Quarterly Economic Update

Second Quarter 2015

R. Michael Otto, CFP®, MBA
920-733-3874

Kerntke Otto McGlone
Wealth Management Group

With the most recent stock market volatility, many investors are looking over their shoulders and wondering if the gains of the past few years are in jeopardy. Many market strategists predicted that volatility would return to the equity markets in 2015 and the first half of the year has supported those forecasts.

Despite all three major indexes hitting new highs this quarter, only the NASDAQ finished the first half of 2015 with much of a gain. By the end of the quarter, the Dow Jones Industrial Average was negative, down 1.1% for the year. The S&P 500 index finished up 0.2%, or about where it started. The NASDAQ rose approximately 5.3% for the first half of 2015.

There continues to be talk and debate amongst financial analysts and publications about the remainder of 2015. At *Barron's* midyear roundtable, an annual gathering of 10 investment market strategists, they felt that although the market isn't cheap, they were still optimistic about the remainder of 2015. Some analysts are saying a long overdue correction is imminent. According to *CNN Money*, the U.S. stock market is long overdue for a big fall, but the solution isn't to exit stocks. Instead, they suggest that there may be opportunities during market dips. They remind investors that stocks often go up after a correction. Corrections do not always mean the bull market is done. ***(Source: CNNMoney 6/4/2015)***

In a contrasting view, Jeff Reeves at *Market Watch* claims a market correction is not 'due'. He suggests that perhaps the most important data point of all for the bears to remember is that rallies do not end simply because they've gone on for a few years and are "due" to correct. To support this theory he suggests investors study the bull market of 1987 to 2000, which lasted 4,494 days and saw a roughly 585% increase in the S&P 500. He adds that this is not to discourage investors from thinking critically or skeptically about the numbers. Obviously, it's human nature to wonder when the party is going to end, but he warns against predicting the end just because we've had a long run-up. ***(Source: MarketWatch 6/15/2015)***

Interest Rates

Again this quarter, interest rates and Fed watching continues to feel like a spectator sport for investors. Investors are carefully watching federal funds rates in anticipation of a rate increase.

The federal funds rate is an important benchmark in financial markets. It is the interest rate that the borrowing banks pay to the lending banks to borrow funds. It is negotiated between the two banks, and the weighted average of this rate across all such transactions is the federal funds effective rate.

According to CNBC on June 23rd, Federal Reserve Governor Jerome Powell, a voting member on the policy-setting committee said he sees conditions for an interest rate liftoff as soon as September, and an additional increase in December. Powell added that he believes the dollar and oil prices have broadly stabilized. He estimated the economy will grow at around a 2 percent pace this year. Powell said he's seen positive signs in the economy, including a pickup in wages and an uptick in the labor participation rate. ***(Source: CNBC.com 6/23/2015)***

Here are some common questions about interest rates and how the central bank uses them to try to help the economy:

Exactly what interest rate is the Fed looking to raise?

The reserves that banks are required to hold at the Fed are known as federal funds. The interest rate that banks use for these overnight loans is known as the federal funds rate.

How does the Fed control the federal funds rate?

The decision to change the target federal funds rate is overseen by the 12 members on the Federal Open Market Committee, better known as the FOMC. Centered on the prevailing economic conditions, the committee votes on the desired target interest rate that they believe will help keep the economy running smoothly.

Why does the Fed maneuver the federal funds rate?

The FOMC's goal is to use the federal funds rate to prevent unnecessary shocks to the overall economy. Congress enacted the Federal Reserve with control over the federal funds rate to provide maximum employment, keep inflation low, and provide reasonable long-term interest rates.

How does the federal funds rate affect other interest rates?

While the federal funds rate is only directly applicable to banks that lend to one another, it has become a benchmark for consumer and business loan rates. Business executives and investors keep a close eye on the federal funds rate and the FOMC's position on the economy to help them adapt their business plans accordingly.

Mid-year Concerns	
1	Equity Markets Are Still Volatile
2	Potential Interest Rate Increase
3	Concerns From Greece and China
4	Investor Comfort Levels

The prime rate, for example, is established by banks and is offered to their best customers. It is used to determine interest rates for a variety of loans, including credit cards, car loans, small business loans, and home equity lines of credit.

We still live in a slow-growth, low inflation world that is likely to keep interest rates low for the immediate future. Currently, 27 of the world's 34 major central banks are making an effort to suppress interest rates. Investors need to keep a watchful eye on interest rates, but also need to avoid over focusing on rate hikes. ***(Source: Fidelity 6/5/2015)***

Should you have any concerns about your holdings we would be glad to recheck your personal situation during your next review or at any other time.

Greece's Monetary Issues

As of June 30, Greece was facing great financial fears. If Greece vanished today, the world economy would contract 0.3 percent, once. Economically, the loss would scarcely be noticed since Greece has only 11 million people. That's why a Greek financial crisis isn't the same thing as a United States or global financial crisis. It isn't big enough to hurt.

How will the Greek issues affect the markets?

After Greece's fears surfaced, the Dow plummeted 350 points June 29th, its worst day of the year. Some analysts believe the effect may be short-lived: S&P Capital IQ published a 70-year historical analysis of past market shocks that found events like this produce an average decline of 2.4 percent on the next trading day, which has been recovered in an average of 14 trading days. ***(Source: NBC NewsWorld)***

China's Equity Markets

China had a tumultuous quarter. The economy continued to slow, growing 7% in the first quarter, the slowest in six years. Some analysts are concerned that what happens in the Shanghai stock market may not stay there.

