GCG | Wealth Management

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GCG's 4th Quarter Market Analysis

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State of the Markets—Q4/2016

What is driving the Market? Politics? Federal Reserve's actions? Fundamentals—Earnings and Relative Valuations? Specific events may matter far less than trends in economic and market conditions when determining market performance.

S&P 500 Index YTD as of 09/30/2016

Source: bigcharts.marketwatch.com, Morningstar

The market as measured by the S&P 500 Index has recovered from the downturn in the first quarter. The impact of Brexit on the S&P 500 Index lasted two days. Year-to-Date, the US market as measured by the S&P 500 Index had a total return—which includes reinvested dividends—of 7.84%.

MARKETS

Even during the most recent up-turn in the market over the past few years, we have seen several events that in the moment seemed potentially impactful to the markets. These events caused the "fear indicator," the VIX, to spike, only to recover and move on. Every time the market has a sell off the VIX gets the media attention. It is one of the key indicators of market volatility that has gained popularity in the media over the past several years. 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 attempt to use the VIX to gain insight into the markets. However, it seems that, given the sharp rises, the VIX does a very poor job of forecasting future market activity. Rather, it simply tells us that there is volatility at the moment. Using the VIX to predict the market in the future is like using a thermometer to predict the weather. A thermometer tells the temperature now. It doesn't tell us what the temperature is going to be. It is interesting to note that the current readings on the VIX are relatively modest despite all of the uncertainty in the markets. Brexit caused the VIX to rise, only to quickly fall back.

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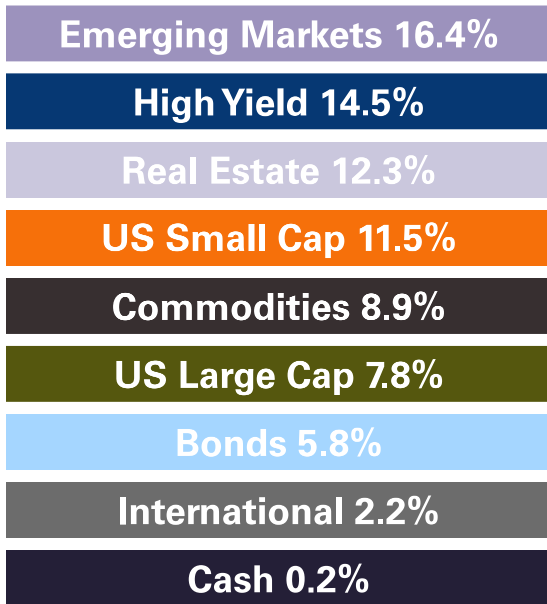
We see that as well when we look back at the periodic table of investment returns. As you know, we don't try to time the different asset classes in the market but would rather stay properly diversified based on each investor's time horizon, tolerance for risk and investment objectives. Diversification and asset allocation do not guarantee against loss, rather, they are methods to manage risk. If someone can predict how that boxes will be filled in for the future, they have a better crystal ball than me. We strive to maintain the appropriate diversification and risk profile for each portfolio to be better positioned properly for whatever the future holds.

