Second Quarter Commentary, July 2016

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A Brexit and TINA Quarter

When trying to understand the complex forces underlying current trends, the investment community tends to use interesting names and acronyms to describe what is moving the markets. The two top of mind are the ubiquitous "Brexit" and "TINA." The former refers to the late June vote by the UK to leave the European Union. The latter stands for "*there is no alternative"* when it comes to defining where and what to invest in. This is meant to portray the fact that yields and returns for bonds and other asset classes are so low, that stocks are the only option available.

Fortunately, TINA heavily favors investment in the United States' capital structure, and this has helped most of our major indices move higher since the beginning of the year. In a world starving for yield and safety, investing in the United States is a wonderful alternative. However, this has caused our bonds to become very expensive and big dividend growing companies to have considerable moves over the course of the year. For example, AT&T (T) and Verizon (VZ) have been great performers in our custom equity portfolio's with both up over 15% YTD along with having a 4% dividend yield!

Yet, it certainly feels like we're in a bear market, what with the surprising "Brexit" vote in the UK, the dismal first few days of the year, and increased volatility across the board. So it may come as a surprise that the second quarter of 2016 eked out small positive returns for many of the U.S. market indices, and most of them are showing positive (though hardly exciting) gains over the first half of the year.

Equity Markets

The Wilshire 5000 Total Market Index--the broadest measure of U.S. stocks and bonds—was up 2.84% for the quarter, and is now up 3.69% for the first half of the year. The comparable Russell 3000 index gained 1.52% for the quarter and is up 2.20% so far this year.

The Wilshire U.S. Large Cap index gained 2.65% in the second quarter of 2016, putting it at a positive 3.94% since the beginning of January. The Russell 1000 large-cap index provided a 1.44% return over the past quarter, with a gain of 2.34% so far this year, while the widely-quoted S&P 500 index of large company stocks posted a gain of 1.90% in the second quarter, and is up 2.69% for the first half of 2016.

The Wilshire U.S. Mid-Cap index gained 4.33% for the quarter, and is sitting on a positive gain of 6.67% for the year. The Russell Midcap Index is up 1.54% for the quarter, and is sitting on a positive gain of 3.82% for the year.

Small company stocks, as measured by the Wilshire U.S. Small-Cap index, gave investors a 4.09% return during the second quarter, up 4.98% so far this year. The comparable Russell 2000 Small-Cap Index gained 1.96%, erasing gains in the first quarter and posting a 0.41% gain so far this year, while the technology-heavy Nasdaq Composite Index lost 0.56% for the quarter and is down 3.29% for the first half of 2016.

International

When you look at the global markets, you realize that the U.S. has been a haven of stability in a very messy world. The broad-based EAFE index of companies in developed foreign economies lost 2.64% in dollar terms in the first quarter of the year, and is now down 6.28% for the first half of the year. In aggregate, European Union stocks lost 7.60% in the first half of 2016. Emerging markets stocks of less developed countries, as represented by the EAFE EM index, lost 0.32% for the quarter, but are sitting on gains of 5.03% for the year so far.

Commodities

Looking over the other investment categories, real estate investments, as measured by the Wilshire U.S. REIT index, was up 5.60% for the second quarter, with a gain of 11.09% for the year. Commodities, as measured by the S&P GSCI index, gained 12.67% of their value in the second quarter, giving the index a 9.86% gain for the year so far. The biggest mover, unsurprisingly, is Brent Crude Oil, which has risen more than 15% in price over the quarter.

Fixed Income

Meanwhile, interest rates have stayed low, once again confounding prognosticators who have been expecting significant rate rises for more than half a decade now. The Bloomberg U.S. Corporate Bond Index is yielding 2.88%, while the Bloomberg U.S. Treasury Bond Index is yielding 1.11%%. Treasury yields are stuck near the bottom of historical rates; 3-month notes yielded 0.26% at the end of the quarter, while 12-month bonds were yielding just 0.43%. Go out to ten years, and you can get a 1.47% annual coupon yield. Low? Compared with rates abroad, these yields are positively generous. If you're buying the German Bund 10-year government securities, you're receiving a guaranteed -0.13% yield. The 5-year yield is actually worse: -0.57%. Japanese government bonds are also yielding -0.3% (2-year) to -0.23% (10-year).

Outlook

The American economy is on track to grow at a 2.0% rate this year, which is hardly dramatic, but it is sustainable, and not likely to overheat different sectors and lead to a recession. Manufacturing activity is expected to grow 2.6% for the year based on the numbers so far, and the unemployment rate has fallen to 4.9%, which is actually below the Federal Reserve target. Inflation is also low: running around 1.4% this year. Historically low oil prices and high domestic production have lowered the cost of doing business and the cost of living across the American economic landscape.

Questions remain. One big concern is what will the Brexit vote mean in the future? A recent report by Thomas Friedman of Geopolitical Futures suggests that the EU, at the very least, is going to have to reform itself, and the vote in Britain could be the wake-up call it needs to make structural changes. The Eurozone has been struggling economically since the common currency was adopted. It is still dealing with the Greek sovereign debt crisis, a potential banking crisis in Italy, economic troubles in Finland, political issues in Poland and, in general, a huge wealth disparity between its northern and southern members. Is it possible that a flood of regulations coming out of Brussels is imposing an added burden on European economies? Should different nations be allowed to manage their policies and economies with greater independence and focus?

Friedman thinks the UK will be just fine, because Europe needs it to be a strong trading partner. Britain is Germany's third-largest export market and France's fifth largest. Would it be wise for those countries to stop selling to Britain or impose tariffs on British exports?

Who knows what new acronyms will be needed for future trends. However, we do know that investors' best outcomes result from a good, individual plan, solid goals, and proper monitoring based on risk tolerance. Please let us know if you have any questions on your own investment portfolio.

Have a wonderful summer!