# Market Commentary

2ND QUARTER 2015

## Economic Summary


It is halfway through the year and the stock market as a whole doesn't have much to show for itself for the period (flat on most of the indices). Volatility has increased as the markets digest the past 5+ years of strong stock market returns (up over 200% on most indices). The economy continues to show signs of strength and may actually be improving. Wage growth is almost non-existent, energy prices have plummeted, and housing starts are starting to pick up. These developments could bode well for corporate profits in coming quarters.

The decline in oil prices has negatively impacted the earnings of energy companies. The drop in energy prices has also created buying opportunities in select, high-quality energy stocks. Many such companies are attractively priced and have long-term price appreciation potential from these levels. Additionally, what may not be priced into the market are the many positive effects in other industries associated with lower energy prices. Consumers should be beneficiaries of lower energy prices as will many industrial companies.

***The Fed Rate-Raising is now a Parlor Game***

While the Federal Reserve has yet to lift interest rates from zero, it might begin the process soon—*might!* Many Fed watchers now assume the first rate increase in September, but no one really knows. The Fed will likely proceed very cautiously and rates could remain low by historical standards indefinitely. With inflation running just under 2% currently, real interest rates will remain negative for quite some time. To quote our friend Jason Trennert from Strategas Research Partners, "If there has been one investment strategy that has 'worked' better than all others over the past few years it has simply been to take central bankers at their word." Rates will remain low until measures of inflation rise.

**Past performance does not guarantee future results.**

## Economic Summary (continued)

***Bush vs. Clinton Again?***

The 2016 Election is less than 16 months away. The Republican field of candidates is very long (chart 1) while the Democrats proceed with their apparent coronation of Hillary Clinton (chart 2).

Regardless of the final nominees, we hope the Republican prevails. After eight years of failed policies and poor leadership across the board, hopefully the electorate will be smart enough collectively to renounce the Socialism and regulatory overreach of the current administration. Not surprisingly, several Republican candidates have indicated they would shoot for a 4% growth rate vs. the pitiful 2% of the last 6½ years. To attain that rate of GDP growth, many economists believe 10 million more jobs would be needed. That can't happen unless national policies are changed to reward work. But today, even with an estimated 90 million Americans having dropped out of the work force, business leaders say they can't find willing workers. Perhaps today's youth (and many others) value leisure more than work, and if the American work ethic is gone, it's because government policies have crippled it.

The Dodd-Frank law is one specific example of legislators and regulators gone wild. Amazingly, there are still 145 rules to be written as part of this law passed in July, 2010 (chart 3, next page).

While the stock market performance has been good during Obama's reign (chart 4, next page), much of the credit deserves to go to a very accommodating Federal Reserve.

