KALOS *Market Commentary*

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Solid U.S. Should Overcome Weak Global Economies

Looking forward to 2016, the U.S. economy should enjoy a reasonably solid year. GDP growth is projected to hit around 2.7% which would put it a bit higher than 2015's projected 2.5% increase. Consumer confidence should remain fairly high, helped by the ongoing decline in the jobless rate and a steadily improving job market. Housing should also continue to improve, which not only boosts confidence, but also increases consumers' net worth which normally results in greater spending. A recession is nowhere in sight, and the Federal Reserve appears unlikely to raise rates significantly leaving corporate America with a very positive monetary backdrop. Still, while 2016 appears likely to be a solid year, various concerns will likely make 2016 somewhat rocky.

Industrial growth will probably not impress, particularly in sectors with significant international exposure. The U.S. dollar was up over 8% against a basket of currencies in 2015, making U.S.-made goods more expensive overseas. In 2016, the dollar is expected to see further gains as the United States increases interest rates while other countries, particularly euro-based economies, continue easy money policies.

Terrorism, whether through ISIS, al Qaeda, or various other imitators could easily worsen in 2016, especially for Americans. Upcoming elections will increase international focus on the U.S., making Americans and the U.S. a more attractive target.

International economies will likely continue to struggle. While China's November economic activity was stronger than expected due to increased factory output, analysts largely agree that more policy steps are needed to counter headwinds from various issues including a cooling property market, high domestic debt levels, and weak global demand. Other emerging markets are also expected to grow at sub-par rates. Europe seems to be stabilizing as the European Central Bank stimulus lifts economic activity, but growth will likely remain anemic for the foreseeable future.

Dodd-Frank legislation continues to hurt business growth through restricting banking sector lending, forcing small and medium sized companies to find capital via more expensive means.

Weak global demand will likely keep commodity prices depressed. While crude oil prices are predicted to rise from around $37 a barrel to somewhere in the mid-$40s, even if the 20% increase materializes, it leaves the per barrel price below half the 2014 level. New permission to export oil should eventually increase prices, but it will take years before export infrastructure is created. Natural gas will likely struggle even more, given abundant supplies and a mild winter to date. While most commodities have not been hit as severely as energy, they have struggled and little relief is in sight which is unfortunate for many emerging markets dependent on this sector.

The election cycle will likely also stunt growth in 2016. In the last year of a two-term president election cycle, departments in Washington frequently pass unpopular rules that normally would not be approved. Given our current administration, most of these rules will be anti-business. Many if not most of these rules, however, can be undone by next administration. This has the effect of curtailing investment because business don't know which rules will remain and what the new rules might evolve into.

Against this backdrop, it may seem foolish to remain optimistic about the economy and U.S. markets. Yet, many factors encourage optimism, particularly as we move beyond the next election cycle.

The U.S. still retains numerous fundamental economic advantages versus the globe. Long-run U.S. secular growth has been predicted by some to be only 2.0% for the next several years, and possibly permanently, and these assumptions are largely backed into economic predictions and market valuations. Yet growth in the U.S. has averaged much higher than 2.0% for all of its history. While much slower long-term growth is possible, it seems unwise to extrapolate the recent short term trend indefinitely. In essence, the U.S. is being compared to Greece or many of the highly inefficient and inflexible economies of southern Europe. We have far more policy options and have shown an ability to eventually improve policy when needed.

We also have strong resources and remain well positioned to lead the world. U.S. corporations are sitting on near record levels of cash, which provides U.S. companies much better foundations to weather immediate challenges while also providing greater resources to take advantage of opportunities versus their weaker competitors.

We have better demographics than all other developed nations and much better than China. Even with jobs and wages increasing, labor costs should not dent corporate profitability significantly because more experienced and expensive retiring baby boomers will be replaced by cheaper, and far more tech savvy millennials. While millennials may lack experience, they bring a new technology skill set that will likely boost productivity in unexpected ways and help the U.S. continue to lead the globe in innovation.

The U.S. remains the most productive, innovative, and skilled work force in the world outside of the 250,000 people in Luxenberg. By contrast, Russia is attempting to build a new Silicon Valley from the ground up. In Skolkovo on the outskirts of Moscow, the government is building a new university and ordering professors and engineers to move. Innovation, particularly long-lasting disruptive innovation, simply doesn't work this way.

Moving beyond the economy to equity markets, a flat 2015 peppered with destabilizing international events allowed U.S. stocks to grow into their valuations, making stocks a more attractive long-term choice than a year ago. Today, various worries have been incorporated into equity prices. Yet the economy remains very healthy, a recession is nowhere in sight, and consumers who make up 70% of economic activity, continue to grow stronger and more optimistic. While short-term events will drive stocks both up and down, longer term trends and valuations suggest the market should offer investors with reasonable time-horizons solid returns. While the year could be volatile, it is also highly possible that the tendency of investors to look well into the future when pricing stocks could drive markets up higher, particularly if international circumstances improve. And for many investors, stocks will remain a much more attractive option than bonds, which will likely offer investors low interest rates and yields through 2020.

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