2016 YTD

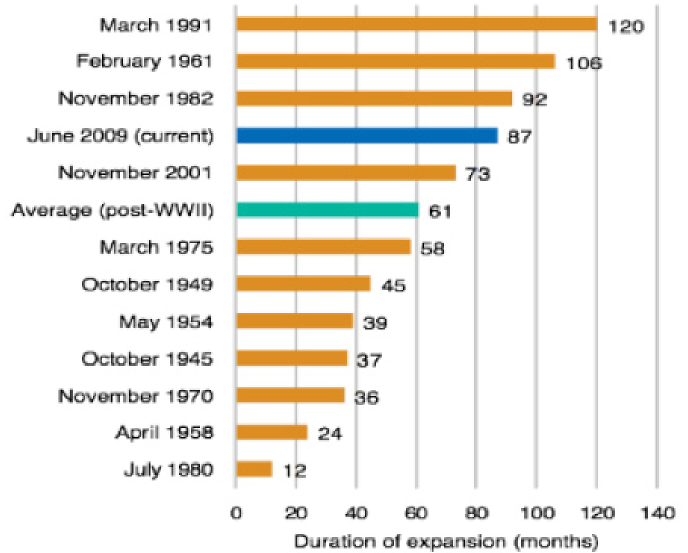


Source: Barclays, Bloomberg, FactSet, MSCI, Russell, Standard & Poor's, JPMorgan Asset Management

Looking more specifically at how the boxes stacked up year-to-date, then the riskiest asset classes are leading. This may be a good omen or just a sign of investors desperate for positive return opportunities. Traditional asset classes are all positive for the year; even developed international stocks have recovered to the positive. As we have discussed several times, there can be opportunities in being a contrarian investor: that is, buying where everyone is selling. It takes patience and courage but can also be rewarding in the long-run.

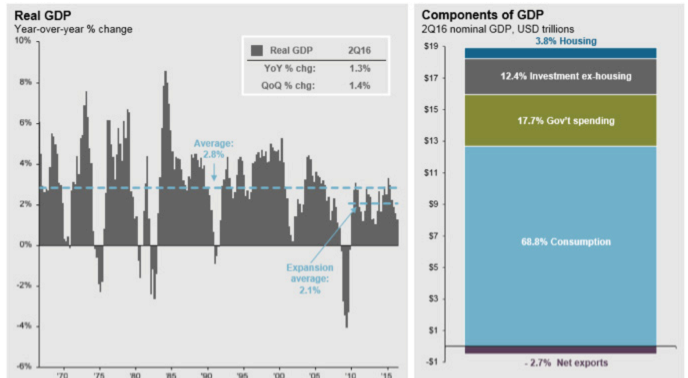
ECONOMY

While it may still be hard for some to believe, we are a few months away from taking 3rd place for the longest economic recovery. The question is how long before the next recession. So, let's take a look.



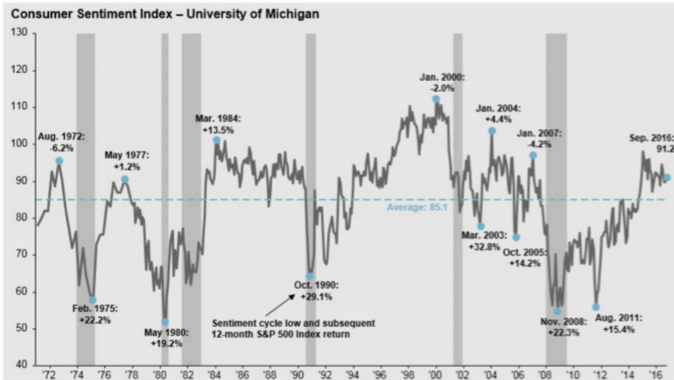
Source: PIMCO, Bloomberg

The most recent GDP reading for the 2nd quarter was recently revised to 1.3%. Still very anemic growth. Remember that consumers are by far the largest component of the GDP. They hold the key to whether or not the growth will continue. This is still below the long term average of 2.8% and below the post-crisis average of 2.1%.



Source: BEA, FactSet, JPMorgan Asset Management

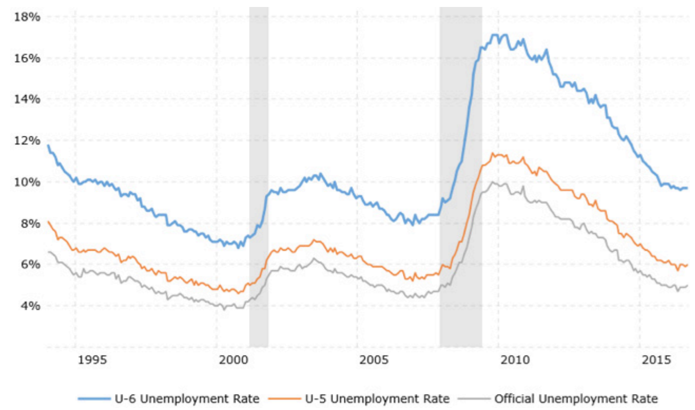
Consumer sentiment is still generally above average about economic conditions despite the recent market sell-off. We have seen a similar rise from the depths of recessions before. Now we will see if the readings continue at the same levels as previous economic expansions.



