GCG's Second Quarter Market Analysis

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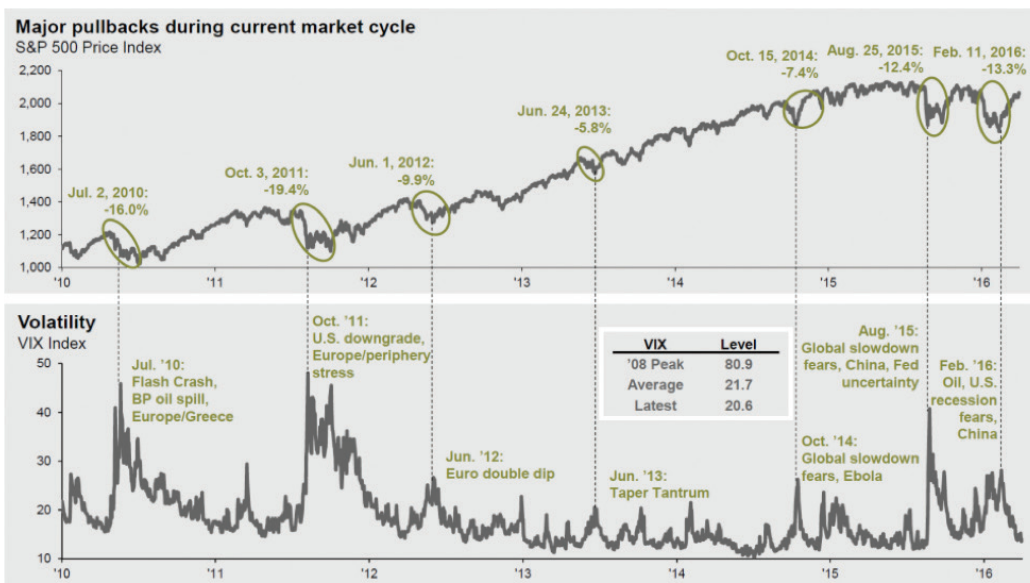
State of the Markets

What is driving the Market? Oil? Politics? Federal Reserve's actions? Specific events matter far less than trends in economic and market conditions in determining market performance.

MARKETS

2016 started out with one of the worst performance months on record. Market, as measured by the S&P 500 Index, went down from day one. Dramatically proving the possibility of upside, by the end of the quarter, the market staged a dramatic recovery. The US market as measured by the S&P 500 Index had a total return—which includes reinvested dividends—of 1.35%.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) CBOE.
Guide to the Markets – U.S. Data are as of March 31, 2016.

Even during the upward trend in the market over the past few years, we have seen several events that, at the moment, seemed potentially impactful to the markets and caused the, "fear indicator," the S&P 500 Volatility Index or VIX, to spike only to recover and have the markets move on. Every time the market has a sell off the VIX gets the media attention. This index measures the implied volatility in the market based on options trading. As we have seen over the past several years, the volatility index tends to rise sharply and fall slowly. Some investors try to use the VIX to gain insight into the markets. It seems that, given the sharp rises, there is no way to predict in advance when the market's volatility is going to rise. It is interesting to note that the current readings on the VIX (15) are relatively modest despite all of the uncertainty in the markets.

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We see that as well when we look back at the investment returns for the various major asset classes. While real estate is still defying gravity and interest rates for the time being, the other asset classes continue to be jumbled in the first quarter. As you know, we don't try to time the different asset classes in the market but would prefer to stay properly diversified based on each investor's time horizon, tolerance for risk and investment objectives. Diversification and asset allocation do not guarantee against loss rather they are methods to manage risk.