The Shanghai Composite which was a rising star for the last year is off nearly 22% from its peak in mid-June, including a 3.3% fall on June 29th. China's interest-rate cut on the prior weekend did little to restore investor confidence.

The Chinese government has been pulling a number of levers to try to stimulate the economy. Despite this uncertain growth picture, the Shanghai SE Composite Index which has fallen 7.3% in the last month, has gained 14.1% in the last three months, and 32.2% for the year to date. ***(Source: Morningstar.com 7/1/2015)***

Conclusion: What Should an Investor Do?

Investors are concerned about return. After all, the market has been up. On June 24th, in an article entitled *Will the DJIA hit 16,000 or 20,000 first?*, Nicholas Colas the Chief Market Strategist for Convergex noted that the Dow Jones Industrial Average was up 324 points for the year to date – which meant an increase of 1.8%. Although there are 30 companies in this oldest of all broad market measures, just 2 names made up all that performance. Goldman Sachs was up 12% year to date, adding 174 points to the Dow and UnitedHealth's 21% return was worth another 164. You'd think it would be the other way around, but GS's higher stock price gives it a heftier weighting. The other 28 names in the Dow netted out to zero impact for the year. ***(Source: www.convergex.com)***

The first half of 2015 was not easy for investors. As advisors we are faced with the tough task of balancing portfolios between risk free rates, risk premiums and market returns.

GETTING NOWHERE FAST

Despite all three major U.S. indexes repeatedly hitting new highs, only the Nasdaq composite ended the first half with much of a gain.

Market	Q2	1st half
Nasdaq composite	1.8%	5.3%
S&P 500	-0.2%	0.2%
Dow Jones ind.	-0.9%	-1.1%

SOURCE: USA TODAY research

So what can investors do?

Safety comes with a price. Rates on longer-term certificates of deposit got a small bump in Bankrate.com's June 24 survey of interest rates. The average one-year CD yield was 0.27% for the 15th straight week. The typical five-year yield was up 1 basis point to 0.87%. A basis point is one-hundredth of 1%. Jumbo CDs sport slightly higher yields for a $100,000 deposit. The average one-year jumbo CD yield was 0.3% for the seventh consecutive week. The average five-year CD yield was up 1 basis point to 0.92%.

For the 37th week in a row, the average money market account yield was 0.09%. ***(Source: www.bankrate.com)***

For many investors, these low fixed rates will not help them achieve their desired goals. Most investors attempt to build a plan that includes risk awareness. Many times this can lead to lower but safer returns. Traditionally, bonds have been the defacto standard to hedge against market risk, but with bond values at historical highs they no longer offer the kind of protection they once did and quite possibly pose a greater threat of loss than stocks. Investing is not about keeping pace with the market (who likes losing 40% during years like 2008?) or beating the market – it's all about hedging risk so your portfolio suits your individual needs regardless of the market.

Have a Strategy. Investors need to be prepared. Market volatility should cause you to be concerned, but panic is not a plan. Market downturns do happen and so do recoveries. This is the ideal time to ensure that you fully understand your time horizons, goals and risk tolerances. Looking at your whole picture can be a helpful exercise in determining your strategy.

Focus on your own personal objectives. During confusing times it is always wise to create realistic time horizons and return expectations for your own personal situation and to adjust your investments accordingly. Understanding your personal commitments and categorizing your investments into near-term, short-term and longer-term can be helpful.

Make sure you are comfortable with your investments. Equity markets will continue to move up and down. Even if your time horizons are long, you could see some short term downward movements in your portfolios. Rather than focusing in on the turbulence you might want to make sure your investing plan is centered on your personal goals and timelines. Peaks and valleys have always been a part of financial markets and it's highly likely that trend will continue.

Discuss any concerns with us.

Our advice is not one-size-fits-all. We will always consider your feelings about risk and the markets and review your unique financial situation when making recommendations.

We pride ourselves in offering:

- ✓ consistent and strong communication,
- ✓ a schedule of regular client meetings, and
- ✓ continuing education for every member of our team on the issues that affect our clients.

A good financial advisor can help make your journey easier. Our goal is to understand our clients' needs and then try to create a plan to address those needs. We continually monitor your portfolio. While we cannot control financial markets or interest rates, we keep a watchful eye on them. No one can predict the future with complete accuracy, so we keep the lines of communication open with our clients. Our primary objective is to take the emotions out of investing for our clients. We can discuss your specific situation at your next review meeting or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial matter.

Help us grow in 2015!

This year, one of our goals is to offer our services to several other people just like you! Many of our best relationships have come from introductions from our clients. Do you know someone who could benefit from our services?

We would be honored if you would:

- ✓ Add a name to our mailing list,
- ✓ Bring a guest to a workshop,
- ✓ Have someone come in for a complimentary financial checkup.

Please call Mike Otto at Kerntke Otto McGlone, (920) 733-3874 and we would be happy to assist you.

Kerntke Otto McGlone Wealth Management Group, 3701 E. Evergreen Dr. Ste 500A., Appleton, WI 54913