SOUNDVIEW FINANCIAL

THADDEUS M. O'BRIEN, MBA
tobrien@soundviewfa.com

ROBERT J. BORONSKI, MBA, CFP®
bboronski@soundviewfa.com

January 20, 2016

<>

<>

<>

Looking Back

The U.S. economy continued to improve in 2015.

The value of all the goods and services produced adjusted for inflation (real GDP) increased 2%.[1] More citizens found jobs as the unemployment rate declined for the 5th year in a row to 5%.[2]

Corporate profits (EPS) decreased from their record setting high in 2014 but at $94 still posted their 3rd highest annual profits in history.[3]

Existing home sales increased to their highest level since 2009 before dropping back towards year end to their April 2014 level. New home construction (Housing Starts) increased 6.4% to 1,149,000.[4]

Overseas the story was mixed as the economies of rich countries continued to improve while those of emerging countries continued to deteriorate.

The 19-country European Union (Euro Area) economies grew at a 1.6% clip with unemployment declining to 10.5%. Japan u-turned its economy from contraction to expansion growing at a 1.6% rate.[5, 6]

The once highly touted BRIC emerging countries found themselves in peril. Much of it their own making. Brazil and Russia's contracting economies were largely due to incompetent, corrupt governments with Russia adding military aggressiveness to the sour mix. China grew at its slowest rate in 25 years. India was the best performing BRIC country growing at 7.4%.[6]

Unlike the prior year, the triple-positive American economy of low unemployment, low inflation and low interest rates, failed to lift the domestic market higher as US equities fell -1.3%.[7]

With a slight rise in interest rates, US bonds returned -0.3% with tax-free municipal bonds up 3.3%.[8, 9]

As in the US, the improvement in rich country economies wasn't reflected in their financial markets as international stocks returned -5.3%. Emerging country stocks lost -14.6%[7]

With gold falling another -10.9% and oil prices nearly cut by half, -45.3%, the 0.1% US inflation rate was the lowest seen in 60 years (excluding 2009).[10]

Looking Ahead

In last January's Outlook letter we detailed some of our investment approach (past newsletters can be found at http://www.soundviewfa.com/Newsletters.aspx).

In short, our investment process begins with putting the "big rocks" of the macro economic environment into place first. We do this with our quadrant decision table which sets probabilities for four possible economic scenarios: *Inflationary Bust (Stagflation), Inflationary Boom, Deflationary Bust and Deflationary Boom.*

Our highest probability scenario for 2016 remains *Deflationary Boom.* In this scenario inflation (prices) are stable or falling while the economy is growing.

The *Deflationary Boom* scenario favors equities especially companies with price elasticity (i.e. lower prices increase demand), platform companies (i.e. in-house design & sell, out-source production), financial services, Real Estate, oil importers (e.g. Japan) and the

762 Post Road • Darien, CT 06820
Thad: (800) 656-0098

www.soundviewfa.com
Fax: (866) 798-8050

P.O. Box 290 • Monroe, CT 06468
Bob: (203) 261-3859

U.S. dollar. This overarching theme will guide our security selection until and unless it changes or is proved incorrect.

Each New Year brings a new cache of uncertainties for investors. Two primary ones for 2016: 1) will the slowdown in China and the emerging markets continue or even accelerate and 2) how much and how fast will the US Federal Reserve raise interest rates?

As we write this, Global stock markets are experiencing their worst ever start to a new year. Much of the decline is blamed on uncertainties with regard to China's economy. Yet, the bark of a slowing China may be worse than its bite.

For all rich country firms listed on a stock exchange, less than 5% of their profits come from China. In the US only 19 of the 500 members in the S&P 500 index make more than ¼ of their sales from China. The majority that do are technology-component makers. The fact is that unlike a country like Japan, "China has exported $16 trillion of goods in the past decade, but not one big business idea." [11]

The global financial markets seem to wait with bated breath to see if and when China will use some of its $3.3 trillion in reserves to stimulate its economy. We might guess they will at some point but China will find it difficult to grow regardless. Emerging market countries have historically found it difficult to do well economically when the US and other country reserve banks are raising interest rates because it tends to pull foreign investment capital from them. If China reacts by putting in place reform measures, the effect of that too will draw money out of the country.

A slower growing China moving ahead would imply lower commodity prices. The lifting of Iran's oil export sanctions will further support low prices. Yet with oil prices already below $28 per barrel notwithstanding some further decrease in prices we wouldn't disagree with oil prices being higher than today a year hence. Which means that at some point the energy sector will have most, if not all, of the poor outlook built into its price. Equity markets being, after all, forward rather than backward looking in nature.

As we are not mesmerized with China watching nor are we obsessed Fed watchers. Originally, the Fed signaled four rate hikes for 2016. Currently markets are pricing in about one hike. This Fed Board has been transparent, pragmatic and patient so it is reasonable to assume further rate increases will be handled the same.

Our Community

Being involved with so many interesting and talented clients is one of the true treasures of our profession. This month we are excited for our long-time client and friend, artist Ron Taylor and his One-Man-Art-Show Retrospective of award-winning artwork at the Rowayton Art Center. The Opening Reception is Sunday, Jan. 31st from 4-6 pm with wine and hors d'oeuvres. Those attending will enjoy a colorful respite from Connecticut's cold / gray winter landscape. The Retrospective will be on display thru February 21st.

We look forward to a profitable 2016 and to seeing you. Thank you for your continued confidence and trust.

Sincerely,

Robert J. Boronski, MBA, CFP®

Thaddeus M. O'Brien, MBA

[1] Bureau Economic Analysis YOY Q3-2014-Q3-2015, [2] Bureau of Labor Statistics, [3] MarketGrader.com (Q4 Estimated), [4] Bloomberg, [5] countryeconomy.com, [6] The Economist, 1-9-2016, p. 76, [7] Hays World Wrap, 1-4-2016, [8] Barclays Capital US Aggregate Bonds, [9] Barclays Capital Municipal Bond, [10] bls.gov, CPI-U, [11] The Economist, "A Great Wall of Worry", The World in 2016