2016 YTD

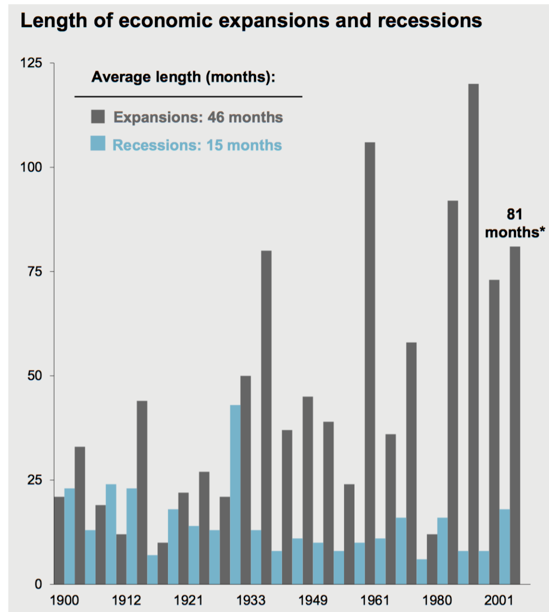
- Real Estate 5.8%
- Emerging Markets 5.8%
- High Yield 4.1%
- Bonds 3.0%
- US Large Cap 1.3%
- Commodities 0.4%
- Cash 0.01%
- US Small Cap -1.5%
- International -2.9%

Source: Barclays, Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management. Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Barclays Global HY Index, Fixed Income: Barclays Aggregate, REITs: NAREIT Equity REIT Index. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Barclays Aggregate, 5% in the Barclays 1-3m Treasury, 5% in the Barclays Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period of 12/31/99 – 12/31/15. Please see disclosure page at end for index definitions. All data represents total return for stated period. Past performance is not indicative of future returns. Guide to the Markets – U.S. Data are as of March 31, 2016.

Looking more specifically at how the asset classes stacked up in the 1st quarter. If you had investments in emerging markets and didn't bail out you were rewarded for your patience and courage. Bonds had a strong quarter as the Fed modified its stance on short term rates. Bonds should not be feared but continue to be used to provide the appropriate risk adjusted returns in a diversified portfolio. Small caps and international bring up the rear so far in 2016. If someone can predict how that boxes will be filled in for the future, they have a better crystal ball than us. We will maintain the appropriate diversification and risk profile for each portfolio and be positioned properly for whatever the future holds.

ECONOMY

Switching to the economy, the most recent GDP reading for the 4th quarter was on par with the post crisis growth rate.



Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through March 2016, lasting 81 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/cycles/ and reflect information through March 2016. Guide to the Markets – U.S. Data are as of March 31, 2016.

This is now the 4th longest U.S. economic expansion in the last 115 years. Who knew? As you review this history, you could conclude two things, people remember the pain of the recessions for a very long time after the recovery has been underway and that recessions happen more often than most people think. By definition, recessions are bad. However, most investors should continue to focus on their own time horizon and realize that over a 30 or 40 year period, we will experience 5-8 recessions. Focusing on avoiding the next one, most likely means missing the long periods of positive market performance in between.

Having said that, there is no question that this recovery is very mediocre by comparison. We must not forget that the Financial Crisis in 2008 was the worst economic downturn since the Great Depression. This caused an unprecedented response. Economists and historians will debate whether the actions by the Fed and the government during and after the crisis helped or hurt the recovery.

Initial claims for unemployment are one of the early indicators that may signal a change in economic circumstances. This indicator is currently showing that current private business layoffs have continued to remain subdued. Even in the best of economic times, initial claims for unemployment insurance rarely drop below 250,000 to 300,000 per week. We have entered that zone where new unemployment claims reflect growing confidence in the economy by companies.

The Unemployment Rate is now at 5.0%. However, wage growth is still not recovering as expected. The unemployment rate actually ticked up in the most recent reading. As is evident in the initial claims data above, this was not due to new layoffs. In fact, it was due to more people re-entering the workforce and looking for jobs. This is reflected in a recent rise in the labor force participation rate.

There has been much discussion about the potential reasons for the falling labor force participation rate. Recently, a couple of papers were released looking into this phenomenon. This chart shows the two major components describing the decline. Retiring baby boomers (demographics) certainly have had an impact, but the displacement caused by the financial crisis also contributed. As those displaced workers come back into the labor market, we will see the line move back toward the natural rate.

Source: BLS, Haver Analytics & Deutsche Bank

INTEREST RATES

When the Fed was established the congress gave the Fed a dual mandate. Full employment and stable prices. The Fed has had to run the edge between pumping up the economy and causing higher inflation or slowing inflation and stalling the economy. Right now, with employment continuing to head toward significant improvement, one could conclude that the Fed is more clearly concerned about low inflation and more specifically low wage growth.

