

CAPITAL MARKET REVIEW

First Quarter 2016



The Economy

Inequality. We hear about that a lot in these election years. Of course the politicians are discussing the very real issue of income inequality in the modern world.

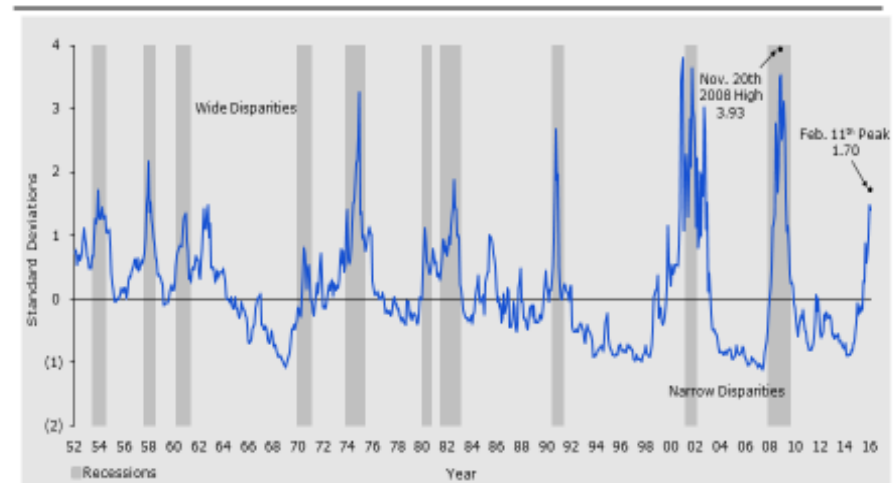
On Wall Street there is another type of inequality occurring. One might believe that a dollar of earnings is a dollar of earnings regardless of how that dollar is earned. Why would a dollar earned selling books be worth any more than a dollar earned manufacturing automobiles? Yet investors will pay \$279 for \$1 of Amazon's earnings and only \$6 for \$1 of earnings from Ford. Something is not exactly right about that.

In fact according to some research done by Invesco the spread between the cheapest stock valuations and the average stock valuation is higher than it has ever been without the US being in recession. So what does this mean?

As far as the economy goes this is uncharted territory, so only time will tell what it means. My instincts suggest it isn't good news.

From an investors point of view however there is no greater force in the universe than reversion to the mean. The spread must shrink. Growth has been in favor for a long time but it may be getting close to a time where Value will once again be in vogue.

Valuation spreads – The cheapest quintile compared to the market average
1952 through February 2016



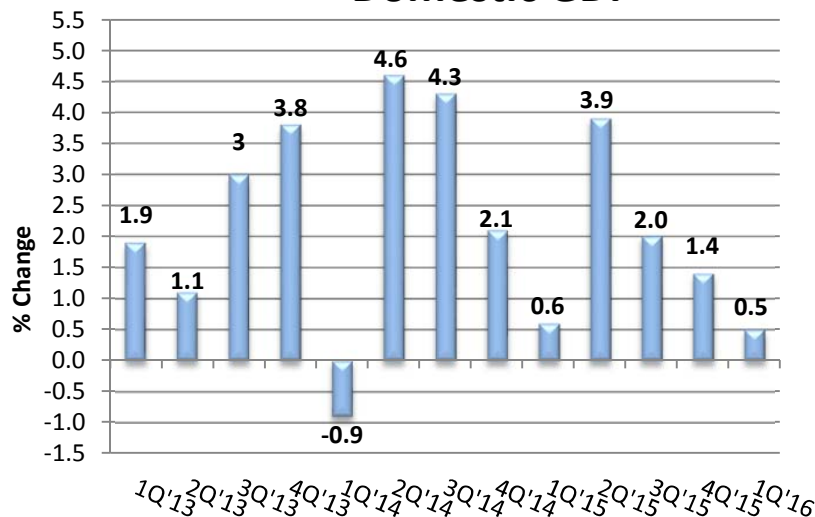
The Economy

Still chugging along. Fourth quarter GDP was up 1.4 percent. First quarter was lower at 0.5 percent but still in our new-normal range. Is anyone else getting bored with this? We have been stuck at this low rate of growth for almost eight years now and there is no sign of it ending anytime soon.

The official unemployment rate is 5.0 percent in March. The labor force participation rate is improving so there continues to be slow growth in jobs.

