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FINANCIAL

BIG CHANGES IN JUNE?

Market Review **June 2016**

May saw the price of oil creep back up above $50 per barrel. It didn't stay there long, but it has settled into a groove just a dollar or two lower. Global supply issues prompted this price increase. Nigeria, the largest producer in Africa, is dealing with rebel activity in the oil fields of its Niger delta and is at its lowest output in 20 years. Wildfires are burning through Alberta and holding down tar sands production by 20%. In the US, the active rig count continues to fall, as more and more producers are succumbing to the pressure of low prices. Meanwhile, the US is on track to beat its oil consumption record from 2007, as consumers guzzle cheap gasoline.

With the exception of the decline in US production, these are temporary production issues and should be under control within the next couple of months. Oil prices increased a few dollars and US crude oil inventories declined slightly in May, but it is unlikely that this is the start of a sustainable recovery in the price of oil. Iran is ramping up production, now that the embargo is lifted, and OPEC is unwilling to cut its output. Meanwhile, US producers would start to be profitable above $50 per barrel and might start drilling again. Investors would like to see oil priced closer to $65 per barrel, but that target is unlikely in the near term.

Investors are also watching the Federal Reserve closely. After last month's meeting of the Fed, investors seemed to be discounting the possibility of another interest rate hike. Recent comments from several board members, including Janet Yellen, indicate that the market is underestimating the Fed's willingness to raise rates soon. Yellen said that, if the US economy continues to improve, a rate hike could come as soon as June.

Unfortunately, the Fed will have some difficulty finding economic data to support a rate hike in June. It has relied heavily on jobs reports to justify its policy and the May jobs report was very disappointing. Released on June 3, it showed that the US economy added only 38,000, when the market expected a gain of 160,000 and the previous month saw an increase of 123,000.

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With uncertainty in the US economy, the Fed may wait a month or two. This delay would allow it to determine whether the May jobs report was an anomaly or the beginning of a trend, and it would allow the Fed to keep a weather eye on Britain as it votes on whether to stay in the European Union.

Mark your calendar for June 23. On that day, the world will be watching to see whether British voters decide to leave the European Union. They coined the term "Brexit" to refer to this departure. The British public seems split on the Brexit—a recent poll had 46% in favor of staying, 43% ready to leave, and approximately 10% undecided—and the arguments grow increasingly tense. On the one hand, you have conservative and nationalist politicians campaigning for Britain to leave a dysfunctional European Union to forge its own destiny, which sounds patriotic and optimistic. However, the other side of the argument is a chorus of well-respected world leaders, business executives, and economists, who are all too eager to describe the economic consequences of such a hasty decision.

As much as this seems like a regional issue, the world is waiting to see whether Britain will be the first country to leave the European Union and gauge the consequences. During this waiting period, investment in Britain has declined, as investors are hesitant to bet on such an uncertain future. A similar, although moderated, effect is visible across Europe. As the union staggers under the deluge of immigrants and struggles with the lingering debt crises, there is a concern that a Brexit could encourage other dissatisfied union members to reconsider their membership and start plotting their escapes.

Market Movers

May was a month of "wait and see." No asset classes or categories moved much, so losses and gains were both small. The upcoming Brexit vote and Fed interest rate decision are causing investors to maintain their current strategies. On the whole, our bias toward US assets served our portfolios well in May, as foreign assets struggled more than their US competitors. Diversifying assets have added tremendous value since the beginning of the year. The performance of globally diversified portfolios is beginning to converge on that of the US stock market since the beginning of the year. Our Core Allocation portfolios continue to outperform Morningstar's World Allocation fund group.

Asset Categories	*May 2016*	*YTD*
US STOCKS	1.86%	3.96%
FOREIGN STOCKS	-1.43%	1.92%
US BONDS	0.10%	3.31%
FOREIGN BONDS	-0.09%	6.69%
HARD ASSETS	-1.66%	8.97%
HYBRIDS	1.34%	3.07%

*DATA USED IS SOURCED FROM MORNINGSTAR®

US STOCKS struggled in the early days of the month, but regained their footing by the end of May. Small (VB), Mid (VO), and Large Caps (IVV) rose at a similar pace. When compared against their foreign counterparts, this tight grouping suggests investors are more confident in the fortunes of the US economy than those abroad.

FOREIGN STOCKS were mixed in May. Developed Large Caps (VEA) and International Small-Mid Caps (VSS) were relatively flat, but Emerging Markets (VWO) suffered a loss of more than 3% in May. Our decision to limit our exposure to Emerging Markets helped to protect our portfolios from these volatile returns.

US BOND held steady in May. Higher-quality bonds, such as Treasuries (SHY) and Corporates (VCSH) and TIPS (TIP), took nominal losses of less than 1%. Meanwhile, lower-quality bonds, such as High Yields (SJNK) and Bank Loans (BKLN), posted nominal gains of less than 1%. Our increased allocation to these bond sectors was rewarded as they were the top performers since the beginning of the year.

FOREIGN BONDS performed similarly to their US competitors. Emerging High Yields (HYEM) took a small loss of less than 1% and Emerging Treasuries (PCY) picked up a small gain of less than 1%. Since the beginning of the year, these bond sectors added a tremendous amount of value to our portfolios.

Despite the headline loss, **HARD ASSETS** held their own in May. Master Limited Partnerships (AMJ) ticked up more than 2% and was the strongest performer of the month. Real Estate (RWO) was relatively flat. Unfortunately, Precious Metals (GLTR) sagged to a loss of more than 7% on the news that the Fed is likely to raise rates soon. However, year-to-date, Hard Assets have been the strongest performing asset category.

HYBRIDS performed well in this mixed environment. While US Stocks did reasonably well and US Bonds held steady, Preferred Stock (PFF) and Convertible Bonds both gained more than 1% for the month. Even as lower-risk components of our portfolios, Hybrids continue to provide strong performance.