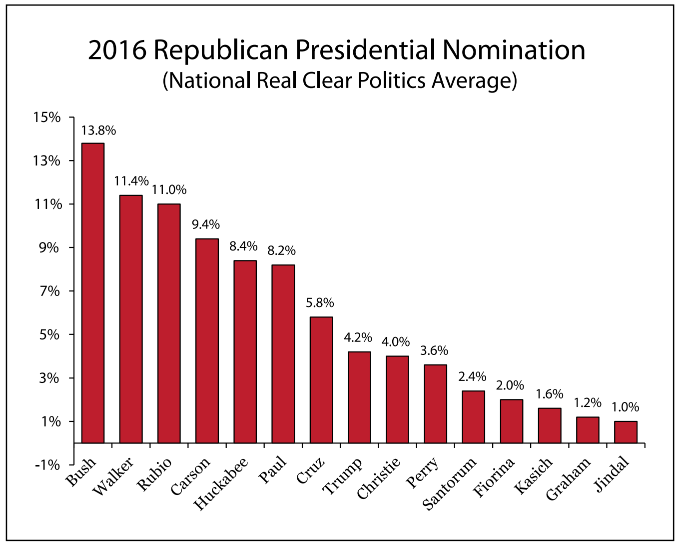


**Chart 1**

source: real clear politics

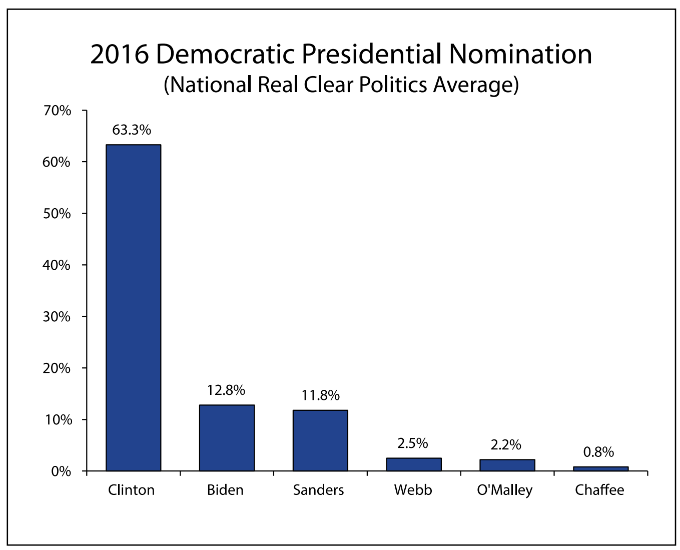


**Chart 2**

source: real clear politics

**Past performance does not guarantee future results.**

## Economic Summary (CONTINUED)

***Thoughts about Debt***

To state the obvious, too much debt can be crippling. General Motors and Chrysler found that out during their bankruptcies as did many financial services firms during the financial crisis. More recently, the City of Detroit was restructured during bankruptcy proceedings. Greece and Puerto Rico dominate the headlines now. A little closer to home, the city of Chicago and the state of Illinois are in terrible financial health. How much do Greece, Puerto Rico and Chicago affect our views on the market? Not much. We have no direct investments in the debt of any of them and the risk of contagion from them is minimal. The larger point to make, though, is that some governments and poorly managed companies routinely take on too much debt. Promises are made that cannot possibly be fulfilled. In the process, debts build that cannot be repaid without drastic cuts to the bondholders. With poorly-managed companies, the bankruptcy process usually wipes out the stockholders, while bondholders take a hit. For these reasons, we avoid purchasing securities of entities that are heavily indebted.

Instead, we have focused our portfolios on what we believe are high-quality companies with solid balance sheets and strong managements. Many portfolio holdings have the ability to consistently grow revenues, profits and dividends. Companies with excessive debt are eliminated from consideration. With too much debt, they are not in control of their own destiny. Similarly, when analyzing bonds, quality is paramount. In a low interest-rate environment, some investors are tempted to lower their credit standards or lengthen their maturities in search for yield. We believe this is an imprudent course. Because interest rates will eventually rise, we are keeping bond maturities short.

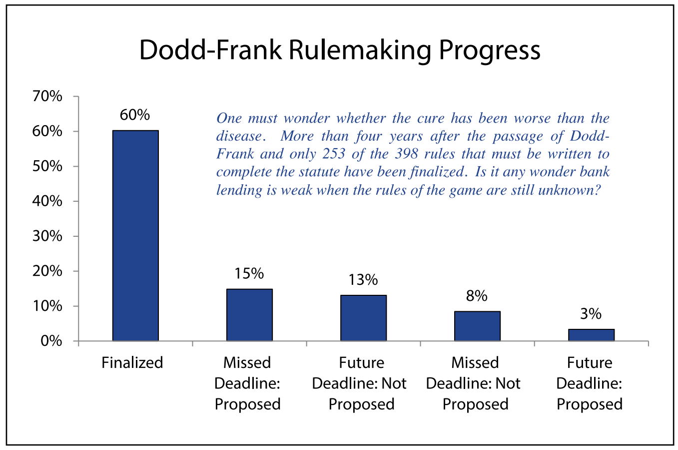


**Chart 3**

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS" JULY 1, 2015

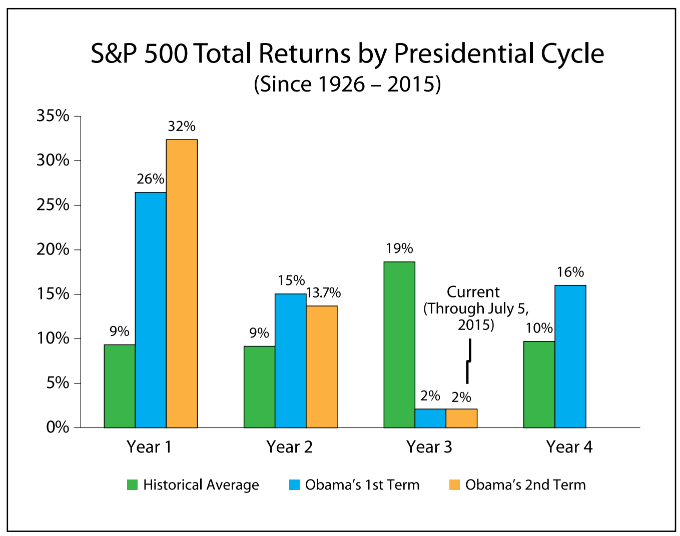


**Chart 4**

SOURCE: STRATEGAS RESEARCH PARTNERS
JULY 6, 2015

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

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