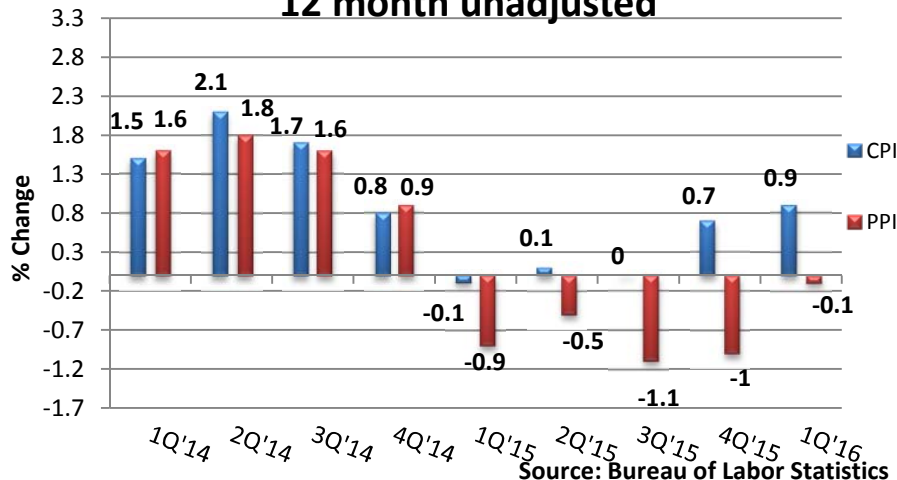
Inflation has ticked up with CPI coming in at 0.9 percent in March. The Fed remains on hold after their first interest rate hike last year. We think they will have a difficult time continuing to raise rates as there is little sign of inflation and growth remains very slow.

Domestic GDP



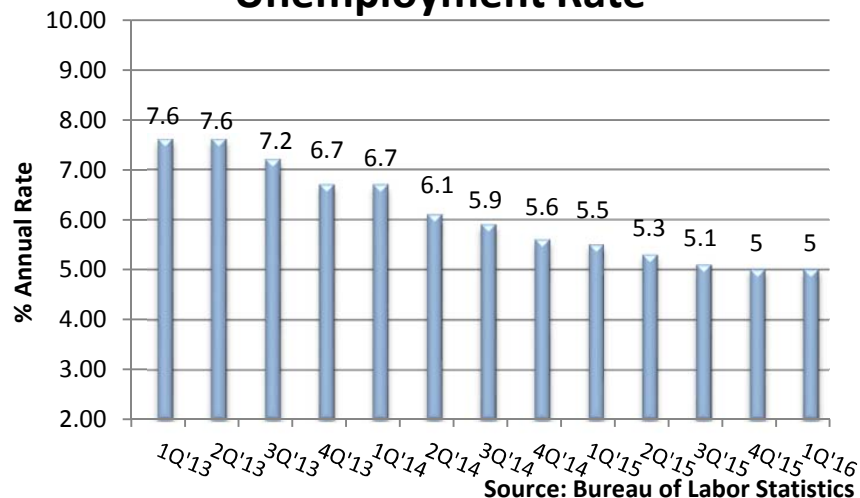
Source: Bureau of Economic Analysis; Forecast from Wall Street Journal

