ACCESS | WEALTH MANAGEMENT

October 2016

3rd Quarter 2016 Commentary

Technology update:

If you recall, in early Q1 of this year, we announced some of the advancements in technology we were implementing to better serve and communicate with you - our clients. The most interactive piece of technology we have adopted is the Black Diamond portfolio reporting software. This product allows you to access your portfolio on your desktop or mobile device 24 hours a day / 7 days a week. Upon signing in, you are able to see and review your portfolio allocation, your performance both year to date and since inception, your annual projected income, and your account activity summary. This tool also allows us to electronically share with you your quarterly reports, manager commentary and communication specific to your investment accounts, and other important documents. This system also keeps an electronic “library” of these documents for you to reference down the road. For those clients who are not using this tool, we would encourage you to contact a member of our team to request assistance in getting your account set up so that you can begin taking advantage of this valuable service to view transparent, straight forward information about your portfolio – and to be able to view it at your convenience.

Gearing up for the fourth quarter

Sports fans know that the fourth quarter is often when much of the game-deciding action occurs, and that may be the case for the stock market this year. The Federal Reserve has pushed the possibility of a rate hike this year into the final quarter; the long-awaited return to positive earnings growth may or may not be in store this quarter; economic data needs to show signs of bouncing back; and then of course there’s the U.S. election. Any or all of these could have a substantial impact on stocks. Add in a historical tendency for some pretty nasty October surprises, and the potential for an increase in volatility persists.

We continue to believe the secular bull market which began in 2009 is ongoing, but that we’re in the “late innings” to stick with the sports theme and that we are likely to see some discomforting bumps along the way. Timing these pullbacks correctly is extremely difficult and we urge our clients not to try. Instead, stick with your long-term asset allocations and view pullbacks as a chance to add to positions as needed. If the risks are causing you to lose sleep, we suggest looking into potential hedging strategies, which could cost you some money to implement, but may also provide you with some peace of mind and keep you from making a bigger investing mistake.

Here are a few key things that we will be watching as we head into the Fourth Quarter:

- **Earnings take the ball:** After five consecutive quarters of declining corporate earnings, the coming reporting season could prove to be important to the near-term state of the bull market. With valuations at least modestly elevated by most measures, earnings need to start to carry the weight if this bull market is to advance. Earlier this year, analysts were expecting the third quarter to see earnings growth move back into positive territory according to Bloomberg; but recent downgrades have resulted in a consensus of still-negative growth. The collapse in the oil market is now in the rear-view mirror, which should help to solidify both the energy and basic materials sectors’ earnings growth rates. If earnings do disappoint, we believe the market is vulnerable.

- **The Federal Reserve remains the quarterback:** The second most asked question we get these days is: "When will the Federal Reserve raise interest rates again?" The most recent Federal Open Market Committee (FOMC) meeting boosted expectations that a rate hike is likely before the end of the year; contingent on economic data remaining decent in the coming months. More of the FOMC's voting body is leaning toward raising rates and the "running out the clock" strategy we are seeing from the Fed will likely add to the potential increase in volatility in the fourth quarter.

- **U.S. Elections:** As we wrote in our Q2 Market Commentary the election continues to be in focus, with two relatively unpopular candidates. This leads us to the most-asked question we receive: "How will the U.S. presidential election turn out and what will it mean?" While many investors are rolling their eyes when even thinking about the election, we want to remind folks that the United States has proven to be able to weather many storms and leaders of all stripes, conservative and liberal, strong and weak, popular and not, and we have little doubt the same will be the case this time around. But it's an "open election"—with no incumbent running—and those have historically brought choppier market action and we certainly expect volatility to remain elevated.

- **Passive vs. Active:** It's difficult to quantify, but we (and many other's) suspect the current massive push towards indexing remains one of the primary drivers behind the market's relentless drive to new highs. In fact, Steve Bregman of Horizon Kinetics takes it a step further and argues that ETFs have become the most crowded trade in history. That's quite a statement. Bregman argues that the ETF industry has created a massive systemic risk to everyone who believes they are well-diversified. Since 2007, there has been an exodus from actively managed funds and a march into passively managed indexed equity funds and ETFs. More than $1.1 trillion has moved into indexed equities. In 2005, there were only 204 ETFs. By 2015, that number had increased to 1,594 even as the number of listed stocks *declined*. Bregman questions if we really know what will happen when there is net-selling in the index ETF sector? Is there really enough underlying liquidity? If one looks back to the bursting of the technology bubble, the lack of liquidity led to the implosion of many of the technology companies in the NASDAQ index. We certainly don't like the idea of being passively linked to "the market" as we approach 8 straight up years in the S&P 500 and are near all-time highs.

So what?

We believe long-term investors should remain committed to a diversified portfolio which may include exposure to U.S. and non-U.S. trade sensitive stocks. We see upside to global economic growth prospects but also greater market volatility ahead. This comes after a summer lull, record highs for U.S. equities and a rebound in emerging market assets. We expect the U.S. Federal Reserve to press on with slow interest rate increases while other major central banks start to approach limits of their easy policies. We are allocating to active managers, and we especially like managers who have a history of using cash positions wisely. That's where our focus will remain as we approach year end.

Respectfully,

Anthony L. Christensen

President