Financial Services Advisory
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# Brexit Casts Further Doubt on Global Strength

**Second Quarter Market Review from Your Portfolio Management Team—July 9, 2016**

The decision by the majority of British voters to leave the European Union (EU) caught most observers by surprise, sending global stock markets plummeting in late June as investors tried to digest how this event could impact the global economy in the months and years ahead. In addition, what does this vote mean for the whole notion of global trade? Even in the U.S., the notion of the value of global trade has come under criticism on the campaign trail.

However, after falling over 5% on the news of the Brexit, stocks managed to recoup much of the loss by month-end by rallying almost 4%. At the end of the late month fireworks, stocks in the U.S. finished up slightly for the quarter, with foreign stocks down slightly. Overall, we remain in the landing that we have discussed ad nauseum over the past year or so.

Since we watch the markets (and your accounts) on a daily basis, as you might expect, we were following the markets closely in the aftermath of the Brexit vote. In fact, we made a few small trades in our more aggressive strategies (Core Equity and Tactical Growth) to trim back our equity allocation in those strategies. Since markets have since rebounded, and we remain in a trading range, there has been no need to trade the other strategies and no need to do any further trimming in Core Equity and Tactical Growth.

| *Index* | *YTD* |
|---|---|
| Dow Jones 30 | 4.3% |
| S&P 500 Index | 3.8% |
| EAFE | -4.4% |
| Barclays Bond | 5.3% |
| 90-Day T-bills | 0.1% |

Source: Eaton Vance Market Monitor
Note: EAFE represents the MSCI index of foreign stocks; Dow Jones 30 represents the Dow Jones Industrial Average; Barclays Bond represents the Barclays Capital Aggregate Bond Index.

## Outlook for the Second Half of the Year

Stock and bond markets around the world continue to struggle with a number of issues (with Brexit being the most recent bump in the road), which explains why there is not enough enthusiasm for stocks to rally to new highs, nor enough pessimism to push stocks into a sustained downtrend.

Across the FSA strategies, we pulled the money market allocation down considerably in the second quarter. Now that does not necessarily mean that we are very optimistic about the general stock market. In some cases we invested that money in bond funds, which are in a relatively positive uptrend. In other cases, we have sought to invest in certain sub-sectors of the broader market that have exhibited healthier uptrends—such as equity income funds.

With investors still trying to digest the impact of Great Britain leaving the EU, along with the upcoming earnings season—which will kick off next week—there are plenty of opportunities for markets to continue moving back and forth. A usual, we will be very sensitive to any serious breakdown in the global markets, while continuing to look for good opportunities that might be available (but not so obvious to most investors).

**<u>Portfolio Review</u>**

Below we review the six broad strategies that FSA manages. Keep in mind that your specific portfolio may differ to some degree from the averages, as our portfolios are individually managed.

**Income (Strategy 1)**

Bonds continue to confound the experts by doing relatively well, so any strategy that holds a high percentage in this asset class has managed to post gains and avoid much of the turmoil. And that describes the Income Strategy, which currently holds an eclectic mix of high quality bond funds, along with high yield, emerging markets and floating rate funds. The money market allocation is below 10%.

**Income & Growth (Strategy 2)**

As the overall market environment calmed down in the second quarter, we took the opportunity to reduce the money market allocation to roughly 10%, by adding to our conservative equity income funds, as well as to our bond fund positions. This included the addition of a floating rate fund, which is a short-term fund that tends to do well if interest rates are rising.

**Conservative Growth (Strategy 3)**

The turmoil around Brexit had little impact on these accounts, as their combination of bonds and equity income funds were well positioned to dampen the recent volatility. Earlier in the quarter we sold the managed futures funds as they broke through the FSA Safety Nets®. In addition, we added to our overall equity income funds as well as high yield and floating rate bond funds. Currently, these portfolios hold about 5% in money market funds.

**Core Equity (Strategy 4)**
As markets calmed down during the second quarter, we continued to increase our invested position by adding to our broad equity income funds as well as several sector funds, including Industrials, Infrastructure, and MLPs (Master Limited Partnerships—a type of energy play). In addition, we continue to hold the Consumer Staples sector fund, which has performed quite well this year. At this time, the money market allocation in these accounts is 30% - 35%, while we wait for the stock market to break out of its landing.

**Tactical Growth (Strategy 5)**
The mix of stock and bond holdings in this strategy has seemed to be the right fit for this type of market. During the quarter, we added a small energy sector fund to some accounts, while other accounts were invested in a small silver position. We also increased the Basic Materials position and added a small emerging markets equity position. Finally, in some accounts we added a natural gas position. Overall, these accounts hold less than 15% in money markets.

**Sector Rotation (Strategy 6)**
The newest strategy within the FSA line-up was mostly in money market funds at the beginning of the quarter and got the 'all-clear' signal in early May. During the June rotation, the portfolio held two financial funds, along with Industrials, Basic Materials, Real Estate, and Energy. For the July rotation, we sold the two financial funds, as well as the Industrials fund, while adding a second energy fund, along with Consumer Staples, and Health Care. Currently, the portfolio is exhibiting a two-pronged investment stance, with half of the portfolio in sectors that will benefit from inflation, with the other half in more defensive sectors. Obviously, this portfolio is reflecting the schizophrenic nature of the stock market today.

Please remember to let us know about any changes taking place in your lives that could have an impact on your investment objective, and if you wish to talk before our next review.

**Note:** Your quarterly billing statement will be available for viewing next week in the FSA Vault. As a reminder, given that Schwab includes our management fee on the monthly statement and also on your year-end tax summary, we will be discontinuing our billing notices; however, we will still add them to the FSA Vault each calendar quarter.

FSA Investment Team

Please remember to contact Financial Services Advisory, Inc., **in writing**, if there are any changes in your personal/financial situation or investment objectives for the purpose of reevaluating our previous recommendations and services. A copy of the Financial Services Advisory, Inc.'s current written disclosure statement discussing our advisory services and fees continues to remain available upon request. For further details, please see important disclosures at www.FSAinvest.com/disclosure.