Inflation Indicator 12 month unadjusted



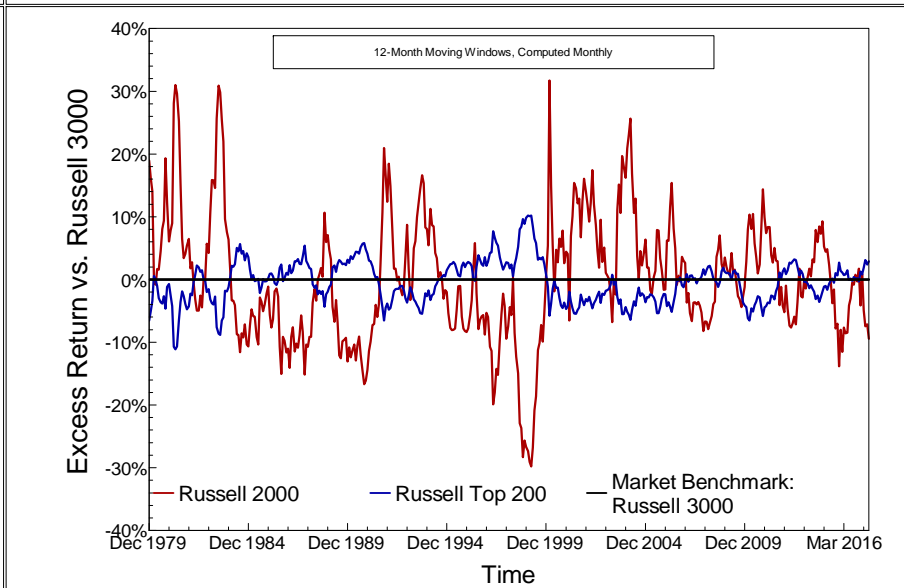
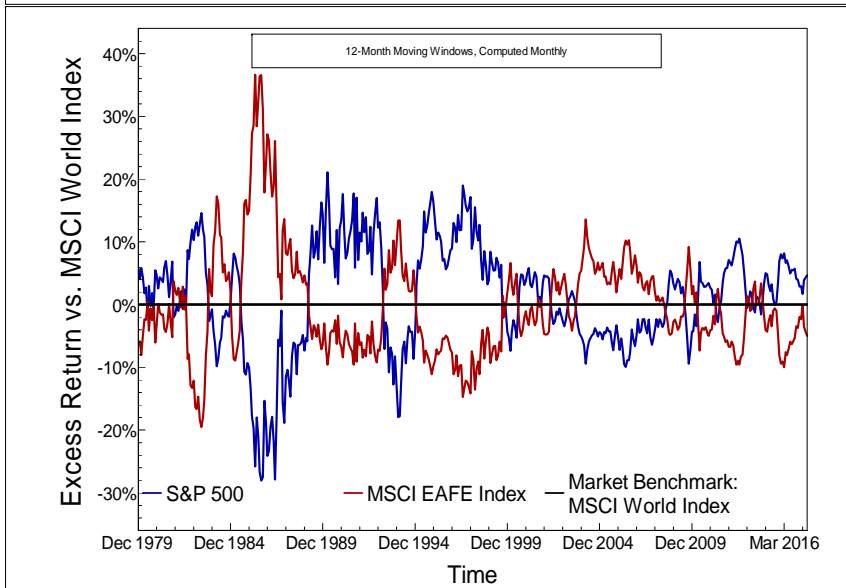
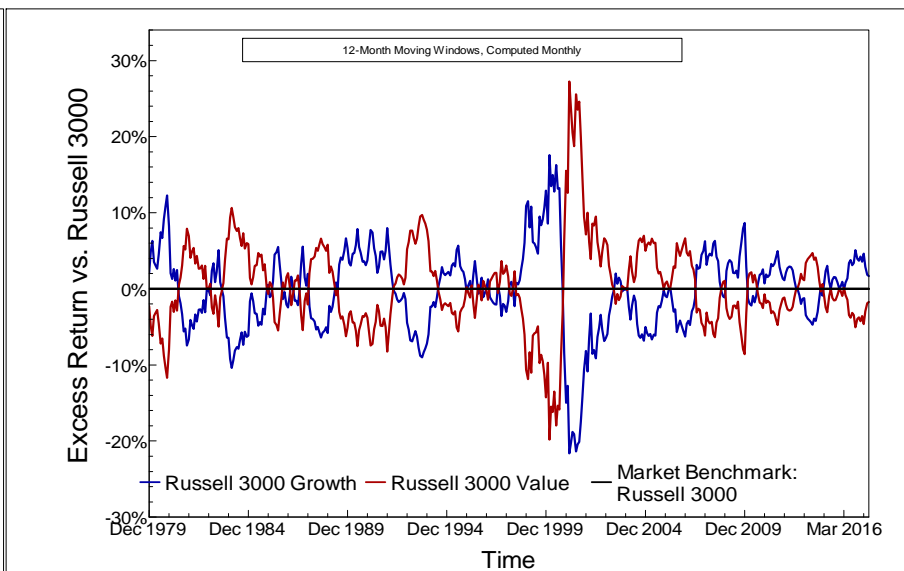
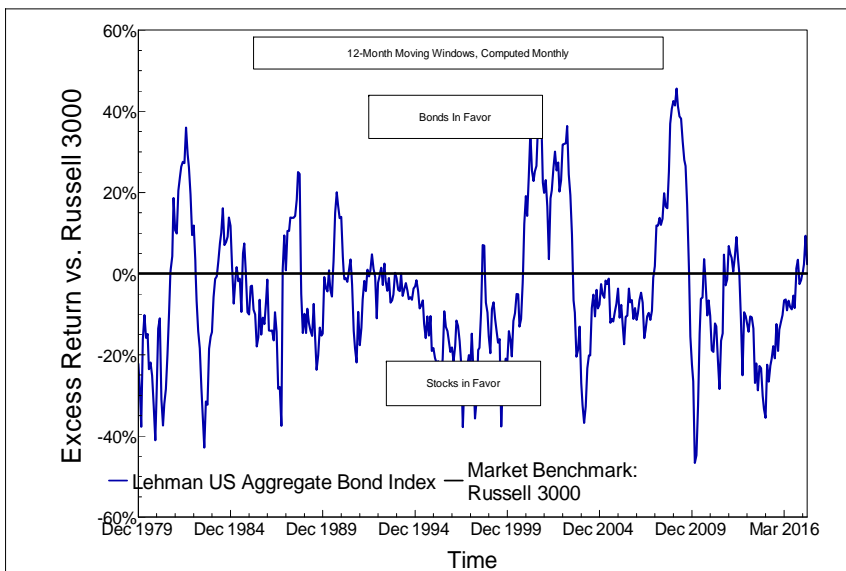
Source: Bureau of Labor Statistics

