Making Sense of Finance

Karagosian Financial Services 4/15/2016 Volume 19, Issue 2

First Quarter 2016 Review

STOCK MARKET

After a strong fourth quarter in 2015, the U.S. stock market began the year with a broad based sell-off. January started off 2016 with a decline of 5.1% in the S & P 500 index. However, by mid - February, the market staged a sizable rally and the index managed to finish the first quarter with a gain of 0.8%. The Dow Jones Industrial Average also posted a gain of 1.5% while the Nasdaq Composite lost ground in the quarter with a decrease of 2.8%, marking its first negative quarter since 2009.

The Federal Reserve having raised interest rates in December for the first time in years caused some unfounded fretting in the market. Also, worries about weak global demand for oil accompanied by continuing increases in supply drove down oil prices early on this year; this at a time when stock and oil prices appeared to be highly correlated. Oil then rallied along with stocks in March (up 13% and 7% respectively). This correlation has no historical precedence, and appears to have become more of the norm only since last summer, even though lower fuel and energy costs should benefit most companies and consumers. As mentioned in the last newsletter, it looks as though energy stocks have found a bottom, and as a whole had positive returns in the first quarter. But by far the best performing sector was precious metal mining stocks as the price of gold increased 16% last quarter. Other top performing sectors in the first quarter of 2016 were utilities (investors strived for the higher yield of utility stocks as bond yields came down), consumer staples and industrial companies. Financial stocks and healthcare stocks as a group declined last quarter. Financials are continuing to feel the negative effect on their earnings from the current low interest rate environment; while healthcare stocks (in particular biotech) were hurt by the political rhetoric surrounding drug pricing in the United States.

Equity markets outside of the U.S. were mixed in the first quarter. On a local currency basis, Canada and some emerging markets (for example Brazil, Mexico) outperformed our market. Canada also performed very well in U.S. dollar terms, as the Canadian dollar was the strongest currency in the quarter gaining almost 7% versus the U.S. dollar. (The Canadian economy is resource driven and a possible bottom in commodity prices may have helped drive the currency appreciation). Japan's stock market, measured in its local currency, performed very poorly last quarter; the Nikkei

Making Sense of Finance

Everyone and their neighbor has an opinion. At Karagosian Financial Services, we have a combined 40 plus years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is geared toward making sensible and prudent choices based on logic and experience, and not based on emotion.

Contributors:

Seaver T. Wang

Christine Terry

315 Fifth Avenue 704B

New York, NY 10016

www.toinvest.com

Representatives are registered through, and securities are sold through Nationwide Planning, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Insurance sold through licensed Nationwide Planning, Inc. Nationwide Planning, Inc. and Karagosian Financial Services are non-affiliated entities.

225 dropped 12%. However, in U.S. dollar terms many Japanese stocks gained due to the appreciation of the yen. However, this yen appreciation has hurt Japanese exporter stocks, as the perception is they cannot compete as well as they had in the past. Chinese stocks were also big losers in the quarter, given concerns about slowing of growth in the local economy.

BOND MARKET

Bonds reversed course in the first quarter of 2016 and gained back much of what they lost in the previous quarter. The Barclays Aggregate Bond Index which is a measure of various types of bonds in the U.S. had a total return of 3% in the first three months of 2016. This index gain is reflective of the broad based rally in the bond market as all categories finished in the black; and the longer the maturity the larger the return. In a flight to safety, the 10 year Treasury yield went from 2.27% at the end of 2015 to 1.78% at the end of the first quarter. (Bond prices increase as yields decrease).Even high yielding junk bonds, which are more dependent upon the health of the economy similar to stocks, stabilized and generated a positive return last quarter.

As expected, there was no increase in the Fed Fund target rate in the first quarter. The Federal Reserve suggested it may slow the pace of interest rate increases in 2016. Short term Treasuries barely moved in the first three months, thereby keeping money market rates extremely low. In other countries, the scenario is even worse for savers. Following in the European Central Bank's footsteps, in January the Bank of Japan set interest rates below 0%. This negative rate environment has caused some large financial institutions in Japan to stop accepting investments in money market funds and actually plan on closing the funds and returning the money to investors. This monetary policy is done with the intent of getting companies and consumers to spend more and hopefully grow their economy. Time will tell.

OUTLOOK

Last quarter, while stock prices fell off a cliff, we emphatically declared that we sensed an opportunity. Sure enough, stock prices have recovered nicely, and then some. In this instance, rational minds prevailed. While the natural sense is usually to cut and run, a contrarian view often prevails. How else can you hope to do better than average if one does the same as everyone else? Despite the roller coaster activity in the stock market over the past three months, we still think equities (stocks) are the place to be over the coming years. Let's look at the competition. Bond interest rates remain near record lows. A 10-year Treasury note yields 1.78%, but inflation today is about 2%, and historically, inflation is usually above 3%. While it may seem safe in the short term, an investor is actually losing money every year for the comfort of smaller swings in price. Publicly traded REITs (Real Estate Investment Trusts), are a good source of income, but with rising interest rates, (practically inevitable over the next ten years), this will put pressure on those shares, as well. Commodities have very long cycles and are too volatile to be a primary investment for individuals, in our opinion. For instance, it is often forgotten that gold (a good performer in 1Q) declined over 50% from 1980 to the year 2000. If you are cautious of stocks, then commodities are out of the question. How about hedge funds and private equity funds? Don't they avoid market swings and have superior returns? The simple answer is; those are investment vehicles NOT asset classes. A hedge fund usually buys and sells stocks just like a mutual fund, and they are often a "hedge" fund in name only. They DO charge 10x to 20x regular mutual fund and advisor fees though whether they do well or not. As for private equity, the reason there is less correlation with the stock market is because there is no market; ….that's why it's called private equity. Even mutual fund giant, Fidelity, has drunk the Kool-Aid, partaking in private equity deals with Snapchat, Zenefits, Blue Bottle Coffee and other speculative start-ups. The way these investments are priced is based on what the private equity fund or a committee decides its worth. No valuation method is given. I am not joking. They can price their investments based on what they think it is worth. Over the past year, Fidelity has written down the value of some of these investments by more than 50% in some cases, so this vehicle definitely is not immune to downturns. Finally, the reason stocks remain the best asset class, in our view, is because there exists a component of innovation and management control that other asset classes lack. Companies can raise prices, cut costs, or move to a more tax friendly region, etc. Without a doubt, stocks will remain volatile, but even if the returns are half of their historic norms (5% versus 10%), it is still multiples better than the alternative. And of course, investing is always about the long-term.

Representatives are registered through, and securities are sold through Nationwide Planning, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Insurance sold through licensed Nationwide Planning, Inc. Nationwide Planning, Inc. and Karagosian Financial Services are non-affiliated entities.