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The Intelligent Investor- March 2016

Quick Market Update:

The year 2016 got off to a volatile start and the month of February was no different. Much to the relief of investors we did start to see oil stabilize and equities recover from their mid-month lows. We are starting to see some opportunity present itself in various sectors and pockets of the market, but we also remain cautious as the market as a whole isn't overly cheap.

We see an opportunity in High Yield Bonds as the credit spreads (difference between US Government Bonds and High Yield Bonds) have grown significantly, indicating we are well compensated for the additional credit risk. We are also seeing certain financial stocks trading at relatively cheap multiples, most likely indicating a lot of bad news already priced in.

Risks certainly remain and we foresee continued volatility, however, that volatility also plays into the hands of active managers who can take advantage of the short term dislocation of price and value. Our managers are focusing as much on what NOT to own as what to own as we start to see markets de-correlate, making asset allocation and diversification once again important themes.

Recession or No Recession:

Recently, the focus for investors has been all over the map:

1. Oil prices
2. Corporate earnings
3. The global economy
4. China’s economy
5. China’s currency (the yuan)

6. Anxieties about banks (especially in Europe)

7. The Federal Reserve's next move

8. Global central banks that may be running out of ammunition to counter economic weakness

9. Emerging market debt

10. "Brexit" -- the possibility Britain will exit the European Union this summer

11. Political uncertainty in the U.S.

It's not an all-inclusive list, but it adds up to a whole host of worries that investors are having to grapple with in the short term.

Yet, U.S. stocks in February ended mixed as oil prices ticked higher and the economic data improved.

Notably, the more positive economic reports come at a time when the global outlook is tepid at best, but it highlights that the driver of U.S. economic activity isn't coming from overseas. Instead, it is homegrown.

Table 1: Key index returns

	MTD %	2016 %	3-year* %
Dow Jones Industrial Average	+0.30	-5.21	+5.53
NASDAQ Composite	-1.21	-8.98	+12.98
S&P 500 Index	-0.41	-5.47	+8.45
Russell 2000 Index	-0.14	-8.98	+4.30
MSCI World ex-USA**	-1.65	-8.47	-2.82
MSCI Emerging Markets**	-0.28	-6.78	-11.13

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

U.S. Recession Worries:

If you listen to the pundits of doom and gloom, we're going to enter a recession this year that will take stocks to new lows.

First, let us state the obvious – economic forecasters do a pretty lousy job of calling turning points in an economic expansion.

Think of it this way: Pile a bunch of seasoned sport analysts into a room and ask them who's going to come out on top of an important football or basketball game. While they will offer a thoughtful analysis of each team's strengths and weaknesses, and may even agree on many points, they will draw different conclusions as to the outcome of the game. Ultimately, their predictions for the final score will vary widely.

The same holds true for economists.

Take former Fed Chief Alan Greenspan, who headed up the Federal Reserve from 1987 – 2006. In March 2007, Greenspan said there was a "one-third probability" a recession would take hold in the U.S. that year (*Washington Post*).

By December, the U.S. entered what would eventually be called the "Great Recession". So much for Dr. Greenspan's complex forecasting models. His successor, Dr. Ben Bernanke, actually had just told Congress the economy might strengthen.

We believe the legendary Economist, John Kenneth Galbraith, said it best—

> *"The function of economic forecasting is to make astrology look respectable."*

Perspective:

Although, economic forecasting is an inexact science, we will give you our opinion anyway. We will descend into another recession. It will happen. It may be in 2016 or 2017 or 2018 or beyond, but an eventual recession (and subsequent recovery) in a free market economy is to be expected.

When it happens, stocks will probably lose value since bear markets closely correlate with recessions (St. Louis Federal Reserve data).

While the individual plans we recommend mitigate some of the risks, they do not eliminate risks. Over the longer-term, however, we are confident these plans have you on a path towards financial independence.

Given the volatility that strikes the market from time to time, we want to encourage you to avoid watching the daily gyrations in stocks.

Warren Buffett offers some valuable insight to this—

> “Games are won by players who focus on the playing field—not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays” (Bloomberg).

Speaking of weekends-we hope you will join our MBL Fantasy Golf League this year. Be on the lookout for an email to sign up for the league, we will compete during the Wells Fargo Championship and 4 Major tournaments. We hope the league will help you take your eyes off the markets for at least 5 weekends a year.

Getting back to the Buffett theme, he also said, “Markets over a long period of time are going to go up,” in a late February interview on CNBC. His advice is an excellent foundation for those with a long-term perspective. While none of us enjoy seeing the market decline, let’s remember that it never goes up in a straight line.

Bottom line:

There is plenty of uncertainty in the world (hasn’t that always been the case?) and we are bombarded with bad news daily, but we believe this comment from Buffett’s just-released 2015 annual letter to Berkshire Hathaway shareholders reflects our sentiment:

> “For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America’s golden goose of commerce and innovation will continue to lay more and larger eggs. America’s social security promises will be honored and perhaps made more generous. And, yes, America’s kids will live far better than their parents did.”

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.

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