Unemployment Rate



Source: Bureau of Labor Statistics

Market Comparison



Domestic Equity Markets

Volatility is the name of the game. Markets have become extremely volatile in the absence of proprietary trading. The worst start in history was followed by a rebound and we ended up about where we started. The S&P 500 is up 1.3 percent for the quarter and the small company Russell 2000 index is down 1.5 percent.

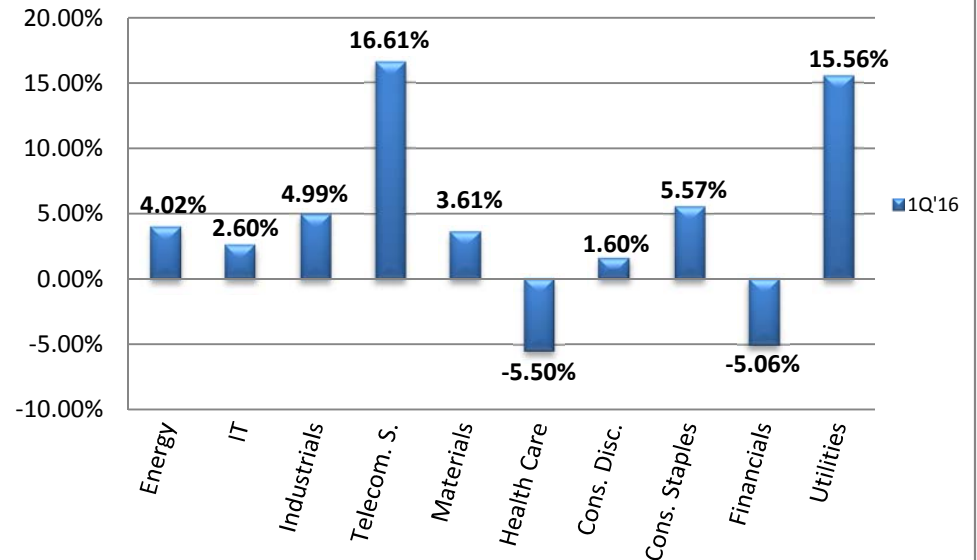
Telecoms and Utilities were the best place to be as investors once again looked for yield and safety in high dividend paying stable companies. Health Care and Financials were the only sectors that did not make a full recovery from the worst start in history.

This next quarter may be the one that tells us if we finally get the rotation to value or if the second half rally will be just another false start and the FANG bubble will continue to build. In the short-term that might be difficult to tell by just looking at the index, but the former would be healthy and long lasting while the later can not be sustained.

