Quarterly Economic Update

First Quarter 2016

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Matthew Henry, an English author who lived in the 1600's, is credited with saying, "After a storm comes a calm." Perhaps that best describes the first three months of 2016. Investors experienced an unusually volatile first quarter and as of March 31st, the U.S. stock market ended the quarter higher than it started the year. Following its worst start to a year since 2009 and a fall of more than 10%, equity markets enjoyed an equally swift recovery of over 10% that more than cancelled each other out.

By the end of the quarter, the Dow Jones Industrial Average was up 1.49% for the year. The S&P 500 index was up 0.77% or about where it started. The NASDAQ fell 2.75% for the first quarter of 2016.

The quarter produced a V-shape chart that was filled with volatility. In short, the world had a scare about a U.S. recession and deflation and then recovered from it, all in less than three months. As a result, the Dow Jones Industrial Average saw its biggest quarterly comeback since 1933.

Fidelity Investments stressed to investors that although the U.S. markets seemed to have ended the quarter in a decent place, that, "We cannot, therefore, ignore the dramatic events of the past 11 weeks, even if they have left the world's biggest stock market exactly where it started."

Since investors should not ignore the dramatic events of the past quarter, what has changed since the year started?

Oil seemed to have found a bottom and prices have risen, with crude up more than 50% from its January low, while the dollar has weakened. Oil and the dollar tend to have an inverse relationship, with the dollar rising when oil falls and vice versa. Oil remains more than 60% down and the dollar more than 20% up from their levels of summer 2014. These factors relieve some of the fears investors had over bankruptcies in the U.S. energy sector. (***Fidelity.com: 3/18/2016)***

Gold investors were rewarded this quarter. Gold often thrives as a haven in times of turmoil or as a protection against inflation. Gold prices soared 16.5% in the first quarter, but many analysts feel that gold prices might now be overinflated. ***(Source: Wall Street Journal 4/4/2016)***

Last year was a strong year for the dollar, but Jeffrey Rosenberg, Blackrock's Chief Investment Strategist of fixed income feels the dollar will not appreciate as much in 2016 as it did in 2015. ***(Source: Wall Street Journal 4/4/2016)***

Corporate profits are important for investors to watch. Fidelity suggests that currently corporate profits have been disappointing and many companies have guided us to expect worse. Also, corporate share buybacks were high this quarter. At $95 billion in February, according to TrimTabs, the money U.S. companies spent on their own stock was the third highest in a month on record. The U.S. stock market is trading at an earnings multiple of approximately 18, which is not considered historically cheap, therefore investors need to keep a watchful eye on earnings. ***(Source: Fidelity.com 3/18/2016)***

Interest Rates

Again this quarter, interest rates and Fed watching continued. Investors were carefully watching federal funds rates in anticipation of a rate increase. In December of 2015, the Fed raised interest rates for the first time in 7 years and suggested that this was the beginning of anticipated rate increases. In December, Stanley Fisher, the Central Bank's Vice Chairman, said that for 2016, four interest rate increases "were in the ballpark." ***(Source: Barron's 4/4/2016)***

That sentiment changed on Tuesday March 29th when Federal Reserve Chair Janet Yellen said in a speech that various headwinds existed which made it difficult to justify aggressively increasing lending rates. While global growth has become an issue, rising real interest rates have also weighed on both economic activity and financial market euphoria. Whether you agree with it or not, this seems to be the policy direction of the Federal Reserve. Even at the Fed, however, many aren't in agreement. Prior to this, several Fed members expressed a more hawkish view, suggesting that interest rates may indeed rise faster.
(Sources: Forbes 3/30/2016, Thestreet.com 3/30/2016)

In the wake of Yellen's statements, markets cheered. The prospect of continued low rates is usually seen as good for stocks, and that is playing out. Longer-term, though, Yellen's stance raises deeper questions. ***(Source: Barron's 4/4/2016)***

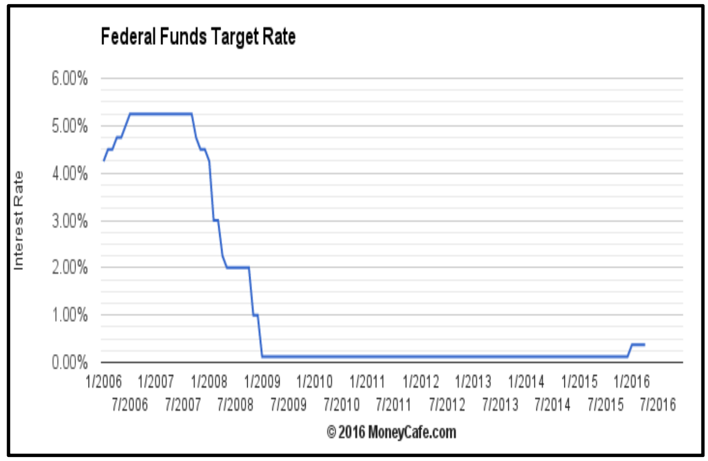
As for some overseas central banks, they are unclear in where rates can go, at least when it comes to exchange rates. Both the Bank of Japan and the European Central Bank cut rates further into negative territory this year and both saw their currencies strengthen. This is largely because markets perceive, perhaps correctly, that the banks can take rates no lower. ***(Source: Fidelity.com 3/18/2016)***

Are there still several rate increases in our future?

