The fourth quarter of 2015 marked the third consecutive quarter of year-over-year declines in earnings. According to Zacks, first quarter 2016 earnings are expected to show a decline of 9.5% from the same period last year. If estimates for the second quarter prove accurate, earnings are forecast to decline 4.9% year-over-year. The record for corporate revenues does not look any better, with five consecutive quarters of lower year-over-year results. Excuses abound, but the results are what they are. Inventory to sales ratios have been climbing, and are near levels last seen heading into the 2000 and 2008 recessions. According to Federal Reserve Board statistics, Industrial Production peaked in 2014, coincident with S&P earnings. And according to OECD the U.S. Composite Leading Indicator fell 0.1% in February, its 18th straight decline, to 98.9, the lowest level since December 2009.

No discussion would be complete without bringing the Presidential election into it. Included are two charts, courtesy of Strategas Research Partners, that show the number of recessions starting in each year of the Presidential cycle since 1948. Of the eleven recessions since 1948, seven began in the first year of the cycle. As the second chart shows, GDP tends to be strongest in the final year of the cycle. This is generally attributed to Congressional efforts to pass spending programs designed to stimulate the economy going into the upcoming election. It is interesting that GDP growth

does show up in the last year of a Presidential term, but it may have the effect of pulling economic activity forward, thus leaving the first year of the new term vulnerable to weakness to the point of recession. The Conventional political thought is that it is better to get through a recession early in a term in order to have better times when the voter goes to the polls. There is nothing inevitable about these charts, as recessions have also begun in years two and four but if the economy is losing stem, it would be more in line with historic precedence.

2017 could be more disruptive in that it will include a new administration and possibly a change in party. It is also not known how long the coattails of the new President will be, but there could be a change of leadership in the Senate as well. Policy changes could occur in regulation, the environment, taxation and trade. Given the already shaky foundation of corporate sales and earnings, the weakness in the European and Japanese economies and the limited number of options the Fed has to stimulate growth, some level of economic softness does not seem out of the question. The market's ability to reflect a weaker economy may be limited by the lack of alternatives. Zero or negative interest rates may limit the flow of funds into the bond market, real estate has fully recovered from the financial crisis in most of the major markets, and many international economies are no better off than we are. From a valuation perspective, many pundits believe Europe and the emerging markets look attractive on a relative basis. Granted, they have been weaker than the US market for the past couple of years, but can they outperform if the US economy slows down? We think it makes sense to have some exposure to these markets because of their relative valuation. Domestically, the lack of alternative sources of yield will continue to make high quality companies with a history of dividend growth attractive.





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