Domestic Indices Three Months Ending March 31, 2016

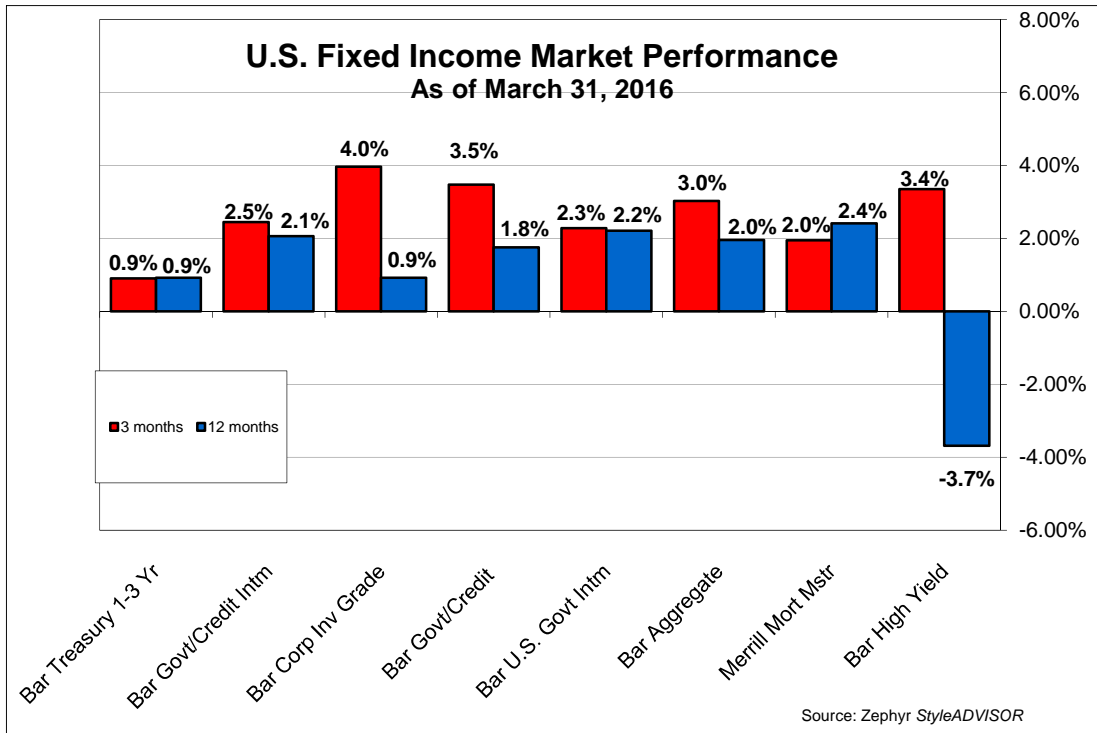
	Yield	Price/Earnings	Price/Book
S&P 500	2.22%	21.7	3.70
Russell 1000 Gr	1.63%	23.1	5.59
Russell 1000 Val	2.61%	19.3	1.80
Russell Midcap	1.79%	25.7	2.64
Russell 2000 Gr	0.81%	41.8	3.67
Russell 2000 Va	2.31%	26.1	1.46

