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GCG's Third Quarter Market Analysis

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Uncomfortably Normal

Third quarter returns for stocks, both domestic and global, have been shaken up due to China's currency devaluation and slowing economic growth. Equity returns for the year, through September 30, were convincingly negative. However, bonds displayed relative strength, eeking out a small gain. All major U.S. stock indices experienced a correction this quarter (defined as being down 10% from their most recent highs) with the Dow Jones Industrial Average experiencing its largest ever one day point decline.[1] We don't want to discount the potential severity of the current environment, but at the same time we think the higher likelihood is that we are just experiencing "normal" market fluctuations. Legendary investor Warren Buffett has been quoted as saying:

"Getting shaken out of the market due to 'normal volatility'...
is like being scared at the 12th Halloween movie."

We are not so flippant about this, and understand the discomfort of sitting through corrections. But Mr. Buffett does raise a valid point, which is that we are not currently in the midst of anything we haven't seen before... and many times, at that.

Market Returns as of 9/30/2015 (%)

INDEX	2015 TOTAL RETURN	THIRD QUARTER RETURN
DJIA	-6.95	-6.98
S&P 500	-5.29	-6.44
Russell 2000	-7.73	-11.92
MSCI EAFE	-4.91	-10.19
Barclays Aggregate Bond	1.13	1.23

Source: Bloomberg: Reflects total returns.

DECENT U.S. ECONOMIC GROWTH

In the face of all of this market volatility and supposed impending doom, the U.S. economy looks surprisingly stable. Second quarter GDP growth has been revised up to 3.9%, stronger than initial projections.[2] Along those lines, consumers continue to spend as jobs are easier to find, wages are modestly increasing, and inflation is persistently low. Given that approximately 70% of our economy is driven by consumer spending, these are encouraging trends.[3]

Other signs of economic strength:

- Job creation over the past six years has been at all time highs, with the unemployment rate decreasing from almost 11% in 2009 to just over 5% currently.[4]
- Housing starts hit their highest level since 2007 and new home sales are the highest since 2008.[5]
- U.S. auto sales for August were the strongest in 10 years.[6]

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This is not to say there aren't reasons for concern:

- Spreads between investment grade corporate bonds and U.S. Treasury bonds are beginning to widen, which may signal decreased confidence in corporate strength and the economy in general.[7]
- Wages are growing, but still at a below average pace.[8]
- There are many unknowns as to how China's slowing economy will affect global growth.

CHINA

The genesis of weak financial markets can most likely be traced back to earlier this summer when China devalued its currency, which raised concerns of slowing growth in that economy. This has implications for already weak commodity prices (of which China is one of the largest buyers) and global growth in general. In the face of these events, Chinese stocks have experienced a drastic sell-off.

However, the Chinese stock market has experienced two other bear markets since 2009, neither of which seriously affected our domestic bull market or general economic strength.[9] A slowdown in China should have a minimal impact on the U.S. economy. S&P 500 companies derive just 2% of revenues explicitly from China[10] and exports to China comprise just 1% of our GDP. The implication for global developed economies should likewise be muted, as exports to China from the Eurozone and Japan are less than 1.5% and 3%, respectively.[11]

STOCK MARKET VALUATION AND VOLATILITY

Equity valuations became a little stretched through the first half of the year, but the recent sell-off has provided a more attractive entry point. The S&P 500 is now trading below its long-term price/earnings ratio, and valuations of foreign stocks look similarly, if not more attractively valued at the moment.[12] And while it never feels good to sit through corrections, they are to be expected. Much of the current consternation is not so much a result of an unusually volatile market environment, but perhaps more a result of having been used to an exceptionally low volatility environment over the past six years. History will show us that, on average, corrections of 10% or more occur on an annual basis. For perspective, this most recent correction was the first one we've had in approximately 4 years—the 3rd longest stretch in the past 50 years![13] As of right now, we are perhaps in choppy, but hardly unchartered waters.

INTEREST RATES

Another contributing factor to the market volatility has been the uncertainty surrounding the Fed's decision to raise interest rates. I have written in past quarterly letters that an increase in interest rates would be an endorsement from the Fed that the U.S. economy was on sound footing. The fact they did not raise rates in September, for some at least, gave a negative signal about the true health of our economy. However, Federal Reserve Chair Janet Yellen did forecast a rate hike before the end of the year was likely, followed by gradual hikes thereafter. She stated that:

"the more prudent strategy is to begin tightening in a timely fashion and at a gradual pace, adjusting policy as needed in light of incoming data."[14]

The Fed meets in late October and then again in December. All eyes will be watching to see what, if any actions they take.

