KALOS *Market Commentary*

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Recent Market Recovery Appears Warranted

After January's steep U.S. market plunge followed by a solid recovery back to January 1 levels, the last weeks of March have been fairly dull. Investors seem to be calmer as they sift through various indicators seeking to determine which global trends are most likely to impact growth and profits.

Confidence appears to be growing that the U.S. economy really will avoid a recession in spite of soft global economies, the strengthening dollar, and weakness in manufacturing. While most economists, including me, have been consistent in voicing this viewpoint, investors have been rattled by numerous areas of weakness, including the perennially poor GDP growth numbers. While enthusiasm may not be running incredibly high and GDP projections have generally declined to around 2% for the year, confidence that the expansion, however anemic, will continue appears to be firming. In fact, U.S. GDP numbers for first quarter have been revised back up to 2.5%.

China remains a key factor impacting global and U.S. growth projections, even if their economy impacts ours less than commonly believed. While the world's third largest economy may not be growing at the heady rates of yesteryear, it's also not imploding as many had feared. Growth will likely decline to around 6 percent for 2016, which remains strong for an economy at their level of development.

Looking the other direction, Europe continues to inch forward, spurred on by the European Central Bank's (ECB) injection of liquidity into the system. The aggressive tactics of the ECB seem to be spurring slow growth, although even their actions can only do so much for a perennially sick patient. Regardless, Europe's challenges impact Europe far more than the U.S., and ongoing struggles of the old continent will likely continue to simply slow the U.S. a bit rather than inflict significant pain.

Jobs and the U.S. consumer likely remain far more important to the U.S. economy and U.S. equity markets. U.S. employment surged in February, driving the unemployment rate down to an eight-year low of 4.9 percent. Continued labor market strength further eased recession fears. The lower unemployment rate was also helped by corrections to December and January numbers that added 30,000 more jobs than previously reported. Unemployment trends also reveal that part-time workers are successfully finding full-time work as the number of underemployed workers has fallen by 1.2 million over the past two years. In addition, more people are also finding part-time work, which not only helps immediate jobs and payroll numbers, but also suggests more jobs gains in the future.

Housing gains, another key economic indicator that has been incredibly weak post meltdown continues to strengthen. The number of existing U.S. homes that went under contract jumped 3.5 percent in February, signaling solid gains. Because consumer spending accounts for around 70 percent of the U.S. economy, strong jobs and housing gains by themselves likely signal that the economy should continue to grow at least modestly in spite of what may be happening outside of our borders.

As jobless numbers decline and the slow but steady expansion reaches its seventh year, it's not surprising that core inflation is finally trending upward, even if the pace remains slow. Core inflation, which excludes food and energy prices, is now at 1.7 percent according to the Federal Reserve, and is projected to hit 2 percent by year-end. The uptick provides more impetus to the Fed to raise rates this year.

But the Fed will likely raise rates very cautiously. End of March, market gains probably partially resulted from the Fed's delay in raising rates, although the move was hardly a surprise. Most likely, the lack of increase, even though expected, calmed investors through demonstrating patience and caution and also setting positive expectations for similarly prudent actions in the future.

Within global markets, commodities may represent both a unique opportunity and risk. After reaching a 25-year low in January, broad commodities markets have rebounded, and the sector has even outperformed broader equity markets in 2016. Unfortunately, for many if not most commodities, it appears likely that much of the recovery stems from a rebound from oversold levels rather than the beginnings of long-term recovery. A few sectors, such as sugar, are likely to continue their recent upward trend, but many other major sectors, such as metals, appear to face much more market clearing activity before prices strengthen.

But oil is different as recent weakness in oil prices and anything related to oil likely represents an opportunity for many investors. The U.S. currently produces more oil than we are consuming, but the overage is only about 1-2 percent per day. At today's prices, overproduction will not continue. The old mantra "the cure for cheap oil, is cheap oil" will very likely prove true again. And, global demand is growing. Over the next decade, China's oil consumption should leap 50 percent from today to around 15 million barrels of oil per day, not too far from the U.S.'s consumption of about 20 million. Other developing countries are following a similar trajectory.

Various investments associated with oil performed abominably over the recent past and may offer tremendous opportunities. For instance, master limited partnerships (MLPs) have generally suffered huge price declines, yet most have not seen significant decreases in revenue while dividend payments have continued uninterrupted resulting in incredibly high yields. Many investors shy away from the category because of the more complex tax treatment (they usually require filing K-1s), but they may offer an attractive opportunity. More importantly, they could represent potential opportunity across the entire oil industry.

Looking forward, we believe the recent market recovery is warranted based on underlying economic fundamentals in the U.S. and abroad. While growth will likely remain muted, it should at least continue. For investors seeking higher returns, some areas appear to offer more opportunity. Oil will recover at some point and many equities in the sector are likely to look very cheap at some point in the future. Many international markets, particularly emerging economies, probably represent excellent value given their relatively depressed valuations. As always, equity markets today require courage, but numerous indicators suggest that they will be rewarded, probably this year.

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