



Market Commentary

2ND QUARTER 2016

Economic Summary

The Stock Market

In stark contrast to the first quarter's wild market swings, in the second quarter, the U.S. stock market drifted quietly higher until late June, when the surprising decision by United Kingdom voters to exit the European Union (BREXIT) shocked investors worldwide. The S&P 500 Index dropped 5.5% in two days, but by month's end, recovered nearly all its losses. All told, the S&P 500 returned 2.46% for the quarter and 3.84% for the six months.

The positive return appeared driven more by lower interest rates than investor confidence in a stronger economy and rising earnings. Higher yielding defensive sectors like utilities, telecoms and consumer staples were among the market's best performers. June marks the 88th month of this bull market which is up 206% since it began in March, 2009. This is above average in both length and return, but follows the worst bear market since the depression, so more upside potential may remain.

The Bond Market

Last quarter, we commented that nearly 25% of all global sovereign debt carried negative yields due to easy monetary policies at central banks around the world. Amazingly, that portion has risen to 36% as of June 30th. Ten-year U.S. Treasury yields declined from 1.7% to 1.4% during the quarter. Chart 2 shows the combined balance sheets of the Federal Reserve, the European Central Bank and the Bank of Japan along with the average ten-year bond yield of their sovereign debt.

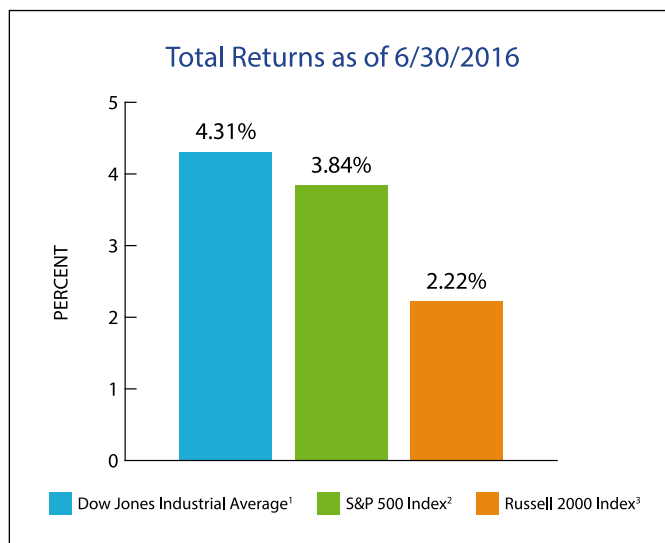


Chart 1

SOURCE: MORNINGSTAR DIRECT

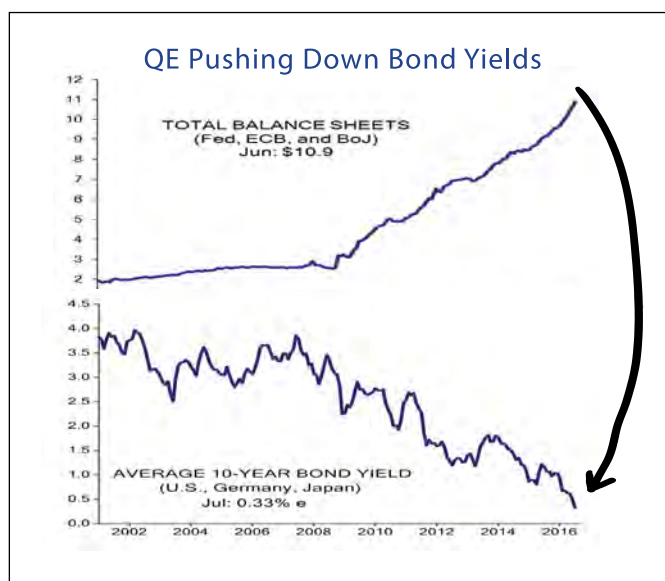


Chart 2

SOURCE: EVERCORE ISI

"DAILY ECONOMIC REPORT", JULY 6, 2016

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)

Since the financial crisis, their balance sheets have grown over 400% and yields have dropped 90%! The long-term effects of ultralow and negative interest rates are unknown. But we believe that monetary policy has reached its limits as a stimulus for economic growth. Ideally, the Fed should be normalizing interest rates at this point of the economic cycle. But particularly after Brexit, there likely will be only modest rate increases this year, if any.