Source: Standard & Poor's, University of Michigan, FactSet, JPMorgan Asset Management

Initial claims for unemployment are one of 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. According to the Department of Labor (as of 10/07/2016), the latest reading was 250,000 new claims for unemployment insurance. We may have entered that zone where new unemployment claims reflect growing confidence in the economy by companies. It may also reflect another growing phenomenon that companies are starting to struggle to hire qualified candidates and are more likely to hang on to current employees.

The good news is that job creation rebounded sharply in June. As the employment picture strengthens the lack of qualified workers may slow the pace of hiring. The Unemployment Rate is now at 5.0% (as of September 2016). 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. Looking at the various levels of unemployment we can see that as we approach the "natural level" of "full" employment, continued gains in all three levels tend to be incrementally harder to come by.

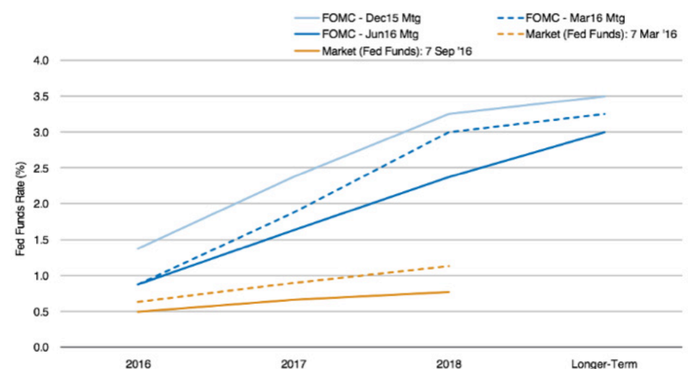


Source: Macrotrends.net; Bureau of Labor Statistics as 09/30/2016

INTEREST RATES

The Fed has a dual mandate of full employment and stable prices. Right now, one could conclude that the Fed is clearly more concerned about the wage growth numbers. They are not concerned with a little inflation so long as the wage growth numbers continue to improve. Recent commentary by several Fed board members have contained language that the targets for inflation and unemployment are not locked in stone and should be adjusted for various other factors.

We started 2016 shortly after the Fed increased the Fed Funds rate by 0.25%. At that time the Fed projected four rate hikes during 2016. Now, the Fed has revised down their own projections and is currently anticipating 1-2 increases in the next 6-12 months. The market is still is not convinced and is anticipating only one increase in the next two years. A look at the Fed Funds rate projections by the Fed and the market show a marked difference in expectations.

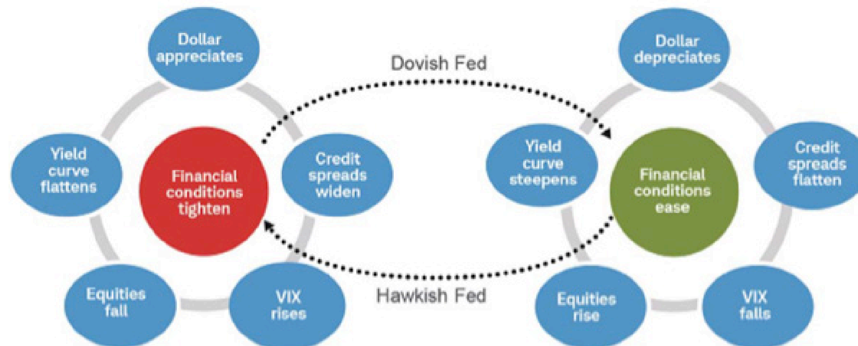


Source: Bloomberg, Federal Reserve Board, Minutes of Federal Open Market Committee Meeting

One criticism of the Fed is that they have become too reactionary to short-term fluctuations in the market and economic data. Clearly, the data is ever changing and the Fed can't act in a vacuum. But the market perception is that the Fed says one thing and does nothing.