S&P Sector Returns



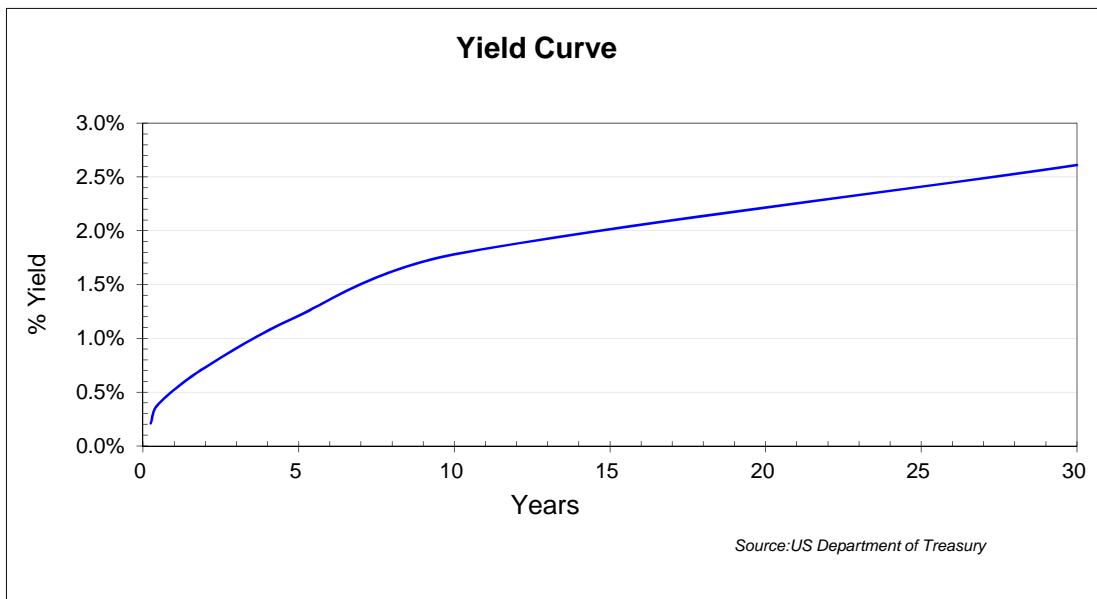
Source: Telemet Orion

DOMESTIC FIXED INCOME MARKET



Bonds rallied during the early year stock selloff and ended the quarter up 3.03 percent. High yield bonds ended the quarter up 3.35 percent. Many of the energy company bonds which had caused concerns in the high yield market rallied as oil prices bounced off the bottom.

With the 10 year treasury still under 2 percent, nothing has changed long-term. Low rates make bonds less attractive.



Yield Curve as of March 31, 2016

Time to Maturity	Interest Rate
3 Month	0.21%
6 Month	0.39%
2 Year	0.73%
5 Year	1.21%
10 Year	1.78%
30 Year	2.61%

INTERNATIONAL MARKETS

The dollar hurt international investors last year but saved us in the first quarter.

International stocks still finished down 2.9 percent as measured by the MSCI EAFE index, but they were down 6.4 percent in local currencies.

Emerging markets were the best place to be during the quarter. Valuations, especially relative to book value had become very attractive. Of course these companies were cheap for a reason. The lower commodity prices have real economic consequences in most emerging countries. The risk is still there but buying cheap usually ends well for the patient investor.

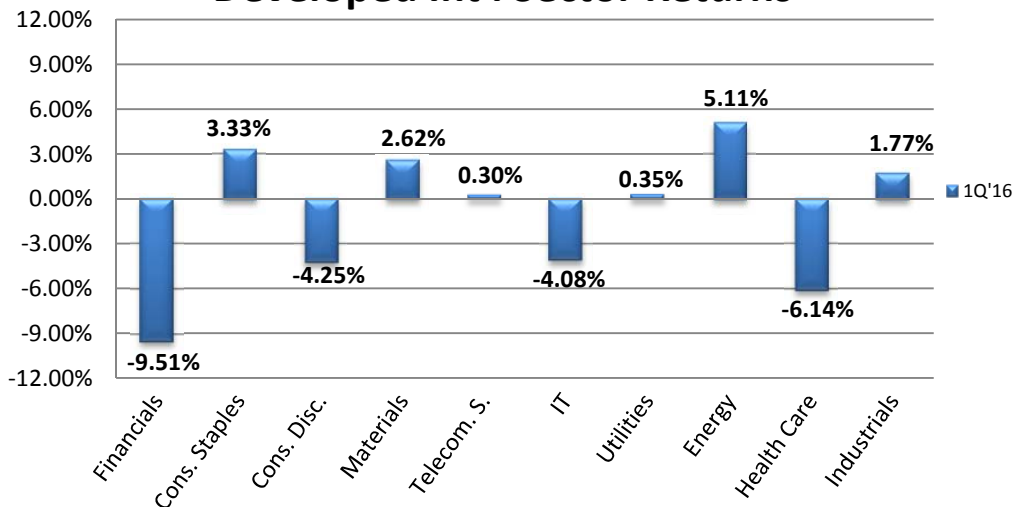
It seems like yesterday Greece was going to be forced out of the EU and now Great Britain could be voluntarily leaving. Our guess is that this Brexit will have the same outcome, although with fewer riots, lots of worry but no actual exit.

In the meantime the globe's experiment with negative interest rates does not seem to be working thus far. This is new territory so only time will tell what effect this will have.