The Economy

The U.S. economy muddles along and continues to be the workhorse for the global economy. As unemployment approaches historical cycle lows (CHART 3), employment growth has slowed but real wages have begun to rise. New and existing home sales are increasing. Low interest rates and improving household formations should support demand for homes and other consumer goods. One area of relative weakness in this recovery has been manufacturing, but the PMI (CHART 4) has turned noticeably stronger over the last few months. Oil prices have rebounded 80% off their lows, and energy companies are looking to increase their capital budgets. This should help growth in related industries. The global impact of Brexit is yet to be seen, but the U.S. is somewhat insulated, as Great Britain and the European Union account for less than 20% of our foreign trade. Economists we follow expect less than a quarter percent hit to our GDP growth in 2016 and 2017, leaving growth projections around 2%. Corporate operating profits, which have been declining over the last year, will likely begin rising in the second half if the U.S. dollar and energy prices stabilize.

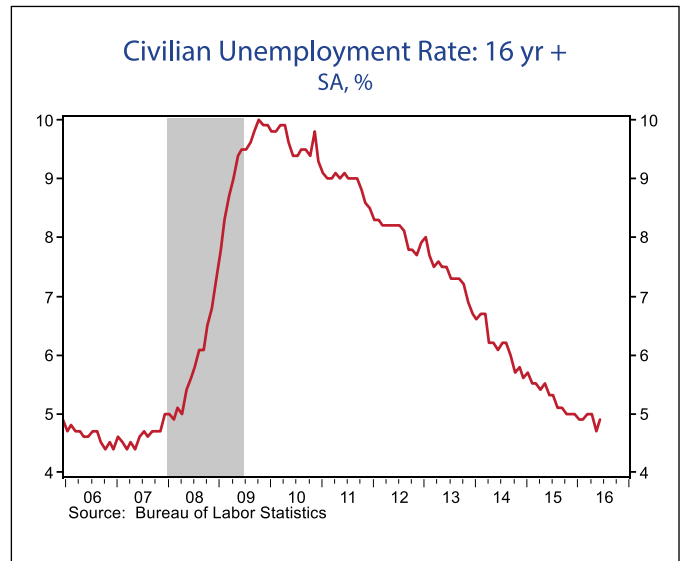


Chart 3

SOURCE: STRATEGAS RESEARCH PARTNERS
"ECONOMICS REPORT", JULY 8, 2016

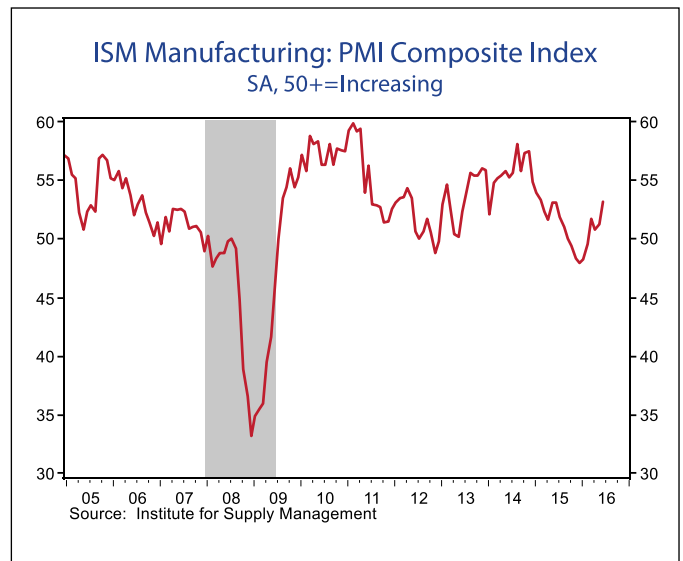


Chart 4

SOURCE: STRATEGAS RESEARCH PARTNERS
"ECONOMICS BALANCE SHEET", JULY 1, 2016

Past performance does not guarantee future results.

