STILL MUDDLING THROUGH

The S&P 500 Index's 1.35% return for the first quarter of 2016 was attained in a somewhat unsettling fashion. The year opened on a demonstrably negative tone as fears of a slowing global economic environment took hold. The Federal Reserve as well embarked upon its interest rate normalization policy path on December 16, 2015, with a stated intent on raising rates four more times during 2016. With markets already in a cautious state due to weakening growth here and abroad, fears of a possible policy mistake by the Fed drove the S&P 500 Index down almost 10% early in the year through February 11th. Since that point, the market staged a powerful rally into quarter end.

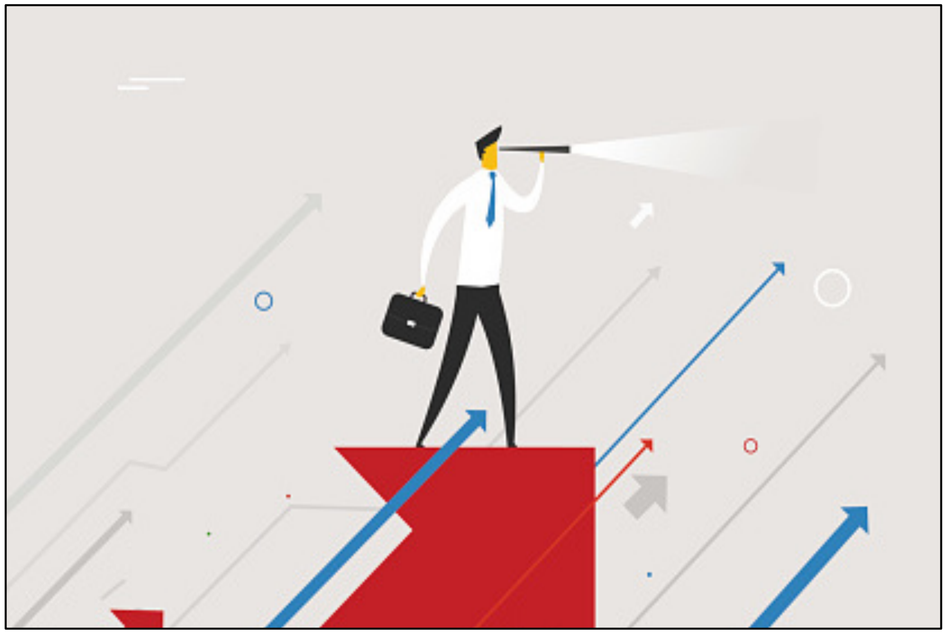
Why the abrupt change in market direction intra-quarter? At the end of the Federal Reserve's regularly scheduled January meeting, Fed Chair Janet Yellen unexpectedly signaled a slowing in the pace of its interest rate normalization policy if not altogether abandonment for the time being. This change in direction was a direct result of weakening domestic economic activity, the knock-on effects of a slowing Chinese economy and the sharp decline in asset prices. Further, in her February 10th testimony to Congress, Ms. Yellen reiterated this new policy stance. With this reiteration, the market got the message that, at least for now, the four rate hikes intended for 2016 were tabled and thus began its impressive rally into quarter end. Given our view for continued sub-par global economic growth and the fact that competing 10-year sovereign bond yields such as those from Germany are currently yielding 0.08%, we believe that the Fed will be on its hiatus for some time to come.

The dispersion of sector returns during the quarter was fairly wide. Healthcare was the worst performing sector logging a negative 5.50% return for the quarter. The sector struggled under the weight of heightened presidential candidate rhetoric concerning pharmaceutical pricing and government policy risk. The Financial sector logged a negative 5.06% return as a persistently flat yield curve weighed on earnings power potential as well as the growing burden of a deteriorating energy sector credit outlook. All other sectors exhibited positive returns with the Telecommunications (+16.61%) and Utilities (+15.56) sectors leading the way as investors seemingly chased the perceived safety and relatively high current yields offered there.

Interestingly, what has been overlooked in the discussion is the fact that the S&P 500 Index has yet to attain a new closing high price since May 2015. This 10-month long consolidation is the longest such stretch since 2009. Over the last 50 years, there have been 11 such periods where price movement stagnated for more than 210 days. Ominously, eight of these instances occurred during bear markets and three eventually proved to be periods of consolidation before the market went on to new closing highs. With first quarter earnings reporting season upon us, management dialog accompanying their official quarterly reports will go a long way in resolving the ultimate direction our markets take from here.

2015 proved to be a difficult year in which to generate positive earnings growth as evidenced by the lack of earnings growth exhibited by the S&P 500 Index in aggregate, (2014 $117.69 vs. 2015 $117.58). We have noted in previous pieces that the largest negative influences on profit growth have been the sharp collapse in oil prices and attendant decline in energy sector earnings, the impact of strong dollar appreciation on multinational company earnings and a difficult earnings environment for financials due to little or no movement in the Fed Funds rate resulting in a rather flat yield curve.

Expectations for a reacceleration in earnings growth this year have been met with disappointment. This is due to a number of things including the fact that the expected rebound in oil prices has not materialized. This realization has put further pressure on overall earnings growth for the S&P 500 as an eventual recovery in energy sector earnings growth has been pushed out to 2017. As well, the forecast rebound in financial sector earnings has been reigned in as the expected benefit of a steeper yield curve from the Fed's rate normalization policy has been delayed. It is of little wonder then, with no growth in earnings in 2015 and now a lowered forecast pace of growth for 2016, that the stock market has shown little, if any, propensity to make any upward progress. On a positive note, when the Energy and Financial sectors are excluded from the earnings growth calculation for the S&P 500, we find that the balance of the index is forecast to generate almost 6% earnings growth in 2016. As a result, we believe that there is an opportunity for investors to generate positive total returns for 2016 depending upon sector allocation and security selection.



We expect 2016 to be another challenging, though likely positive year for returns as a number of crosscurrents buffet the financial markets and the economy.

Indeed corporations have managed through this "muddling" economic backdrop, producing solid profit margins and greatly improved balance sheets since 2009 along with higher dividend payments to shareholders. That being said, increases in dividend payments have slowed during the first quarter of 2016. Overall, net dividend increases totaled $3.9B during the first quarter compared to the $12.6B increase exhibited during last year's first quarter. Much of this slowdown can be attributed to the lack of earnings growth broadly and the pressure that low oil prices have placed on energy sector earnings specifically. Based upon the pace with which dividend payments have increased during the first quarter, we expect 2016 to set another record high in total dividends paid to shareholders.

At the risk of sounding like a broken record, we expect 2016 to be another challenging, though likely positive year for returns as a number of crosscurrents buffet the financial markets and the economy. Current S&P 500 2016 earnings estimates hover around $120 per share, implying year-over-year growth of 1% to 2% and a price-to-earnings multiple of 17X. On balance, we do not view valuation as a major threat unless earnings do not come through as projected.

In closing, with 2016 being a presidential election year, we could not end this piece without some comment. Both parties will be holding their respective nominating conventions in a very short three and a half months this July. At this late stage of the process, both parties are finding it difficult acquiescing around one particular candidate. As such, we expect the market to have knee-jerk reactions to candidates' comments from time to time as they attempt to bolster their respective bases. We expect that this will likely lead to increased market volatility in the shortrun with the potential of shifting investor focus away from what matters most: The fundamentals.