Langdon Shaw Associates, Inc.

9951 Crosspoint Blvd. | Suite 100
Indianapolis, IN 46256
Phone: (317) 842-7272
www.langdonshaw.com

Q1 2016 – Market Overview Newsletter

Economic Update

The end of the first quarter was met with the major stock market indices hovering on either side of zero. However, the ride for stock investors during the quarter was quite different than what these lukewarm returns may suggest. At one point, the S&P 500 was down 10.5 percent from the start of the year, but rebounded nearly 13 percent from its quarterly low. The Wall Street Journal[1] noted this dramatic whipsaw action was exceptionally rare: the last time stocks fell by that much and gained back all of the losses by quarter-end occurred in the years of the Great Depression.

Returns were generally mixed among different equity asset classes and sectors as well. Growth stocks tended to lag value stocks, which proved a reversal from last year. Small cap stocks thus far have been somewhat lackluster. Meanwhile, stocks in the middle have been among the better performers, with the S&P MidCap 400 Index outpacing both the large-cap S&P 500 and small-cap Russell 2000 indexes with a 3.78 percent return. Utilities and telecommunications were among the best performing sectors for the quarter with gains above 15 percent.

On the other side, financial and health care stocks slumped by over 5 percent. International equity markets were tumultuous as well, although for the most part the major developed markets finished the quarter in the red. The broad-based MSCI EAFE Index, representing the major European and Asian stock markets, closed the 1st Quarter down 3.01 percent. Emerging market indexes did well on a broad basis, but performance varied widely among different countries. For example, the Brazilian stock market climbed 15 percent for the quarter, while the Shanghai stock index in China fell by the same amount for the three-month period.

In the bond market, yields on the benchmark 10-year U.S. Treasury note declined through the first half of the quarter, hitting a low of 1.66 percent on February 11. It seemed to be a classic “flight to quality” move as investors scrambled out of falling equity markets and into the relative safety of bonds. When the stock market began to rally later in the quarter, yields rebounded back to the 2 percent range by March. However, the rise in Treasury yields stalled and settled lower at 1.77 percent by quarter end. The quarterly decline in yields was good news for bond investors—quarterly returns were positive for U.S. bond indexes and bond fund averages across all maturities.

Much of the cause for the late-quarter decline in fixed income yields could be pinned on the Federal Reserve. At the March Federal Open Market Committee (FOMC) meeting, the Fed dialed back expectations for interest rate increases for the coming year. Prior to the March meeting, Fed officials were anticipating four rate hikes for 2016. But perceived signs of slow growth in the U.S. and global economies prompted the Federal Reserve to announce a more gradual pace for raising interest rates, with potentially two rate hikes for the coming year. The initial estimate for 4th Quarter Gross Domestic Product (GDP) did seem sluggish at 0.7 percent, but that number was revised up twice to a final reported GDP of 1.4 percent. It was the seventh consecutive quarter of positive economic growth. Time will tell if the Fed’s move to slow interest rate increases was a good decision. We don’t necessarily agree, but as always, hindsight will be 20/20.

One bright spot to the economy was in the job market, although it wasn’t great in all sectors—losses occurred in manufacturing and energy, both of which have suffered with the decline in oil prices and weakness in export markets. Overall, however, employment gains were largely robust for the first three months of the year with over 200,000 new jobs added to the economy in both February and March. The unemployment rate briefly dipped below 5 percent during the quarter, and wage gains for U.S. workers were broadly higher on average.

The mixed picture for the economy and the financial markets means investors may continue to face significant uncertainty in the quarters to come. Continued volatility in future quarters wouldn’t be surprising. As an investor, we believe the suitable approach to this uncertainty would be to maintain discipline, keep your emotions in check, and continue to invest with your long-term goals in mind.

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For more market details from the third quarter, see the “Capital Analysts Q1 2016 Market Review” in the commentaries page on our website at www.langdonshaw.com/commentaries.

Disclosures and Definitions

Sources: [1] http://blogs.wsj.com/moneybeat/2016/03/31/sp-500-just-did-something-it-hasnt-done-since-the-depression

Information is shown for informational purposes only and does not constitute a recommendation to buy or sell any individual security. All indexes are unmanaged; it is not possible to invest directly in any index. Past performance is no guarantee of future results.

The Treasury yield is derived from available U.S. Treasury securities trading in the market and is provided directly by the Federal Reserve. U.S. Treasuries are regarded as the "risk-free rate" and are typically used as an approximation of general interest rate levels in the U.S.

Growth investments focus on stocks of companies whose earnings/profitability are accelerating in the short term or have grown consistently over the long term. Such investments may provide minimal dividends which could otherwise cushion stock prices in a market decline. Stock value may rise and fall significantly based, in part, on investors' perceptions of the company, rather than on fundamental analysis of the stocks. Investors should carefully consider the additional risks involved in growth investments.

Value investments focus on stocks of income-producing companies whose price is low relative to one or more valuation factors, such as earnings or book value. Such investments are subject to risks that their intrinsic values may never be realized by the market, or such stock may turn out not to have been undervalued. Investors should carefully consider the additional risks involved in value investments. Small cap stocks may be subject to a higher degree of risk than larger, more established companies’ securities, including higher risk of failure and higher volatility. The illiquidity of the small-cap market may adversely affect the value of these investments so those shares, when redeemed, may be worth more or less than their original cost.

S&P 500 consists of the common stocks of 500 large-capitalization companies, within various industrial sectors, most of which are listed on the New York Stock Exchange. It is considered a broad measure of U.S. domestic equities. **Dow Jones Industrial Average (DJIA)** is a price-weighted index of 30 widely held stocks traded on the NYSE. The 30 stocks in the Dow Jones Industrial Average are all major factors in their industries and their stocks are widely held by individuals and institutional investors. **NASDAQ** is an index that tracks the cumulative results on a market capitalization basis of all stocks trading in the NASDAQ system. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment. **MSCI Europe, Australia, Far East (EAFE)** Index is a total return index, reported in U.S. dollars, based on share prices and reinvested gross dividends of approximately 1,100 companies (only those securities deemed sufficiently liquid for trading by investors) from twenty countries. The securities represented in this index may experience loss of invested principal and are subject to investment risk. In exchange for greater growth potential, investments in foreign securities can have added risks. These include changes in currency rates, economic and monetary policy, differences in auditing standards and risks related to political and economic developments. **MSCI Emerging Markets Index** is a U.S. dollar denominated index comprising stocks of countries with below average per capita GDP as defined by the World Bank, foreign ownership restrictions, a lax regulatory environment, and greater perceived market risk than in the developed countries. Investments in emerging markets come with much greater risk due to political instability, domestic infrastructure problems, currency volatility and limited equity opportunities (many large companies may still be "state-run" or private). Also, local stock exchanges may not offer liquid markets for outside investors. **Shanghai Stock Exchange Composite Index** is a capitalization-weighted index. The index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange. The **Brazilian stock exchange**, The Sau Paulo BOVESPA, is the third largest stock exchange in the world by market value with over 500 companies traded on the exchange. **S&P MidCap 400 Index (S&P 400)** serves as a barometer for the US mid-cap equities sector and is the most widely followed mid-cap index in existence. To be included in the index, a stock must have a total market capitalization that ranges from roughly $750 million to $3.3 billion. **Russell 2000 Index** measures the performance of the 2000 smallest companies in the Russell 3000 index, which represent 8% of the total market capitalization of the Russell 3000 index. The stocks represented by this index involve investment risk which may include the loss of principal invested. Gross Domestic Product (GDP) is a macroeconomic measure of the value of economic output adjusted for price changes.