Economic Summary (CONTINUED)

Politics

America heads into the Republican and Democratic Party conventions this month with two of the least-liked candidates in history (CHART 5). The stakes are high. A Clinton victory could mean a Democratic majority in the Senate and eventually a liberal majority in the Supreme Court. Obama’s foreign and domestic policies would likely continue compounding the damage already done. Slowing global growth and the resulting rise of populism are worrisome and pose a threat to investors.

To be sure, these are confusing times with many negatives including Brexit, negative interest rates, Mideast instability, political uncertainties, terrorist attacks, global warming fears and protectionism, to name just a few. We contrarians argue that a good time to invest is when there are many negatives and most investors are bearish. Investors have pulled over \$85 billion out of equity mutual funds and ETFs this year versus \$66 billion in all of 2008! (CHART 6) This is certainly not a period of irrational exuberance for stocks!

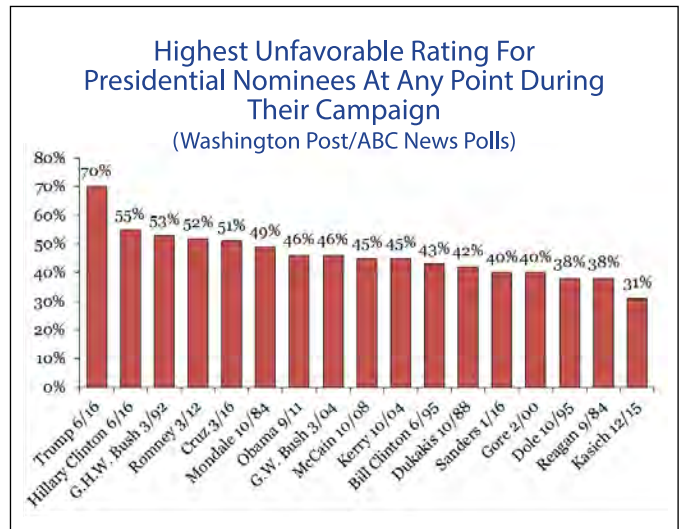


Chart 5

SOURCE: STRATEGAS RESEARCH PARTNERS
“QUARTERLY REVIEW IN CHARTS”, JULY 5, 2016

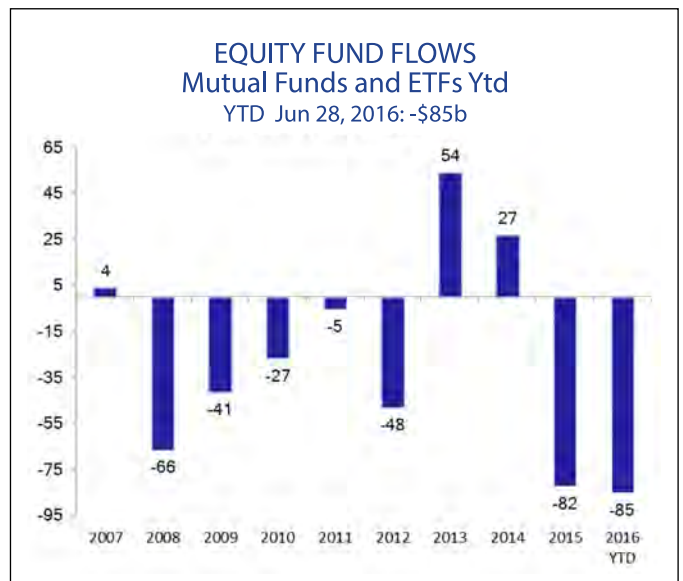


Chart 6

SOURCE: EVERCORE ISI
“DAILY ECONOMIC REPORT”, JULY 7, 2016

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2ND QUARTER 2016

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