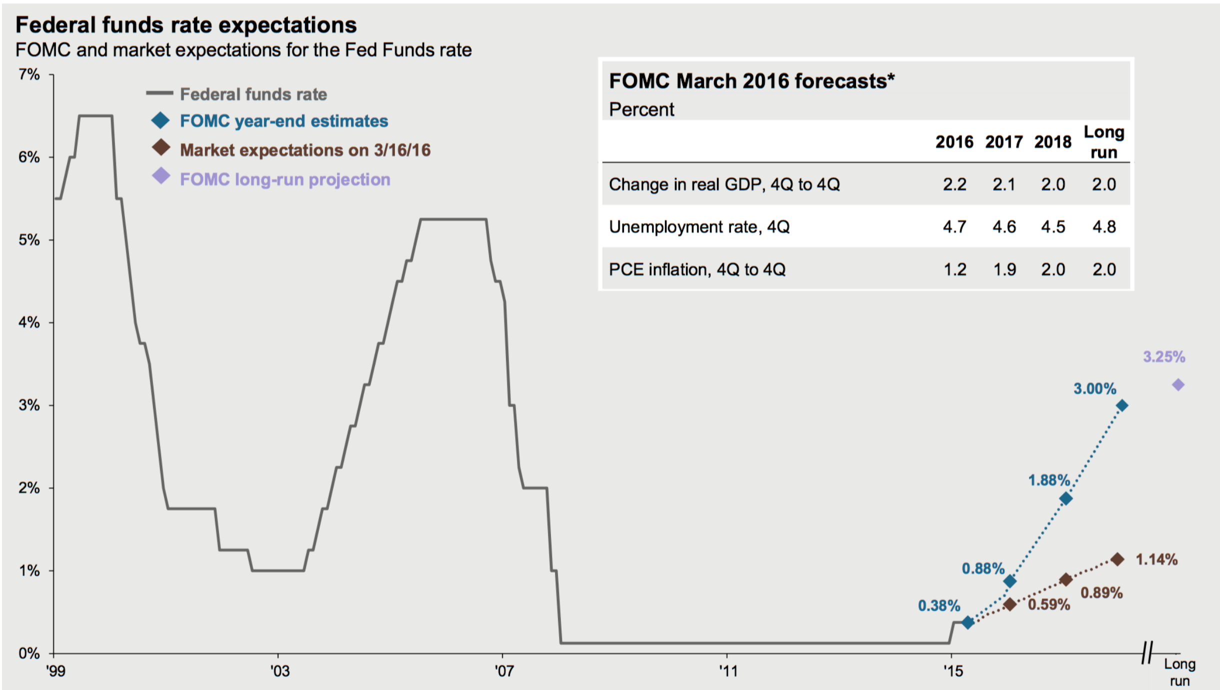
Recent comments to CNBC by Janet Yellen, Federal Reserve Chairwoman, addressed some of the concerns about the economy and the Fed's actions:

> *BUBBLE? "I certainly wouldn't describe this as a bubble economy," Yellen said, noting a, "healing" labor market and a 5 percent headline unemployment number.*
>
> *GLOBAL? The global economy has seen, "relatively weak" growth despite positive signs in the U.S. The Fed has taken a cautious approach on raising interest rates this year after hiking its target in December for the first time in nearly a decade. The bank's policy committee now projects two rate hikes this year.*
>
> *MISTAKE? (Yellen) did not consider the December decision a mistake, as indicators at the time showed, "substantial" progress toward the Fed's labor market and inflation goals. Moving forward, she noted the Fed would, "watch very carefully what is happening in the economy."*

Following the Fed meeting in December, the expectation was for 4 increases in the Fed Funds rate during 2016. The Fed has now reduced that to 2. If you look at the meeting schedule, you will see that following certain meetings (as noted by the star here), the Fed Chairwoman provides a press conference. If there were to be rate changes, it may stand to reason that they would happen at these meeting. The next meeting is in April. The next meeting with a press conference is June. We'll be keeping an eye on that meeting for the next possible rate change.