Many pundits had forecasted that the Fed would begin raising rates at the beginning of 2014. And here we are, headed into the last quarter of 2015 and still nothing. This goes to show the difficulty in trying to anticipate such moves. Whether it's forecasting interest rates or where the stock market is going in the short-term, even the best minds typically get it wrong more than they get it right. An excerpt from an article in the New York Times illustrates this point:

"I know of a guy whose insights into the Fed are better than almost anybody else's. He refinanced his mortgage on a house in Washington in 2011, getting a 30 year fixed mortgage at 4.25%.

He should have waited a year. By late 2012, average rates were almost a full percentage point lower. But by then Ben Bernanke was stuck with his higher mortgage rate, and presumably a bit of regret."[15]

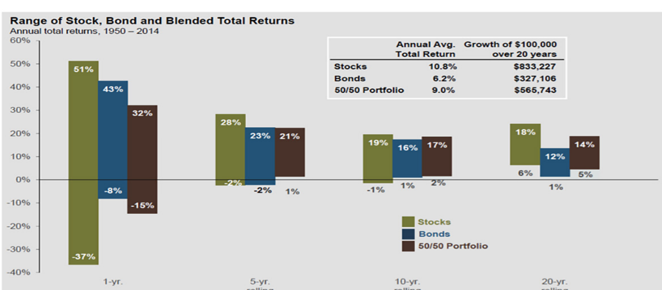
For those of you who may not see the irony, Ben Bernanke was the head of the Federal Reserve at that time (2006-2014). So, if HE can't correctly predict the direction of interest rates, what chance do the rest of us have?

This is why we don't spend a lot of time at GCG trying to forecast what will influence the markets in the short-term. Instead, we help our clients take a long-term view of what they are trying to achieve, and provide a solution that we believe will have a high probability of success over a multi-year or even multi-decade time period, not multi-month.

THE IMPORTANCE OF TIME HORIZON

The current market environment has many investors questioning their exposure to equities. Many are expecting returns on U.S. stocks to be somewhere in the neighborhood of 10%, yet the total return of the S&P 500 is down approximately 5.5% through the end of the third quarter. So you may think "The fourth quarter better be one heck of a quarter to get me my 10% increase," right? Well, let's take a closer look. It's true that since 1926, the annualized return on the S&P 500 has been in the range of 9%-11%. However, in this almost 90-year time period, there were only three instances (1968, 1993, and 2004) where returns were actually between 9-11%, and the range of annual returns was between -43% and 54%![16]

The graph below illustrates this dynamic. As you look left to right, the bars get shorter. This shows us that the shorter the time period, the more variable the potential outcomes for financial assets, and over longer time periods the variability of returns become much tighter. What also is evident is the stability bonds can provide to a portfolio of stocks. Whether it's a 10% allocation or a 50% allocation, overall portfolio volatility historically decreases when bonds are included. Along with generating income, this is one of the best reasons for including bonds as part of a well-diversified portfolio.



	Annual Avg. Total Return	Growth of $100,000 over 20 years
Stocks	10.8%	$833,227
Bonds	6.2%	$327,106
50/50 Portfolio	9.0%	$565,743

Sources: Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management.
Returns shown are based on calendar year returns from 1950 to 2014. Growth of $100,000 is based on annual average total returns from 1950-2014.
Data are as of March 31, 2015.

So your expectations for U.S. equities to return somewhere in the neighborhood of 10% may be fairly realistic if you are looking out over many years. But as history would suggest, you have about a 3 in 90 chance of achieving that return in any given year. So does it feel good that stocks are down approximately 6% year-to-date? No. But is it unusual? No.

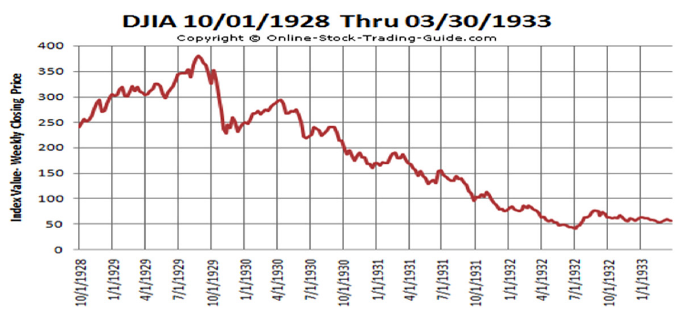
We do not want to imply that there is any guarantee of positive equity returns over long periods. However, using history as a guide, the odds sure look to be in your favor the more time you have!

WE JUST AREN'T WIRED FOR THIS

Did you know that the part of your brain that triggers this flight response...

"On second thought—you hunt, I'll gather."

is the same part of your brain that is triggered when you see this?



There is a part of the human brain that has remained with us for hundreds of thousands of years called the amygdala or "caveman brain." It controls our fight or flight instinct and how we handle stress. It was created to keep us alive on the Savanna, for example, not to make risk-reward decisions in the capital markets.

