Market Commentary

1st Quarter 2016

Economic Summary

The Stock Market

The stock market began 2016 in a downdraft. Through mid-February, the S&P was down almost 10%, as investor angst built on bad economic news out of China, Japan and Europe. Plunging commodity prices and the strong U.S. dollar caused credit stress in emerging economies and for many energy companies, which had borrowed heavily based on higher oil prices. The market decline was likely aggravated by the Federal Reserve's December decision to raise interest rates for the first time in nine years. However, stocks abruptly changed direction in February. Oil prices bottomed, and the Central Banks of Japan and Europe aggressively added liquidity. By quarter's end, the S&P 500 finished with a positive return of 1.35% (chart 1). Interestingly, it did this with no help from the "FATMAN" stocks (facebook, et al) mentioned in our year-end letter. Five of these six stocks, which provided the positive return for the S&P 500 Index last year, were down in the first quarter.

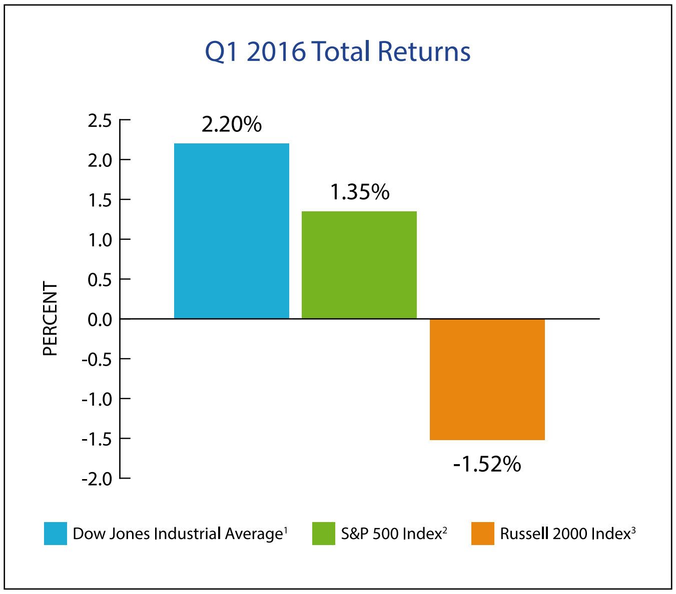

Chart 1

source: morningstar direct

The Bond Market

Globally, nearly 25% of all sovereign debt now carries negative yields due to repeated quantitative easing by the Central Banks in Europe and Japan. As mentioned, the Federal Reserve took a first step toward raising short rates by 25 basis points and indicated more raises were in store for 2016. Weakening growth in Asia and Europe and mixed signals in the U.S. have put further Fed actions on hold for now. The yield on the ten-year U.S. Treasury note declined from 2.2% at year-end to about

Past performance does not guarantee future results. You cannot invest directly in an index.

[1] The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.

[2] The S&P 500® Index is a capitalization weighted unmanaged index of 500 widely traded stocks, created by Standard & Poor's. The index is considered to represent the performance of the stock market in general.

[3] The Russell 2000® Index is an unmanaged index of the smallest 2,000 stocks in the Russell 3000® Index.

Economic Summary (CONTINUED)

1.7% as of this writing. The Consumer Price Index is up 2.3% for the last twelve months. So adjusted for inflation, the majority of U.S. sovereign debt now also offers a negative real yield.

The Economy

The global economy is sputtering, due to a stubborn recession in Japan, anemic growth in Europe and slowing growth in China, as the U.S. just putters along. Can the U.S. economic expansion continue? After all, it's been nearly seven years since the financial crisis ended. Yes, we believe it can. First quarter GDP was likely up less than 1%, but 2016 real growth is still targeted around 2%. This continues a pattern of very slow growth in this recovery. Since 2009, real U.S. GDP growth has averaged just 2.2%, well below the 3.1% post-war average (CHART 2). Zero productivity growth over the last few years compared to about 3% in normal recoveries has hurt overall growth. But that may be changing.

So far, there has been enough slack in the labor force that corporations had little incentive to spend aggressively on productivity-enhancing technology and machinery. But payroll employment has improved and is nearly 3% above pre-financial crisis levels (ALBEIT EIGHT YEARS LATER). The labor force participation rate is also improving (CHART 3). Unemployment has declined to 5%, which is essentially full employment. Workers' pay is beginning to improve (CHART 4), especially at the low end of the wage scale. California and New York are proposing to phase in a $15 minimum wage. Not a positive development for small businesses or wage earners! Worker productivity is now a key swing factor for the economy. Once corporate employee compensation begins rising as a share of corporate GDP, it usually keeps going through the rest of the business cycle.

