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OPEC and the Fed Lead Market on Roller Coaster Ride
April 2016

Dear Client:

We began this happy New Year together with me greeting you in January by saying "Happy New Year to Volatility, Turmoil and Opportunities" and thus far it has been just that and more. Was one to only look at the end result, the first quarter of 2016 appeared as a mundane quarter, ending mildly positive for equities and slightly better for U.S. fixed income while most economies grew. In real time there were two distinct parts of the quarter the frenzied selloff before the market turned on February 11th and the furious rally from that day until the close of the quarter.

First Quarter Review

When all was said and done, the first quarter of 2016 went down in history as the first quarter since the Great Depression to record a decline of 10% or more (as measured by the S&P 500® Index) during the period. Only too then completely rebound and end in positive territory. In the first six weeks of the quarter, stocks plummeted led by the mix of investor concerns involving the global economy slowing, an unclear course for the world's central banks and pervasive pessimism about oil. Suddenly, talks of OPEC, Iran, and Russia agreeing on output levels drove a rebound in crude oil and commodity prices. Then apparent signaling by the Fed of continuation of easy global monetary policies plus indications of an improving U.S. economy helped to quickly lift investor sentiment and stock prices over the last six weeks of the quarter.

This year has already turned out to be one for the record books, and we are not even at the halfway point! It was the ***worst January ever*** for risky assets ever as measured by the S&P 500 Index. As is often the case the sharp drop in equity markets drew many pundits and prognosticators to cite the "predictive" power that one day, week, or month has in determining full-year stock market performance. While these sound bites are great for television ratings while increasing investors' angst…they ignored stock market history dating back to 1926, which has shown that performance of the first trading week of the year holds no predictive power in determining performance of the full-year. By time the first quarter came to a close, the market shock at the beginning of the year had all but reversed itself, with stocks finishing the quarter near (or above) where they started. So yes while I dismiss the first week makes the year analogies, trends can begin at any time of the year (like last year) and we should always be mindful to observe them and respond accordingly. For example, there are widely held theories about the stock market and U.S presidential elections. Trevor Nath of Nasdaq.com recently wrote:

The relationship between presidential elections and the stock market has been a hot button topic for years. The Presidential Election Cycle theory, developed by Yale Hirsch, found that the markets were strongest in the third year of a presidency. On average, the S&P 500 saw 17.5% gains in the third year of a president's first term and 11.5% returns during the second term. That's not to say year 3 is always the best, as witnessed by the catastrophe of the 2008 Financial Crisis.

I would add that last year's S&P 500 return of 1.47% also defies this theory too. So while thus far equities have risen more than 50% during each of Obama's terms, the next occupant of 1600 Pennsylvania Avenue may be promising certain policies that are more beneficial than others. Yet it is the approximately 2 billion other households around the world that will ultimately determine the direction and strength of the global economy.

While the sharp market selloff appeared to direct investors to prepare for a global recession during part one of the quarter, some domestic data indicated otherwise, pointing to a relatively healthy U.S. economy and robust labor market. Despite the investor pessimism, companies remained focused on their growth and market share opportunities, so merger and acquisition activity remained relatively robust during the quarter. At the same time, many active managers and investors sought to focus on the pockets of opportunities created by the extreme market movements.

U.S. Equity Market

In the first quarter, the broad U.S. equity market (as measured by the Russell 3000® Index) rose 1% and the large-cap focused S&P 500 Index rose 1.4%. Large-capitalization stocks fared better than mid- and small-cap stocks. Style-wise, value-oriented stocks outpaced their growth-oriented counterparts across all market capitalizations. Of the 10 economic sectors within the S&P 500 Index (which provides a proxy for the equity market), two sectors posted double-digit gains—Telecommunication Services and Utilities—and two sectors posted losses—Health Care and Financials.

Overseas Markets

In overseas markets, emerging markets bounced back in the first quarter after three years of languor. Monetary easing by major central banks, as well as a firming of crude oil prices and other commodities during the quarter, powered emerging market stocks and bonds higher. Many emerging market currencies also gained ground against the U.S. dollar, quite the contrary to what many analysts believed heading in to 2016. Emerging markets equity, as measured by the MSCI Emerging Markets Index (net of taxes), rose 6%. The downward pause and then steady upward movement in Oil prices was much like a rock lifted off the chest of most emerging economies who are overwhelmingly commodity based nations. As well talk of a stabilizing China who is the catalytic trading partner for many of these countries also was a positive driver. Lastly positive comments and improving sentiments out of India the world's second largest nation by population and ninth largest economy could bode well for growth in Southeast Asia.

