Making Sense of Finance

Karagosian Financial Services 10/15/2016 Volume 19, Issue 4

Third Quarter 2016 Review

STOCK MARKET

The market performed well in the third quarter of 2016 with all three major indices increasing. Most of the gains occurred early on in the quarter. With the upcoming presidential election drawing near, investors may now be acting a little tentative as U.S. markets closed out the quarter with scarcely any movement in September. For the most part, volatility continued to be subdued. The tech heavy Nasdaq Composite index that had been a laggard earlier this year had the largest return last quarter, 9.7%. In contrast the widely touted Dow Jones Industrial Average increased only 2.1% and the S & P 500 Index performed slightly better with a gain of 3.3% in the third quarter. At the end of the quarter, however, all three indices had respectable year-to-date gains of 5%-6%.

Technology by far was the leading sector last quarter. Financial stocks and oil & gas exploration stocks also performed better than the overall market during that time period. Bank earnings should benefit if interest rates rise gradually. And although the price of oil ($48.24) finished the quarter at a slightly lower price than the start of the quarter, hope for future oil price increases was put in place when OPEC leaders agreed to meet in November to establish a plan to cut production. The threat of an agreement is enough to raise oil prices at least temporarily which helps the energy producers. Lagging sectors were the traditional higher yielding stocks – telecommunications services, utilities, and real estate investment trusts, as rising interest rates make their dividend yields less competitive.

In contrast to the previous quarter, most foreign developed markets had larger gains than the U.S. market this quarter. Germany, Japan, Australia and Canada all had returns greater than our S & P 500 index. Problems at Deutsche Bank with the U.S. Dept. of Justice did not seem to affect companies outside of the financial industry in Germany. There is concern in the Japanese market regarding asset values since the government is buying equity in many companies, trying to combat deflation, but in turn causing assets to inflate artificially. This is a result of a prolonged negative interest rate environment. Most emerging market stock indices had impressive returns last quarter. In search of higher returns and yields, record inflows of money to emerging market funds has helped fuel this surge. Stock markets in Brazil, Russia and

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.

South Africa were among the beneficiaries of this increase in emerging market investment dollars.

BOND MARKET

The bond market was relatively calm during the third quarter. The Barclays Aggregate Bond Index (a measure of various investment grade domestic bonds) had a total return of only 0.4% in this last quarter. The yield on 10 Year Treasuries increased slightly from 1.49% to 1.60% at the end of September, though early in the quarter the 10 Year Treasury yield closed at a record low (bond prices rise as yields decline). Short term Treasuries yields had meager increases as well. High yielding non-investment grade bonds and emerging market bonds performed the best on a total return basis last quarter. Investors are still searching for yield in riskier assets given that the Federal Reserve, as expected, did not decide to increase the Fed Fund rate in September. Predictions are for a December increase in the Fed Fund rate but there is much that can happen in the market and political landscape in the interim that can affect that decision.

OUTLOOK

Not surprisingly, the focus has been on the Presidential election with many people questioning the markets. Our extensive studies have found that there are no clear signs that show any additional benefit between a Democrat or Republican President. However, for those that are not satisfied with that answer; the data suggests that a Democratic President and a Republican Congress has been the best combination for the stock market historically with the worst results coming from a President and Congress that are from the same party. We will leave the Presidential election predictions to you. That said, I am reminded of something I heard from Robert Gates (former Secretary of Defense) at a commencement speech I attended. Essentially, he said that people may be impatient at how slowly government works but that this is done purposely because quick changes can be too abrupt and dangerous. This has a dual meaning which is appropriate for investing. No matter whom the President will be economic growth or disaster will likely not come quickly due to a new President's election. Also, as an investor, it is very important to stay the course based on sound investment principles, and not jump in and out of the market based on hypothetical disasters that may never occur.

Little has really changed in the bond market over the past quarter with rates at historical lows, leaving little upside over the long term. Retirees who traditionally look for a dependable yield from these investments are suffering the most, in our opinion. While the stock market may shudder at the thought of a rate hike, this is inevitable, in our view, as zero or negative rates are unrealistic for long periods of time. We find the recent negative movements in the stock market perplexing when the suggestion of a rate hike occurs since that is usually a sign of stronger economic growth. After all, if the economy is growing faster, doesn't the need to borrow money decrease? Furthermore, anecdotal evidence suggests most companies and individuals have already refinanced at favorable rates and have stronger balance sheets than pre-2008 levels. On the fixed income side, the Fed's first rate hike since the great recession last December resulted in stable bond prices and record stock market levels, giving us hope that a gradual increase over the next several years does not have to end in disaster.

In recent newsletters, we've already suggested that there are no great bargains in any of the major asset classes (stocks, bonds and real estate), yet there is no reason to believe there will be a crash either. Without robust economic growth, we also do not see much upside as earnings per share in stocks are being boosted by stock buybacks and cost cutting rather than from growth. This will not last forever and may lead to increased risk over long periods of time. Real estate seems to have plateaued and as long as rates do not rise abruptly should stay stable. We have seen some softening at the very high end of the market, i.e. Russian and Chinese billionaires that purposely overpay for properties, though. As always, we do not try to predict markets or the economy but some positive events that could help spur economic growth might be, a lowering of the corporate tax (among the highest in the world) and the repatriation of up to $1 trillion in cash held overseas lying in limbo. These issues are favored by both Democrats and Republicans, but they remain at a standstill due to disagreements on the details. In addition, consumers are also building record amounts of cash which could be quickly reinvested. Greater volatility between now and the election would not be surprising, but we will remind you that we are long-term investors and strive to eliminate emotional decisions and that our diversified portfolios have already taken these volatility factors into account.

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.