2015	**Dec 15-16**	**+0.25%**
2016	**January 26-27**	**no change**
	March 15-16*	***no change***
	April 26-27	**no change**
	June 14-15*	
	July 26-27	
	September 20-21*	
	November 1-2	
	December 13-14*	

Unlike prior administrations, the Fed now comes out and tells us exactly where every Fed board member projects Fed Funds rate over the next few years. They refer to this as the, "dot plot." All, but one member, has the rate higher still by the end of this year. (Source: Federal Reserve Board, Minutes of Federal Open Market Committee meeting. Release Date: March 16, 2016)



	2016	2017	2018	Long run
Change in real GDP, 4Q to 4Q	2.2	2.1	2.0	2.0
Unemployment rate, 4Q	4.7	4.6	4.5	4.8
PCE inflation, 4Q to 4Q	1.2	1.9	2.0	2.0

Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
Market expectations are the federal funds rates priced into the fed futures market as of the date of the March 2016 FOMC meeting. *Forecasts of 17 Federal Open Market Committee (FOMC) participants, midpoints of central tendency except for federal funds rate, which is a median estimate. Guide to the Markets – U.S. Data are as of March 31, 2016.

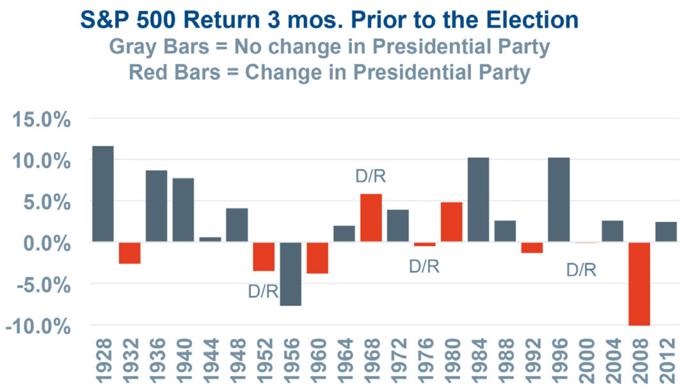
Looking at the same data in a different way. Comparing the "dot plots" from December and more recently, it is clear that most members have lowered their own expectation for rate changes. The market expectations do not line-up with the Fed's own projections. In other words, the market thinks that the Fed won't raise rates as quickly or as high as the Fed itself projects. We will see which is right.

In addition, longer term interest rates have actually come down over the past couple of years. Short rates have gone up slightly. If short rates continue to go up, the yield curve may flatten, that is short rates and longer rates at similar levels. Since the longer rates are determined in the market place and not by the Fed, they are subject to the market's speculation on the long term growth of the economy and the prospects for inflation. Even if long rates rise, they will still be historically low, relatively speaking. The one thing that the Fed and economists are both wary of is an inverted yield curve—that is when the short term rates are higher than long term rates. Each time this has happened during the last 20 years, we went into a recession. Right now, the spread between 2 year and 10 year treasury yield is around the historical average of about 1%.

ELECTION

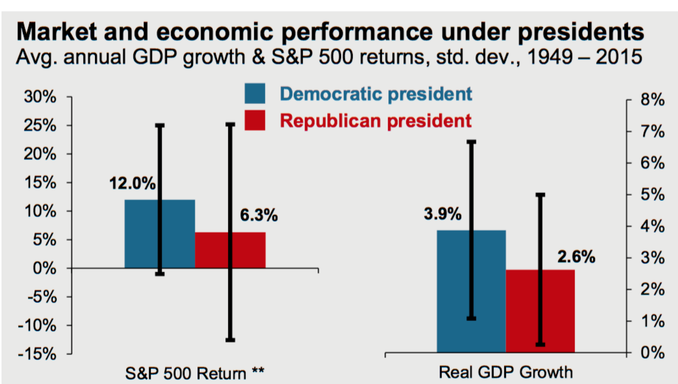
Many investors are curious about the impact of the coming election on the markets. First thing that should be noted is that statisticians would argue that despite 225 years of presidential history, we are really only talking about 56 data points as that is number of presidential terms since Washington. (Some had more than one term, obviously). Statistically speaking, that is not enough data to draw any conclusion. Also, none of the following comments are intended to show favor to one outcome over another. If the reader draws any conclusions as to a specific opinion, one way or the other, it is completely unintentional. But, despite the statistical significance, let's play the game anyway. In terms of the presidential cycle, the first two years have generally been relatively poor as the new administration comes in and the markets adjust to the change in policies. The second two years were generally better as the policies took hold and the market was dealt with less uncertainty. (Source: Kiplinger's - Presidential Cycle 1949-2004 Average Annual Return for S&P 500 Index during each year during the terms.)