So it is no surprise that the emotional response prompted by the amygdala often dominates our reasoning in matters of investing.[17] I had a conversation with a gentleman recently who is convinced that the stock market could go down for the next five years. However, since 1926, there has NEVER been a period of 5 straight years of losses in the S&P 500.[18] Under what premise or precedent does he think this to be a likely outcome? But again, it's not his fault. It's that darned amygdala acting up, being overly protective, and perhaps a bit irrational.

Some of the the best investors have found a way to subdue this part of their brain, maintaining objectivity when the rest of the world seems to be working from emotion. Our job at GCG Financial is to help you make rational and objective decisions. Your financial advisor will work with you to create a long-term strategy and proper asset allocation that is consistent with your objectives, liquidity needs, and tolerance for risk.

Andrew M. Gluck, CFA

As a seasoned investment practitioner, Andrew understands how to navigate the investment universe in pursuit of achieving long-term performance objectives, while minimizing overall portfolio volatility

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Andrew Gluck, the Managing Director of GCG's Wealth Management Group has over 15 years of experience as a Portfolio Manager and Security Analyst. His primary expertise is in providing a comprehensive assessment of proper asset allocation, portfolio construction, and security selection, based on each client's financial goals and tolerance for risk. As a seasoned investment practitioner, Andrew understands how to navigate the investment universe in pursuit of achieving long-term performance objectives, while minimizing overall portfolio volatility.

Prior to joining GCG, Andrew spent 10 years as a Portfolio Manager at Harris Associates in Chicago, where he worked with high net worth individuals and institutions. In addition, he has founded and managed two separate investment partnerships.
Andrew earned a Bachelor's Degree from the University of California, Santa Barbara, and his MBA in Finance from DePaul University, where he graduated with Distinction.

He has earned the designation of Chartered Financial Analyst (CFA) and is a member of the CFA Society of Chicago. Andrew is a member of Securian's Investment Policy Committee and a consultant to Securian's Investment Resource Group (IRG).

Giving back to the community is important to Andrew. For years he has volunteered his time as a coach and board member of AYSO, in addition to serving on the Finance and Investment Committee at The Center on Halsted.

Andrew lives in Glencoe, Illinois with his wife and twin boys.

Andrew is a Registered Representative and Investment Advisor Representative of Securian Financial Services, Inc.

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GCG's Third Quarter Market Update Webinar

Please join us for our Quarterly Economic Update

A Live Webinar Event

Robert Janson, Senior Vice President, Wealth Management will take a look at the current trends in markets and economy with a focus on interest rates, bonds and stocks for the remainder of 2015 and beyond.

October 27, 2015

8:30 AM CST - 9:30 AM CST

4:00 PM CST - 5:00 PM CST

You don't have to leave home or the office to listen in to this event! After registering, a link will be provided for you to watch the webinar on your computer or listen by telephone.

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Questions, Please contact Bryan Marrichi at (847) 457-3184 or
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About Robert Janson, AIF, CIMA
Senior Vice President, Wealth Management, GCG Financial, Inc.

Bob is a member of GCG's Design Center. His primary area of expertise is in the design, implementation and management of investment portfolios. He is a Vice-President of GCG Financial responsible for investment services and strategies. He also serves as Investment Officer and registered principal. Bob has been with GCG Financial since 1997.

Bob has been developing his investment expertise for over 23 years. Prior to GCG, Bob's background includes working with Blunt, Ellis, & Loewi, Charles Schwab Institutional, and Retirement and Estate Advisors. Through this well-rounded experience, Bob 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's professional designations include his Accredited Investment Fiduciary (AIF®), and Certified Investment Management Analyst (CIMA®).

Registered Representative and Investment Advisor Representative, Securian Financial Services, Inc.

Footnotes, disclosures and sources

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Past performance is not indicative of future results. Investments will fluctuate and when redeemed may be worth more or less than when originally invested. One cannot invest directly in an index.
The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. This world renowned 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 75 percent coverage of U.S. equities, it is also an ideal proxy for the total market.
DJIA definition: A price-weighted average of 30 actively traded blue-chip stocks, primarily industrials including stocks that trade on the New York Stock Exchange (http://www.nasdaq.com/investing/glossary/d/dow-jones-industrial-average)
The MSCI EAFE (Europe, Australia, Far East) Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises 21 MSCI country indexes, representing the developed markets outside of North America
The Barclays Capital U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset backed securities.
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity performance in the global emerging markets. As of June 2007, the MSCI Emerging Markets Index consisted of the following 25 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.
The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index.
The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
Debt obligations are affected by changes in interest rates and the credit worthiness of their issuers. High yield, lower-rated (junk) bonds generally have greater price swings and higher default risks.
Investment risks associated with international investing, in addition to other risks, may include currency fluctuations, political, social and economic instability and differences in accounting standards when investing in foreign markets.
Investments in emerging markets involve heightened risks due to their smaller size and decreased liquidity. Funds that focus their investments on companies in one specified sector may be subject to a greater degree of risk and volatility than an investment with greater diversification.

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