me FINANCIAL

WILL THE FED INCREASE RATES?

Market Review **September 2016**

In December of last year, the US Federal Reserve ("the Fed") announced that it would raise interest rates and that there would be a series of rate increases during 2016. Investors and analysts had been anticipating this announcement for months. It finally looked as though interest rates would begin to normalize, bonds would yield enough for retirees, and savers would not be penalized for their caution. Unfortunately, global events intervened and the Fed was forced to delay any rate increases.

No sooner did 2016 arrive and the cratering Chinese stock market shook up emerging markets. Unnerved investors sought safe haven investments around the globe, which created headwinds for the US economy. The Fed held back at their subsequent meetings and analysts speculated that June would be the earliest that another rate increase might be likely. During that June meeting, the Fed expressed concerns that Britain would vote to leave the European Union and opted to wait on another rate hike.

The Fed's caution proved well-founded, but the US economy proved resilient and has performed well. However, mixed economic data is keeping investor optimism in check. Several Fed members have spoken favorably of the economy's progress and that another rate increase might be close at hand. All of this chatter adds to the speculation that September will finally see the Fed get back on track. Fed Chairperson, Janet Yellen, added to this speculation, last week, when she spoke at a policy conference and said that "the case for an increase in the federal funds rate has strengthened in recent months."

One of the key metrics that the Fed examines is inflation, which is a term for increasing prices and declining purchasing power. Around the globe, prices have been flat ("disinflation"), and some countries have seen prices fall ("deflation") in recent years. There are consequences to all three of these conditions, but a little inflation (approximately 2%) is

"Several of the Fed members have spoken favorably of the economy's progress and that another rate increase might be close at hand."

considered to be healthy for an economy. It appears that inflation in the United States is poised to hit that 2% target in the coming months. This is good news and will be encouraging to the Fed. It will also require some investors to make adjustments to their portfolios.

Even though many consumer goods are seeing prices rise modestly, oil is not. After struggling in July and dipping to about $42 per barrel, oil rebounded strongly in the first three weeks of August and, once again, there were rumors that this was a "real" recovery and that "smart" investors should buy now. Analysts know better than to accept rumors on faith. Currently, inventories of petroleum products are rising, North American producers are increasing production, and OPEC producers are still pumping at full speed. Our firm has been saying this for months, but oil will not see a prolonged recovery until the supply of oil comes back into line with the demand for oil. In the intervening period, the price of oil will continue to fluctuate wildly and rumors will abound.

As we look forward to the months ahead, we expect that attention will shift to the US presidential election. Traditionally, attention shifts to the election after Labor Day and this year will be no different. While there is no clear link between a President's party affiliation and economic expansion, certain policies have been known to make investors nervous. We will be watching the election and the resulting discussions for indications of any policy risk.

Market Movers

In August, investors took a pause. They are waiting for Brexit plans to take shape, the Fed to decide whether to increase interest rates, the oil market to come into balance, and for the US presidential elections. As a result, many asset classes saw only nominal movements. For the month, our Core Allocation portfolios were generally flat and kept pace with the overall equity markets. Year-to-date, these portfolios have also exhibited similar returns to global equity markets but with lower volatility. Relative to Morningstar's World Allocation mutual fund category, the Core Allocation portfolios continue to outperform over the trailing one-year and year-to-date periods.

Asset Categories	*August 2016*	*YTD*
US STOCKS	0.30%	9.11%
FOREIGN STOCKS	0.64%	7.81%
US BONDS	0.29%	5.33%
FOREIGN BONDS	1.70%	14.89%
HARD ASSETS	-2.87%	16.44%
HYBRIDS	0.69%	7.51%

*DATA USED IS SOURCED FROM MORNINGSTAR®

US STOCKS held steady with nominal gains for the month. US Small Caps (VB) performed best with a gain of just over .5%, while US Large Caps (IVV) and US Mid Caps (VO) were flat. Overall, US Stocks continue to provide attractive returns and our decision to maintain elevated exposure in these markets has been beneficial.

FOREIGN STOCKS from the developed world continued to post lackluster results in the wake of Brexit. Developed Large Caps (VEA) gained just under 0.5% and International Small/Mid Caps (VSS) retreated slightly. Meanwhile, Emerging Large Caps (VWO) posted a strong gain of nearly 2% for the month.

Overall, US BONDS were up modestly in August. High Quality US Bonds (SHY, TIP, VCSH) reacted to rumors of Fed action and took nominal losses. Oddly, US TIPS (TIP) fell despite predictions of rising inflation. Our reduced exposure to high quality bonds was helpful. Meanwhile, US High-Yields (SJNK) gained nearly 2% while US Bank Loans (BKLN) posted respectable gains as well. We have held increased exposure in these areas which continues to add value.

FOREIGN BONDS were the top performing category in August and Emerging Treasuries (PCY) were the top performing asset class. Emerging High Yields (HYEM) followed close behind with a gain of over 1%. Emerging bonds continue to offer attractive interest rates and attract foreign investors. Our decision to bias these markets within our Foreign Bond allocation has been extremely beneficial.

Last month, HARD ASSETS struggled, but remains a bright spot for the year. Precious Metals (GLTR) gave up their post-Brexit gain with a loss of over 4%, but it is worth noting that they are still up by more than 25% year-to-date. Similarly, Master Limited Partnerships (AMJ) have a roughly 13% gain year-to-date, despite a slight loss in August. This demonstrates the diversification benefits offered by Hard Assets and the value they can bring to a portfolio if used appropriately.

Once again, HYBRIDS performed well in this mixed market. Preferred Stock (PFF) posted a modest gain, while Convertible Bonds (CWB) posted a strong gain of over 1% for the month. In markets where stock and bond markets are both in transition, Hybrids tend to persevere and post respectable returns while offering a more modest risk profile.