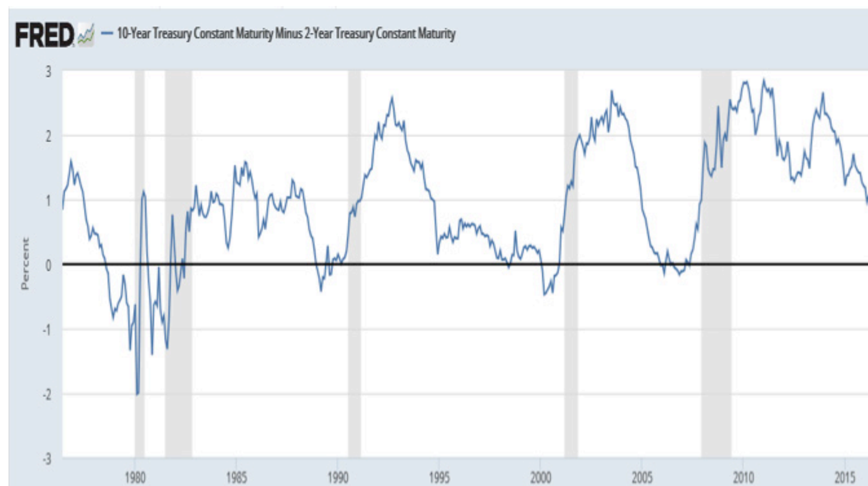
Fed Is Reacting to Financial Conditions

The Fed is at the mercy of the "policy loop" as financial conditions have moved from tighter to easier.



Source: BCA Research Inc., Charles Schwab Charles Schwab graphic

As you can see on this chart, the difference between longer-term rates and shorter rates has actually come down over the past couple of years. This is referred to as a flattening yield curve. 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 40 years, we went into a recession. Right now, the spread is near the historical average of around 1%.



Source: https://fred.stlouisfed.org/series/T10Y2Y

WRAP UP

Generally speaking, the markets have factored in the results of the election and are looking toward fundamental factors like earnings and relative valuations to ascertain the direction of the markets. The Fed's vocabulary of adverbs: "measured," "gradual" and "moderate" are being replaced with an even slower 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. One way to take advantage of market downturns rather than trying to avoid them is to consider re-balancing your portfolio. This may accomplish the old adage of "buy low, sell later." The market upturns generally last longer than the downturns and are ultimately more profitable.

You're Invited

2017 1st Quarter Economic and Market Update

Please join us for our Quarterly Economic Update

- A Live Webinar Event -

Robert Janson, Senior Vice President, Wealth Management with GCG Investments will analyze and provide opinions regarding market indicators and share his ideas on what factors may play a role in the markets for the rest of 2017.

January 25, 2017

8:30 AM CST - 9:30 AM 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.

Register today for one of our webinars: www.gcgfinancial.com/quarterly-update

Questions? Please contact Bryan Marrichi at (847) 457-3184 or bryan.marrichi@gcgfinancial.com

Save the Date

2017 2nd Quarter Economic and Market Update

April 27, 2017

8:30 AM CST - 9:30 AM CST

3rd Quarter Economic and Market Update
July 26, 2017
8:30 AM CST - 9:30 AM CST

4th Quarter Economic and Market Update
October 25, 2017
8:30 AM CST - 9:30 AM CST

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GCG 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 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.

Wilshire REIT Index measures U.S. publicly traded Real Estate Investment Trusts.

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.

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