LAUTRENTIDE
ADVISORY

# Market Commentary

2Q 2016

Despite all of the concern voiced about jobs, the economy, and politics – at home and abroad – stock and bond markets have been doing a fairly good job at climbing the wall of worry in 2016. Viewed in aggregate, stock markets of developed countries appreciated nearly 1% in the first six months of 2016. The US has been a relatively strong contributor to returns, gaining nearly 3.5% in that period. Although we are living in a low-return world, we expect the US economic growth engine to continue to chug along this year and into 2017 and to support higher US equity prices.

We think the fall-out from the UK referendum to leave the European Union – Brexit – will land most heavily on the UK financial sector. The iShares United Kingdom ETF has declined 10% from the June 23 vote to the end of the first week of July, and a number of the British banks have fallen much farther. The UK, even with a benefit of a significantly weaker British pound, may struggle until the many economic uncertainties associated with leaving the EU are addressed. Sustained Euro currency weakness, however, may, in fact, be quite helpful to a number of consumer-focused, export-driven companies located in Europe. We are not expecting Brexit to trigger Frexit or Gerexit. We have a modest allocation to European equities in many of our client portfolios and we expect this exposure to contribute meaningfully to returns in the quarters ahead.

Bond market performance has generally outpaced that of stock markets so far in 2016 as yields on longer-dated US Treasury bonds have fallen through their all-time lows. Returns for Treasury bonds maturing beyond 20 years have exceeded 15% year-to-date. There are now two things, in particular, that give us pause when we think about investing in government bonds: 1) Negative interest rates in many parts of the world – a phenomenon where investors end up with less when the bond matures than what they had when they bought the bond; and 2) longer-dated US Treasury yields that are lower now than during the depths of the 2008 financial crisis.

We think it is a fool's errand to try to predict the turn in the interest rate cycle - that is, the point in time when interest rates will begin to move higher with regularity. However, we do believe that bond price risk (aka duration risk) is extreme in longer-dated segments of many government bond markets, including in the US. For our conservative clients, who typically have a sizable portion of their portfolios allocated to bonds, Treasury exposure is minimal and very short-dated. For all clients, we prefer the risk / reward profile of corporate bonds and securitized credit over government bonds. We eliminated medium-term and long-term Treasury bond exposure in May.

*Summary of our three main Market Themes and the corresponding Investment Views:*

| Market Theme | Investment View |
|---|---|
| Bond price (duration) risk is extreme in many markets | Little to no Treasury bond exposure, and focus on short/intermediate maturity bond funds |
| We are living in a low-return world and the US economic engine is the main driver of growth | Significant exposure to US stocks, corporate bonds and structured credit |
| A new consumer class in developing economies is on the rise | Moderate exposure to emerging markets and to European companies that service global consumers |