However, that cycle has been completely upended in the last 10 years. This is more likely due to the economic cycle and not the president in charge. For Bush's second term, 2005, 2006, and 2007 were relatively good markets, while 2008 was a disaster. 2009-2012 were mostly all good in Obama's first term. So far in his second term 2013 was positive with 2014 and 2015 not so much. The final year 2016 has had a shaky start. Based on this pattern, it somewhat proves that market cycles and presidential cycles are not locked together and should probably not be relied upon for investment decisions.



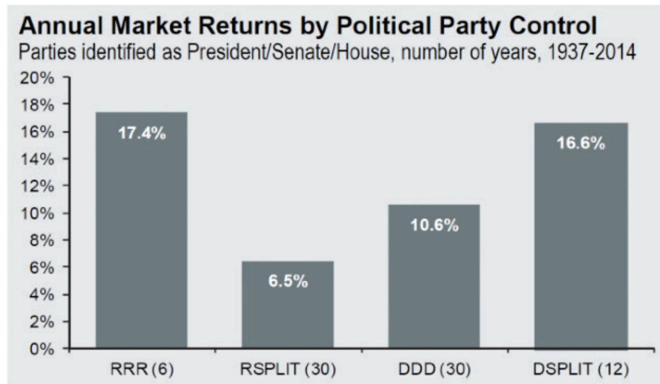
Sources: Bloomberg; whitehouse.gov.

Continuing with this line of thinking, the chart above shows the performance of the market in the 3 mos. prior to the elections. I have indicated in red the times when the party of the president changed. Of those, there were four occurrences when the party changed from Democrat to Republican. The four times it has happened since the 1920s, the 3 month's return prior to the election proved negative 3 times. So if you think 4 data points are enough to form an opinion AND you know that the party affiliation is going to change, then you might come to a conclusion. A better set of data points to use for investment decisions are the usual economic and market indicators that we always use regardless of the election cycle.



Source: U.S. House of Representatives, U.S. Senate, Gallup Inc., FactSet, Standard and Poor's, BEA, J.P. Morgan Asset Management. *In roll call votes where the majority in one party voted the opposite way to the majority in the other. Data compiled by Professors Keith T. Poole and Howard Rosenthal, available at www.voteview.com. Data on voting records are not yet available for the 114th Congress.
**Stock market returns are price returns and do not include dividends. Average annual returns are calculated using year-end to year-end and fourth quarter to fourth quarter numbers for both the S&P 500 and real GDP, respectively. Guide to the Markets – U.S. Data are as of March 31, 2016.

Still another set of data shows what is probably an unexpected and, perhaps, a contrary outcome. Since WWII, the market has been better and less volatile under Democratic Presidents than Republican. The economy has also been stronger under democratic administrations. If you argue that it is coincidence not due to the presidential policies, than you must conclude that the presidential election outcome really doesn't have much impact on the markets or the economy for that matter.



Source: JPMorgan (#) represents number of years for each combination Returns represent Average Annual Rate of Return

Finally, to put a topper on this conversation. Assuming the Republican party retains control of Congress, the outcome in the presidential election will mean good news no matter who wins. As you can see, an all Republican political body has been good for the market, but so too, has a Democratic President and a Republican congress. However, that's too easy. A better conclusion to all of this information related to elections and Presidential cycles is that there is not enough data and, more likely, that market cycles and presidential cycles are not locked together and should probably not be used for investment purposes.

WRAP UP

Generally speaking, the markets lack of catalyst and general uncertainty has caused a lack of direction. Commodity prices stabilizing has helped provide to lower volatility. The question for investors is whether the US economy is strong enough to pull the rest of the world up or if the global economy is pushing in the other direction. The Fed is taking this all in and adjusting policy within a, "measured," "gradual," and "moderate" pace. Investors should review their portfolio risk profile and remember that it is Time in the Market—not timing the market that provides long term success. If you must time the market, focus on taking advantage of downturns rather than trying to avoid them. The upturns last longer than the downturns and, ultimately, are more profitable.