Emerging Markets

In contrast to emerging markets equity, non-U.S. developed markets equity, as measured by the MSCI EAFE Index (net of taxes), declined 3% for the period. Over the past several years, politics have been a major risk for European investors. The United Kingdom's (U.K.'s) coming vote in June on whether it should leave the European Union (EU) means 2016 will be no different. Uncertainty over the outcome of the bitterly contested June 23 referendum has had investors on edge. Investors are bracing for market volatility, which they expect to rise as the vote approaches. The U.K.'s referendum comes at a time of a heightened uncertainty elsewhere in the global economy testing central bankers worldwide.

Despite a roller coaster ride, many corners of the bond market delivered decent returns during the first quarter. The U.S. fixed income market, as measured by the Barclays U.S. Aggregate Bond Index, gained 3% in the first quarter. Policymakers in Europe, China and the U.S. all signaled they expect interest rates to stay lower for a longer period, reflecting softer growth and below target inflation. With the Federal Reserve (Fed) currently in no rush to raise interest rates, long-term fixed income securities fared better than their shorter-term brethren. The yield on the 10-year U.S. Treasury note, a foundation for global finance, fell nearly half a percentage point in the first quarter—its largest one-quarter decline since June 2012. The 10-year Treasury yield ended March at 1.78 percent, down sharply from 2.27 percent at the end of 2015. (When bond prices rise, their yields fall.)

One big factor sending U.S. yields lower is the growing amount of government debt in Japan and Europe yielding below zero, driven by unconventional monetary stimulus. By comparison, U.S. bonds, which offer one of the highest yields in the developed world, are seen by investors as a bargain. In addition, many analysts expect Europe and Japan will move deeper into negative interest rates, spurring greater demand for U.S. fixed income securities. Another big factor sending U.S. fixed income yields lower is the Fed's continued easy monetary policies. During the quarter, the Fed sharply reduced the projected path of interest rate increases this year, signaling it may raise interest rates twice this year, down from the four times it had previously suggested. In addition, Fed Chair Janet Yellen said global economic and financial uncertainty poses risks to the U.S. economy and justifies a slower path of interest rate increases.

A Look Ahead

I continue to see that volatility (sometimes at panic level) will remain across the financial landscape in 2016 amid diverging global growth and monetary policies & expectations. The general capital market opinions I had at the beginning of this year remain mostly unchanged, as there will be more periods of pronounced market gyrations due to investors'

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alternating aversion and appetite for risk assets. It is quite possible that 2016 could be the start of a challenging five-year environment for most investors. As recently voices like Jeremy Grantham Founder & Chief Investment strategist of Boston based GMO funds, Richard Turnill, Chief Global Investment Strategist of Blackrock and others strongly doubting the ability of any U.S equities to deliver annual returns at or above 5% between today and 2021. So these periods of market stress typically throw up opportunities, as some prices move too far, or anomalies are created. My view continues that the current environment creates favorable long term opportunities for selective and tactical investing in **emerging markets, some international equities, distressed assets both equity and debt (including energy) and other opportunistic secondary & private market strategies** where levels of potential long term returns compare very favorably to current risks. Such periods also reinforce the need for a disciplined, long-term investment approach reflected by a clear and thoughtful asset allocation.

The science of portfolio management is the artful balancing act between identifying growth opportunities that expand your wealth and identifying real risks that may put your wealth in jeopardy. Never was there a quarter to begin a year where this critical exercise was more apparent. In addition, I believe it is important to maintain a disciplined investment approach and to focus on total risk management. The markets will fluctuate, but my goal to help you reach your long-term investment objectives remains unwavering.

As always, if you have any concerns, questions, or general thoughts about your portfolio, long-term strategy or any other matter, please never hesitate to contact me. I wish you continued health and happiness as you get out and enjoy spring.

Appreciatively,

Walid L. Petiri

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Sources: Barclays Capital, MSCI Barra, Russell Investments, Standard & Poor's, Reuters, Federal Reserve Board, Nasdaq.com