This will depend on the Fed's interpretation of primary indicators. At some point, improvements in employment and increases in inflation could encourage the Fed to aggressively raise rates. As of March, the markets seem to be suggesting that a "low for longer" path remains the most likely course for rates. The Federal Open Markets Committee in March predicted two increases in the federal-funds target rate from the current 0.25-to-0.5% range.
(Source: Barron's 4/4/2016)

How does the federal funds rate affect other interest rates?

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.

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.

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.

Interest rates are still low by historical standards and as financial professionals, we will watch them. **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.**

Oil Prices

While oil traders may be disappointed with lower prices, this would seem to be good news for the U.S. economy. For years, politicians and consumers have griped about the high price of oil and how it hits consumers in their pocketbooks. Now that gasoline prices have fallen below $2 a gallon in much of the country, consumers will have more money to spend and stimulate the rest of the economy.

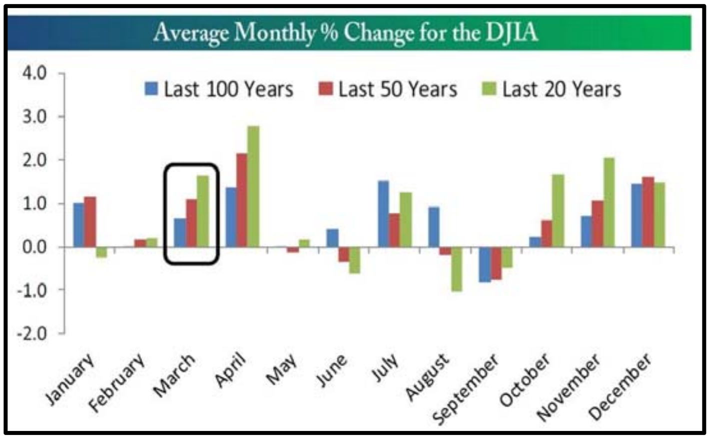
Although low energy prices are still better than high energy prices, a continued decline should worry investors about the possibility of smaller oil companies going bankrupt and the harm that could do to the market.

U.S. Elections

The U.S. presidential elections - scheduled for Tuesday, November 8th, 2016 - are not that far away anymore. We are still finishing caucuses and primaries. While there are front-runners, it's hard to make a final call as to who is going to represent each party and it's much harder to predict who is going to win these elections. Different people have different views and that's true not only when it comes to politics but also to the implications of politics over the markets. Is candidate X winning or losing the elections good or bad for the markets? At this point in time investors need to keep an eye on it.

Conclusion: What Should an Investor Do?

Investors are concerned about the market. After all, the market is once again up. Historically, prior to 2016, March shows up as the fourth best month for stocks after December, November and April. According to Bespoke Investors and Marketwatch, over the past 65 years, the S&P 500 has risen 42 times in March and fallen 24 times, with average return of 1.06%. The positive returns of March 2016 will increase that number.



While the mood is cautious, Bespoke Investment Group's numbers show that April is not the cruelest month for investors. History shows that a positive March is typically followed up with a slight gain in April, however some believe that "this time it could be different." ***(Source: Barron's 4/4/2016)***

Where do investors go from here?

The markets will begin the second quarter with companies reporting earnings. Oil prices, market volatility, interest rate decisions, and global growth worries will all factor in and possibly determine the future path of the market.

In the first quarter, U.S. stocks went from down 10.8% on February 11th to then gain 13.2% and finish the quarter up by over 1%. Although this roller coaster ride allowed investors that stayed to return to a place near where they entered, people still might feel queasy. ***(Source: Barron's 4/4/2016)***

At the start of 2016, most analysts felt that bond yields had nowhere to go but up (meaning bond prices would fall) and the dollar would continue its ascent with gold prices dropping. They were wrong. Moving into the second quarter a positive jobs report encouraged investor confidence, but **CAUTION** is still the principal notion for investors.

What can investors do?

Safety comes with a price. According to Bankrate.com's March 30th charts, rates on one year certificates of deposit (CD's) were 0.28%. The average bank money market yield was 0.11%. Five year CD's were averaging under 1%. Investors are not typically excited with interest rates less than 1%. ***(Source: www.bankrate.com)***

For many investors these 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 safer but lower returns. Traditionally, bonds have been the de facto 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 market performance

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 entire 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 is highly likely that trend will continue.

Fund-research firm Morningstar, Inc. finds that sadly, many investors have self-defeating behavior. They find that many investors are still buying funds and selling at precisely the wrong times. ***(Source: Wall Street Journal 4/4/2016)***

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 matters.

Did you wait until early April to file your tax return?

If you did, you have plenty of company. The IRS is expecting 150 million individual tax returns for 2015 and more than 33% should be filed in early April.

Source: WSJ 4/2/2016

Help us grow in 2016!

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 James at Kerntke Otto McGlone Wealth Management Group, (920) 733-3872 and we would be happy to assist you!

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Sources: Fidelity.com, Wall Street Journal, Barron's, Forbes.com, bankrate.com
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