MSCI Country Returns Three Months Ending March 31, 2016

	Return US\$ (%)	Return Local Currency (%)	Currency Effect(%)
Austria	-0.52	-5.17	4.65
Belgium	-2.41	-6.97	4.56
Denmark	-0.56	-5.36	4.80
Finland	-4.91	-9.36	4.45
France	0.21	-4.47	4.68
Germany	-2.42	-6.98	4.56
Ireland	-3.92	-8.41	4.49
Italy	-11.66	-15.79	4.13
Netherlands	3.37	-1.28	4.65
Norway	1.82	-4.85	6.67
Portugal	3.24	-1.59	4.83
Spain	-3.99	-8.47	4.48
Sweden	0.15	-3.69	3.84
Switzerland	-5.12	-9.22	4.10
UK	-2.32	0.17	-2.49
Europe Total	-2.37	-4.79	2.42
Australia	2.14	-3.40	5.54
Hong Kong	-0.55	-0.47	-0.08
Japan	-6.38	-12.52	6.14
New Zealand	12.01	10.45	1.56
Singapore	5.06	-0.19	5.25
Pacific Total	-3.68	-9.22	5.54
Brazil	28.58	15.19	13.39
Canada	11.49	-1.48	12.97
China	-4.80	-4.73	-0.07
Greece	-12.23	-16.33	4.10
Hungary	17.30	11.17	6.13
India	-2.50	-2.40	-0.10
Indonesia	11.30	7.06	4.24
Korea	5.21	2.61	2.60
Mexico	8.50	7.66	0.84
Poland	13.88	7.34	6.54
Russia	15.76	14.72	1.04
Thailand	7.72	14.42	-6.70
Emerging Markets	5.75	2.78	2.97

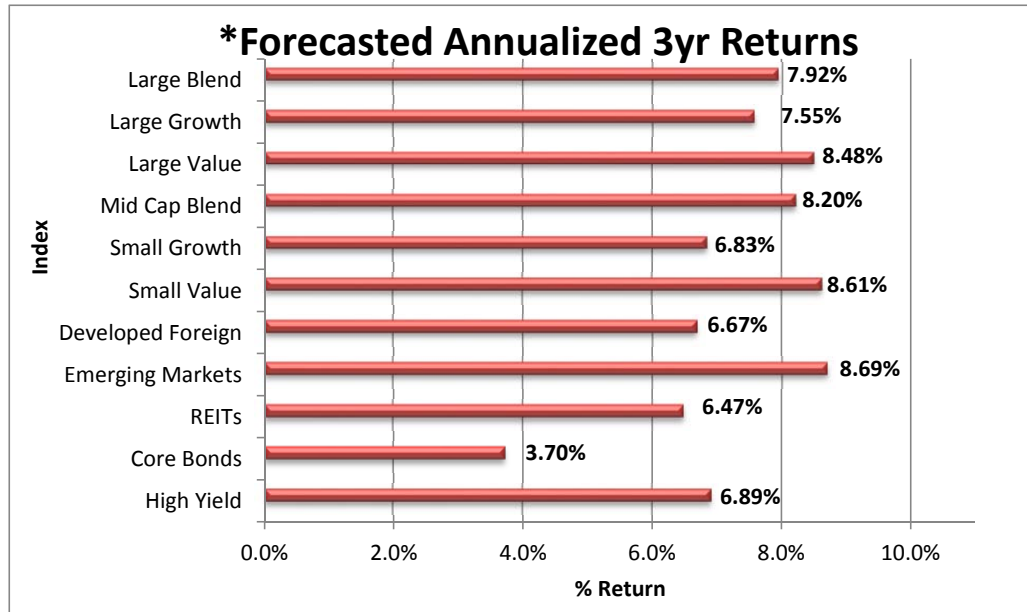
Developed Int'l Sector Returns*



Source: Harbor Capital

* MSCI EAFE Index

Market Forecast



Volatility is likely here to stay for a while. As frustrating as that is, we remain confident in the longer term. Valuations on equities are attractive on the whole and the economy is still chugging along. It is a rough ride but we still believe it will end in a positive direction.

Emerging markets have real economic issues but valuations have become very attractive. Small company stocks are finally getting back into normal valuation bands. Caution is in order but that is a good long term sign.

Bonds remain our biggest concern over the long term, but they are still a shelter in the storm when the market does go down.

**Indices Three Months Ending
March 31, 2016**

	Yield	Earnings Yield	**Hist. Return	***Hist. Risk Prem. + RF Rate
Large Blend	2.22%	7.74%	10.11%	5.98%
Large Growth	1.63%	7.04%	9.82%	5.98%
Large Value	2.61%	9.06%	10.21%	5.98%
Mid Cap Blend	1.79%	7.38%	11.52%	5.98%
Small Growth	0.81%	6.13%	7.60%	6.98%
Small Value	2.31%	8.52%	10.36%	6.98%
Developed Foreign	3.34%	9.96%	4.85%	4.11%
Emerging Markets	2.59%	10.05%	9.94%	5.61%
REITs	3.50%	5.96%	9.05%	4.55%
Core Bonds	2.16%	2.16%	6.57%	2.88%
High Yield	8.18%	8.18%	8.02%	4.05%

* Weighted average using 40% earnings yield, 30% historic return and 30% historic risk premium + RF rate

**Annualized 28 Yr return

***Hist. risk premium of domestic and international equity as defined by Zyphyr Style Advisor's GFD Long Term Index database except for REITs and High Yield which are based on average 20 year rolling returns of the NAREIT Equity REIT Index and the Barclays Corporate High Yield Index minus the average 20 year rolling returns of the 3-month T-Bill and scaled using proprietary data. The Current 3-month T-Bill yield (as of 03-31-2016) is added back to each risk premium.