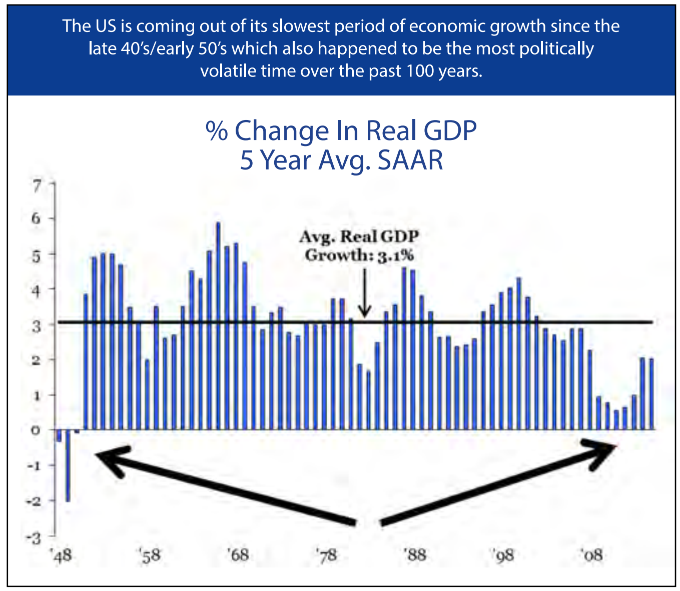

Chart 2

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS", APRIL 4, 2016

Chart 3

SOURCE: EVERCORE ISI
"ECONOMIC CHARTS OF THE MONTH", APRIL 7, 2016

Past performance does not guarantee future results.

Economic Summary (CONTINUED)

Wage pressures should encourage capital spending by businesses which has lagged during the current recovery. This spending will likely add another leg of growth to the economic expansion.

Corporate profits have declined the last three quarters and likely dropped 8% year-over-year in the first quarter. Much of that was felt in the energy and manufacturing sectors, as oil prices dropped by 70% from the 2014 peak and the dollar appreciated by 25% over the last two years. But there are changes in the air. The dollar has declined from its January peak and oil has rallied 40% since February, so we expect profit growth should resume in the second half of the year and possibly finish 2016 with a 5% improvement.

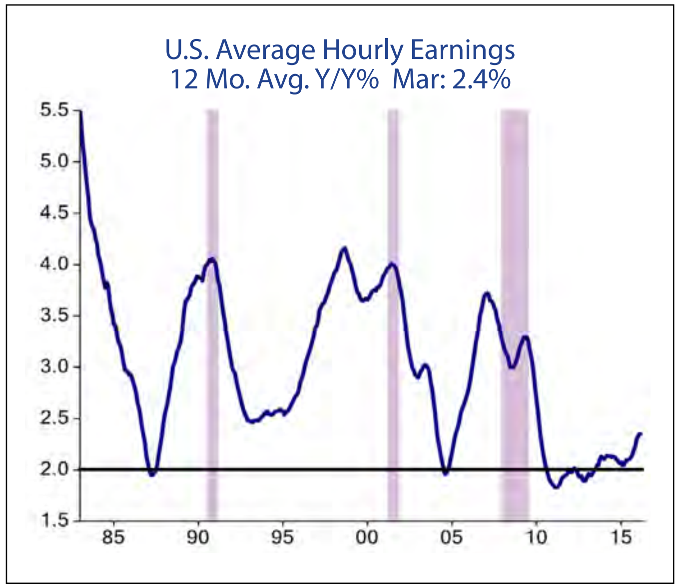

Chart 4

SOURCE: EVERCORE ISI
"DAILY ECONOMIC REPORT", APRIL 6, 2016

Politics

The heavy burdens of government regulations and anti-growth tax policies have penalized the economy. The 2016 elections may well be the most important in our lifetime, as they present a golden opportunity to reverse the many ill-conceived policies of the current administration.

With Bernie Sanders winning eight of the last nine state primary contests, his momentum continues to force Hillary Clinton's campaign rhetoric to the left. While she remains the overwhelming favorite to win the Democratic nomination, perhaps this shift makes her less appealing to independent voters in the general election. For the Republicans, it is looking more like a contested convention in July, so their nominee will not be known until then. In any event, after this fall's election, the political backdrop for the economy and the stock market will most likely be better in 2017 than that of the last eight years.

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