Financial Services Advisory
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March Madness Comes to an End

First Quarter Market Review from Your Portfolio Management Team—April 8, 2016

The annual national distraction that is the NCAA basketball tournament ended on a game-winning shot last week that will no doubt go down as one of the most thrilling in history. Every year, basketball fans are treated to a wild and furious two-week period full of upsets and last minute heroics.

We could probably make a similar claim when reviewing the stock markets over the past quarter—it was madness. Stocks rolled over in January, falling over 10% by mid-February, before mounting a furious comeback, to essentially 'tie the game' by quarter end. U.S. stocks finished the quarter up little changed, while foreign stocks were down slightly.

What fueled this helter-skelter environment, one that resembled the back and forth of a college basketball game? For one thing, oil prices rebounded, from roughly $25 to nearly $40. Over the past year and a half, oil prices have tumbled from over $100 down to $25, which had many investors fretting that these falling prices could be signaling a global slowdown (or maybe even a recession). As a result, as oil prices rebounded this past quarter, it provided hope that the global economy is okay.

Also, with the exception of the U.S. Federal Reserve, other central banks remain in expansionary mode, continuing to flood their monetary systems with money to boost economic activity. Nevertheless, even in the U.S., the Federal Reserve indicated last month that it will probably slow down its prior intended course of increasing interest rates. This news gave the markets (both stock and bond) a lift as it suggested that the Fed will not be adopting a more restrictive monetary policy this year.

Finally, the U.S. economy continues to add jobs, which suggests the underlying economy is growing just fine. On the other hand, some recent economic numbers suggest that first quarter GDP might only be 1.5% or so (similar to the Q4 result). If that turns out to be true, that would increase the risk that our economy could be in danger of slipping into recession within the next year or so.

Is it any wonder that the stock market activity this year has been so frenetic?

<u>Looking Ahead</u>

Stocks have been in this sideways landing for over a year (and it must seem like we mention that fact in every one of these updates). We see these types of environments (stalled prices) from time to time, including 2011, 2007, 2005, 2000, and 1994. This period has been particularly difficult because there has been no asset class that has offered much help in generating returns. All of the major asset classes have been choppy, if not in a downtrend.

For FSA, that means we are spending a lot of time playing defense, which means building up our money market position to prevent a small loss from becoming a big loss. Then as stocks rebound, we redeploy some of that cash to catch some of the rebound. We want to remain in sync with the major trend, but that is difficult to do when the trend remains muddled.

We are going to continue looking for areas of the market that are developing into a positive trend and move money to that area. While you may see the trading activity pick up, we will not forget our primary job, which is to protect the portfolios from serious drops. On the other hand, we also remember that the long-term goal is to grow the portfolios over time. The overall market environment is making that goal difficult right now, but we want to be ready when the environment shifts into a more favorable outlook.

<u>Portfolio Review</u>

Below we review the five 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)

As often happens during turbulent periods, bonds provided somewhat of a safe haven for investors. As investors got more comfortable with risk in the second half of the quarter, we added a high yield bond fund and an emerging markets bond fund to the portfolios.

Income & Growth (Strategy 2)

This conservative strategy managed the volatility of the first quarter pretty well thanks to a healthy allocation to bonds. Municipal bonds were a bright spot in an otherwise lackluster quarter. As stocks rebounded in the second half of the quarter, we increased our stock allocation from 15% to 25%, as well as adding a high yield bond position, which has also recovered along with stocks. Even with these moves during the quarter, Income & Growth portfolios carry a healthy 40% - 45% in money markets, which we are comfortable holding during this choppy environment.

Conservative Growth (Strategy 3)

Our flagship strategy also managed to hold up pretty well in the first quarter with a combination of relatively high bond allocation (currently at 45%), as well as a stock allocation consisting of more conservative dividend-oriented funds. We also have a managed futures fund in the portfolios which has acted as a hedge during the recent market downdrafts. During the quarter we added a conservative fund that holds gold and silver, among other assets, as well as a high yield bond fund. Currently, these portfolios hold roughly 25% in money market funds.

Core Equity (Strategy 4)
As an all-equity strategy, Core Equity should struggle during choppy markets with high volatility; nevertheless, the accounts managed to hold up reasonably well. At the low levels in early February, we had built the money market position to 65% - 75%. Then as stocks mounted a rebound during the second half of the quarter, we began to redeploy some of that money back into stock funds. At quarter end, we held 40% - 45% in stock funds, with 55% - 60% in money markets.

Tactical Growth (Strategy 5)
Our most nimble strategy managed through the challenging first quarter reasonably well thanks to an eclectic mix of bond funds, sector funds, and lower volatility diversified stock funds. From a defensive position in the first half of the quarter, we began to move money back into stock funds as stocks rebounded in the second half of the quarter. Currently, this strategy holds 45% in stock funds, 20% in bond funds, with 35% in money markets.

Sector Rotation (Strategy 6)
This new strategy within the FSA's line-up is designed to stay invested longer, even though there is an exit strategy if there is enough weakness. Well, that exit signal was generated in mid-February when stocks were falling. At this point, the portfolio is primarily invested in money market, with a small allocation to an inverse S&P 500 index fund (a fund that will move in an opposite direction as the broad stock market). This move prevented these portfolios from participating in the March rally, but at this point, the Sector Rotation is in its most defensive position. If the rally continues in April, eventually, this strategy will get a signal to move to fully invested again.

Note: Your quarterly billing statement will be available for viewing next week in the FSA vault. 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.

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. We do our best work when we work together.

FSA Investment Team

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