SELECTED INDEX RETURNS - PERIODS ENDING March 31, 2016

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
US EQUITIES						
Broad Stock Market - Russell 3000	0.97%	0.97%	-0.34%	11.15%	11.01%	6.90%
Large Stocks - S&P 500	1.35%	1.35%	1.78%	11.82%	11.58%	7.01%
Dow Jones Industrial Average	2.20%	2.20%	2.08%	9.29%	10.27%	7.54%
Medium-Size Stocks - Russell Mid-Cap	2.24%	2.24%	-4.04%	10.45%	10.30%	7.45%
Small Stocks - Russell 2000	-1.52%	-1.52%	-9.76%	6.84%	7.20%	5.26%
Small Value Stocks- Russell 2000 Value	1.70%	1.70%	-7.72%	5.73%	6.66%	4.42%
Small Growth Stocks- Russell 2000 Growth	-4.68%	-4.68%	-11.84%	7.91%	7.70%	6.00%
Large Value Stocks - Russell 1000 Value	1.64%	1.64%	-1.54%	9.38%	10.25%	5.72%
Large Growth Stocks - Russell 1000 Growth	0.74%	0.74%	2.52%	13.61%	12.38%	8.28%
US FIXED INCOME						
1-3 Yr Treasury (Gov't) Bonds - Barclays Capital	0.90%	0.90%	0.92%	0.78%	0.88%	2.49%
US Government Bonds Int - Barclays Capital	2.28%	2.28%	2.21%	1.52%	2.48%	3.97%
US Corporate Inv Grade Bonds - Barclays Capital	3.97%	3.97%	0.92%	3.03%	5.17%	5.82%
Government/Credit (Corp) Bonds - Barclays Capital	3.47%	3.47%	1.75%	2.42%	4.04%	4.93%
Int Govt/Credit (Corp) Bond - Barclays Capital	2.45%	2.45%	2.06%	1.83%	3.01%	4.34%
US Aggregate Bond Market - Barclays Capital	3.03%	3.03%	1.96%	2.50%	3.78%	4.90%
Mortgage Master - Merrill Lynch	1.95%	1.95%	2.41%	2.68%	3.22%	4.86%
US Corp High Yield Bonds - Barclays Capital	3.35%	3.35%	-3.69%	1.84%	4.93%	7.01%
INTERNATIONAL (Measured in US Dollars)						
Non-US Stocks - MSCI EAFE	-2.88%	-2.88%	-7.87%	2.68%	2.76%	2.27%
World Stocks (includes US) - MSCI World	-0.19%	-0.19%	-2.90%	7.41%	7.12%	4.86%
European Stocks - MSCI Europe	-2.37%	-2.37%	-7.96%	3.27%	2.67%	2.65%
Japanese Stocks - MSCI Japan	-6.38%	-6.38%	-6.75%	4.14%	4.28%	-0.24%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	1.84%	1.84%	-9.53%	-2.82%	0.81%	5.94%
Chinese Stocks - MSCI China	-4.80%	-4.80%	-18.66%	1.21%	-0.64%	7.65%
Indian Stocks - MSCI India	-2.50%	-2.50%	-13.15%	3.82%	-1.88%	4.90%
Emerging Markets - MSCI EM	5.75%	5.75%	-11.70%	-4.15%	-3.80%	3.34%
Int'l Gov't Bonds -Citi World Gov't Bond (Non USD)	9.10%	9.10%	7.74%	-0.16%	0.24%	3.97%
REAL ESTATE						
FTSE NAREIT Equity-Reits Index	6.00%	6.00%	4.43%	10.47%	11.89%	6.56%
SHORT TERM INTEREST RATES						
T-Bills	0.05%	0.05%	0.08%	0.05%	0.06%	1.07%

Note: Returns for periods longer than 12 months are annualized.