After a Bad Start, Market has Strong Rebound

Market Wrap - First Quarter 2016

It was one of the gloomiest January's in history. The Dow Jones stock index had its **worst five-day start** to a New Year in decades, as investors feared recession, China, higher interest rates and an uncertain presidential succession. By early February, stocks were down over 10%, oil had slid almost 30%, and the outlook was grim.

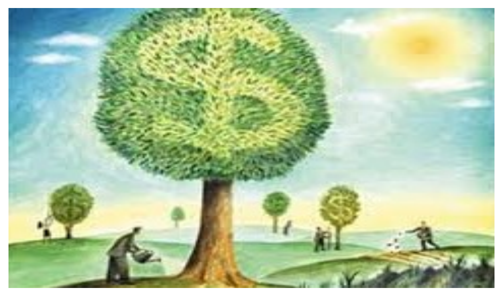
Fast forward to the quarter's end. After an amazing turnaround, U.S. blue-chip stocks managed to eke out a small gain, oil had climbed 46% from its 2016 low, and news was positive on the job front. The strong dollar, which had hobbled U.S. company exports, was deflating, helping American-based companies sell goods overseas and post better quarterly results.

There's a whole new investment landscape in 2016. In an about-face from 2015, many of last year's hot stocks and sectors, like technology and health care, have been knocked from their perch, a **casualty of sluggish global growth**. Last year's laggards, like value and high dividend-oriented stocks (think telecoms and stodgy utilities) are now back in fashion. Why the change? The Federal Reserve has signaled that any rate hikes will be slow and measured. That favors "bond substitutes" that can deliver a decent yield to investors.

Here's what investors want to know for the rest of 2016:

What has helped, and hurt, so far in 2016?

The good news is that the **bleeding has stopped** in last year's big decliners like oil and emerging markets. Both have turned positive so far in 2016. This year's performance stars, like value stocks, high dividend stocks, bonds, real estate and gold, were punished last year by rising interest rate fears. Now, with the Fed on hold, they're showing investors why they deserve a place in the portfolio. What's **hurting portfolios** so far this year? Biotech and health care stocks, some **down over 20%**, technology, and other fast growing small and mid-cap stocks, were strongly negative at quarter-end. Investors are concerned about slowing growth, meaning high-flying stocks like these can get temporarily grounded.



Results
as of March 31, 2016
(assumes reinvested dividends)

6-Month CD	+ 0.07%
Bonds	+ 3.03
S&P 500	+ 1.35
Dow Jones	+ 2.20
Small Stocks	(-1.50)
Int'l Dev Stocks	(-3.01)
Emerg Markets	+ 5.71
DJ Commodity	+0.42

Why do I need to diversify? Why not just invest in what is doing well?

Rest assured, if we just had a crystal ball, we would be doing exactly that. Unfortunately, the market turns on a dime, and today's top performer can become tomorrow's basket case, given 60 seconds and a bad news headline. By that time, it's too late to exit, causing irreparable damage to your portfolio. And the truth is, no one can tell what tomorrow will bring. Absolutely no one saw interest rates staying this low this long,

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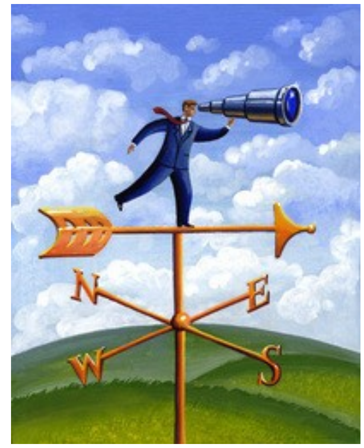

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and many forecasters made decisions to exit bonds far too early, to their detriment. As an example, one of this year's top sectors is emerging markets stocks (up almost 6% on average). We've remained invested in the asset for years, knowing that long-term growth prospects are bright. But many experts bailed at the end of last year, just before the asset class rebounded. Experience shows diversification **works over time to help lower the overall risk of your portfolio** and enhance the risk/reward tradeoff.

What about rising interest rates? Should I avoid bonds?

Last year, bonds did poorly because investors were afraid the Federal Reserve was planning a series of interest hike rates, which would torpedo bond returns. While the Fed did engineer a small rate hike in December, we now expect interest rates to be "longer for lower," since today's global uncertainty doesn't argue in favor of more aggressive hikes. That environment means **bonds should earn decent returns, although lower than average due to today's low-rate climate.** Bonds still have lower risk than stocks and can provide retirees with steady income.

"Investors who are shying away from bonds because they fear rising rates and inflationary pressure **should think twice before writing off bonds completely**. Those calling for higher rates have been wrong for more than six years," comments Robert P. Andres, managing partner of Andres Capital Management in Pennsylvania.

Many stocks are near their highs. Is this a bad time to invest?

The U.S. economy is stronger than it seems, and conditions are actually improving. Stocks aren't cheap, but they remain the **most attractive long-term investments**. We face **unique challenges today**. Bonds pay very little, and investors - especially those in retirement - need a constant flow of income plus growth to support an increasingly long life span. (Believe it or not, about 66% of government bonds across the globe now pay less than 1%. Talk about a challenging environment!).

So what's the solution? With interest rates at historic lows, we have to take intelligent and measured risks to help you reach your financial goals. Think of it like leaving your house every day. Yes, there are risks out there, but you have things to do and life to live. No one wants to spend their entire existence inside in the mistaken belief it might be "safer." Does that mean you need to be reckless? Of course not. A diversified portfolio designed to match <u>your</u> risk tolerance is the key.

What's going on with China?

"Investors worldwide appear to be **regaining their appetite for Chinese stocks**," reports the Wall Street Journal. There has been some recent improvement in China's economy, although analysts expect the volatility to continue, but perhaps at a dampened level. We're still bullish long-term on Asia and emerging markets. The key is to use skilled managers, knowledgeable in each region, to find promising investment opportunities and stick with them through day-to-day turmoil, limiting overall exposure to keep risk down.

What about a European recovery?

The year started with hopes for a European market recovery. After all, European stocks - and foreign stocks in general - are bargain priced compared with U.S. stocks, and we all know the secret to making money is buying low and waiting for prices to go up. But that recovery has yet to happen, despite European monetary stimulus. The June 23 referendum in the U.K. on whether to leave the European Union ("Brexit") is not helping, so only time will tell. ❖

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