A McColl Bros. Lockwood Company

The Intelligent Investor- April 2016

Quick Market Update:

The month of March proved to be a good one for investors—stocks rallied hard and ended the quarter flat or even positive in some cases. While the ride was bumpy to say the least, and risk continued to lurk around every corner, the old adage of Wall Street climbing a wall of worry seems to ring true. We still don't see the recessionary signs many economists are forecasting, but we do see slow or muted growth going forward and a tough slog ahead.

There are definitely pockets of opportunity, and valuations look attractive in several different markets. We are finally starting to see International equities become more attractive as the dollar has stabilized and has at least paused from its relentless strengthening. Valuations have been attractive for a couple of years, but currency conversion presented MAJOR headwinds which seem to be settling. We still remain overweight to the US, but are looking for opportunities to get closer to market neutral on the relationship of US and non-US equities.

We anticipate continued volatility throughout the year and also anticipate conflicting messages from the Fed Board that have the potential to drive investors crazy. We remain focused on long-term, goal-oriented solutions in a broadly diversified portfolio. We continue to use tactical allocations to find short term opportunities where there is a dislocation of price and value.

Collective Wisdom

There is an enormous amount of research that has gone into how stocks are priced. In our short time today, we will keep things simple. Whether we are reviewing an individual stock or a broad measure of equities such as the S&P 500 Index, in reality the price is a gauge of market sentiment that takes into account the collective wisdom of all market participants.

These participants include everyone from the small retail investor to sophisticated institutions that have created complex models to value stocks (our managers).

Simply put, they incorporate all publicly available information and collectively generating what they believe is a fair price for the stock or industry metric at that moment. As sentiment shifts, so does price.

These participants are all "putting their money where their collective mouths are," so to speak.

While this would lead one to an argument for market efficiency, we believe the collective wisdom of investors can sometimes misprice risk, especially when emotions come into play. This creates opportunity for active managers.

Still, we strongly encourage you to avoid purely trying to time the market. As we all know, no one has a crystal ball that consistently calls market highs and lows. The analogy we have used time and time again states short term market swings are unpredictable, and our crystal ball is imported from China and doesn't always work correctly!

That brings us to the ups and downs in the market we've recently experienced – what analysts call 'volatility.'

In some respects, the declines of just over 10% in the late summer 2015 and early 2016 selloff weren't particularly significant. Market corrections in the broader context of a bull market will happen regularly. Our goal is to manage and mitigate risk, but we can't eliminate risk altogether.

Key Index Returns

	MTD* %	**YTD %**	**3-year** %**
Dow Jones Industrial Average	+7.08	+1.49	+6.65
NASDAQ Composite	+6.84	-2.75	+14.23
S&P 500 Index	+6.60	+0.77	+9.49
Russell 2000 Index	+7.75	-1.92	+5.40
MSCI World ex-USA**	+6.33	-2.68	-0.93
MSCI Emerging Markets**	+13.08	+5.37	-6.84

Source: Wall Street Journal, MSCI.com
MTD returns: February 29, 2016—March 31, 2016
YTD returns: December 31, 2015–March 31, 2016
*Annualized
**USD

Economically Speaking

Recently, many feared that the economy was set to slip into a recession. Recessions will take a big bite out of corporate profits, and profits are the biggest medium and long-term factor that affect stock prices.

While recent data are not suggesting the economy is running on all cylinders, it does signal that expansion is muddling along at a modest pace.

However, that's not what stocks seemed to be telegraphing early this year. Everything from concerns over China, falling oil prices, and fears about earnings seemed to be suggesting the economy was set to stall.

While markets try to process information efficiently, they often overshoot to the upside or the downside as emotions takeover for many investors. Like the great Benjamin Graham (Warren Buffett's Mentor) reminds investors:

"Those that can't master their emotions are ill-suited to profit from the investment process."

Expect to see headlines screaming of an impending bear market or even a market crash. They really don't offer much in the way of solid market analysis, but they are designed to get "eyeballs," or page clicks. The old news adage, "If it bleeds, it leads," applies to sensational financial articles, too.

The Case of China

China provides an excellent case in point. U.S. exports to China account for just under 1.0% of U.S. GDP (U.S. Bureau of Economic Analysis), but China seems to have a way of creeping into investor psychology with scary headlines.

Though China has not gotten its problems under control, its economy has avoided the proverbial brick wall. Its currency, the yuan, has stabilized and has even begun to appreciate against the dollar, rising to roughly a four-month high (St. Louis Federal Reserve).

More importantly, stocks have closely tracked crude oil in recent months (St. Louis Federal Reserve), and the uptick in oil has benefited stocks.

The Dollar Dip

Finally, investors are pricing in the impact of the recent dip in the dollar into stocks, especially the larger industrials that do a fair amount of business overseas.

Remember the collective wisdom of the market? It is millions of investors, both large and small, quickly pricing new information into buy/sell decisions. In turn, it's reflected in changing prices.

A stronger dollar is a big benefit to those traveling overseas, and it helps keep a lid on the price of imported goods. But companies doing business abroad must translate those foreign sales back into more expensive dollars, which ultimately hurts earnings.

Notably, the rise in stocks last month was inversely correlated to changes in the dollar. Investors cautiously anticipate dollar headwinds will abate when multinationals begin reporting Q1 earnings later in the month.

Bottom line

Markets will experience periods of tranquility and markets will experience periods of volatility. In some respects, it's much like the weather. Even then, we might put more faith in the three-month temperature outlook than we would put in the many and varied forecasts for stocks. It's noise and best to be avoided.

All of you have financial goals. If you are to achieve these goals, a plan is crucial. Each of you has a customized and tailored portfolio developed specifically for those goals. Unless new circumstances have arisen in your life, we strongly encourage you to stick with the plan that we have both agreed upon. This includes an exposure to stocks.

In summation, we remain humbled by our clients trust and confidence in us, and we take our stewardship roles very seriously. As always, if there are any questions, we encourage you to contact any of our team here.

Luther A. Lockwood

David B. Miller

Luther A. Lockwood II
Managing Principal
Luther.lockwood@mbl-advisors.com

David B. Miller
Managing Director
David.miller@mbl-advisors.com