Robert K. Janson

Bob's primary area of expertise is in the design, implementation and management of investment portfolios.

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Bob joined GCG Financial in 1997 and is Senior Vice-President of Wealth Management. He is responsible for investment services and strategies and serves as an Investment Officer and registered principal. Bob's primary areas of expertise are in the design, implementation and management of investment portfolios and providing investment advisory consulting services to company sponsored qualified retirement plans.

Bob has been developing his investment expertise for over 25 years. Prior to GCG, his background includes working with Blunt, Ellis, & Loewi, Charles Schwab Institutional, and Retirement and Estate Advisors. Through his experience, he has gained a solid understanding regarding the balance between the goals of the client and the ever-changing nature of the markets.

Bob approaches portfolio management with a disciplined and strategic approach that strives to maximize total potential returns while managing the overall risk and volatility of the portfolio. For each client, he develops an investment portfolio that is customized to the client's investment objective, time horizon, and risk temperament.

Bob approaches retirement plan consulting by focusing on the fiduciary needs of the plan sponsor and the retirement readiness of the plan participants. A properly developed investment menu with a prudent selection and monitoring process and an emphasis on sound investment strategies can help provide the fiduciary support plan sponsors require while encouraging successful retirement savings strategies for plan participants.

Bob received a Bachelor of Business Administration - Finance degree from the University of Wisconsin - Milwaukee. My professional designations include; Accredited Investment Fiduciary (AIF®), and Certified Investment Management Analyst (CIMA®).

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The indices mentioned in this seminar are unmanaged and not available for direct investment. Indices do not contain investment expenses, which would reduce returns. Past performance is no guarantee of future results.
The S&P 500 Index is gauge of the U.S. equities market. The index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 80% of the total market capitalization of U.S. equities. An investor cannot invest directly in an index.
VIX is the Chicago Board Options Exchange Market Volatility Index, a measure of the implied volatility of the S&P 500 index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30 day period.
Russell 2000 Index is generally defined as the US companies ranked in market capitalization between #1,000 and #3,000 and is recognized as tracking small cap US stocks.
MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.
MSCI EM Index (Emerging Markets) Europe, Middle East and Africa Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of Europe, the Middle East & Africa.
Goldman Sachs Natural Resources Index includes companies involved in the following categories: extractive industries, energy companies, owners and operators of timber tracts, forestry services, producers of pulp and paper, and owners of plantations.
Bloomberg Commodity Index are composed of futures contracts on physical commodities. Unlike equities, which typically entitle the holder to a continuing stake in a corporation, commodity futures contracts normally specify a certain date for the delivery of the underlying physical commodity. In order to avoid the delivery process and maintain a long futures position, nearby contracts must be sold and contracts that have not yet reached the delivery period must be purchased. This process is known as "rolling" a futures position.
The Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS.
Barclays 1-3 year Government Index includes fixed income securities issued by the U.S. Treasury (not including inflation-protected securities) and U.S. government agencies and instrumentalities, as well as corporate or dollar-denominated foreign debt guaranteed by the U.S. government, all with maturities between 1 and 3 years.
The U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds. Barclays Intermediate Credit Index measures the performance of investment grade corporate debt and agency bonds that are dollar denominated and have a remaining maturity of greater than one year and less than ten years.
The U.S. Corporate High-Yield Index measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt.
Barclays Long-Term Treasury Index includes all public obligations of the U.S. Treasury, excluding flower bonds and foreign-targeted issues with maturates of 10 years or longer.
Wilshire REIT Index measures U.S. publicly traded Real Estate Investment Trusts.
Source: Barclays, Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management. Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Barclays Global HY Index, Fixed Income: Barclays Aggregate, REITs: NAREIT Equity REIT Index. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Barclays Aggregate, 5% in the Barclays 1-3m Treasury, 5% in the Barclays Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period of 12/31/99 – 12/31/15. Please see disclosure page at end for index definitions. All data represents total return for stated period. Past performance is not indicative of future returns.

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