# Market Commentary


The dust of a volatile quarter has cleared and it was a wild ride! This year began with one of the worst starts for the stock market ever as the bell weather S&P 500 fell a dramatic 10.3% by mid-February, then recovered more than all of those losses to end the first quarter up 1.3%. Coincidentally, the 1.3% gain for stocks in the first quarter matched the return for the whole year of 2015. Developed international markets trailed the U.S., ending the quarter down -3.01% and emerging markets stocks reversed a multiple year trend and finished the quarter up 5.71%. By the quarter's end, oil had recovered from its $20 per barrel low to close at $38. The recovery in crude prices is quite important as a large part of the 2015 corporate earnings weakness was attributable to energy companies. This commodity price resurgence is now a positive tailwind for 2016 earnings. Another major positive in the first quarter was the decline in the U.S. Dollar. The dollar's depreciation will positively impact the profits of US multinational companies as more than 45% of their revenues are derived abroad. Bonds outperformed most stock indexes during the first quarter, with the Barclays AGG gaining +3.03%. The actions of an extremely dovish Federal Reserve caused spread compression and lower base rates. Finally, some investors dialed down equity risk in response to the U.S. recession scare, leading small cap stocks to fall 1.52%.

1Q16 INDEX TOTAL RETURN PERFORMANCE
(Ending 3/31/2016)

| | 1Q 2016 | 1 YEAR | | 1Q 2016 | 1 YEAR |
|---|---|---|---|---|---|
| US EQUITY INDEX | | | FIXED INCOME | | |
| S&P 500 Large Cap | 1.35% | 1.78% | Barclays Municipal Bond | 1.67% | 3.98% |
| Russell Mid Cap | 2.24% | -4.04% | Barclays US Agg Bond | 3.03% | 1.96% |
| Russell 2000 Small Cap | -1.52% | -9.76% | Barclays US Corporate High Yield | 3.35% | -3.69% |
| WORLD EQUITY INDEX | | | OTHER | | |
| MSCI ACWI NR USD | 0.24% | -4.34% | Wilshire US Real Estate (REIT) | 5.20% | 4.76% |
| MSCI EAFE NR USD | -3.01% | -8.27% | S&P GSCI Commodities | -2.49% | -28.65% |
| MSCI EM Emerging Markets | 5.71% | -12.03% | Alerian MLP Index | -4.17% | -31.83% |

The macro headwinds stemming from low oil prices and a strong dollar should continue to gradually subside this year. These moderating forces, combined with a modest acceleration in revenues on the back of rising inflation, makes the outlook for 2H16 earnings a bit brighter and suggests that there may be some upside in stock prices from current levels.

sandycove ADVISORS
37 Derby Street, Suite 5, Hingham, MA 02043
o: (617) 622-1500 | f: (617) 979-8727
www.sandycoveadvisors.com

| # | Year | Q1 Change | Q2 G/L % | Q3 G/L % | Q4 G/L % | Year G/L % |
|---|---|---|---|---|---|---|
| 1 | 1975 | 24.7% | 14.4% | -9.7% | 7.4% | 38.3% |
| 2 | 1987 | 21.6% | 4.9% | 7.3% | -25.3% | 2.3% |
| 3 | 1986 | 17.6% | 4.1% | -6.6% | 7.3% | 22.6% |
| 4 | 1976 | 17.2% | 0.3% | -1.3% | 1.5% | 17.9% |
| 5 | 1998 | 11.3% | 1.7% | -12.4% | 17.1% | 16.1% |
| 6 | 2013 | 11.3% | 2.3% | 1.5% | 9.5% | **35.6%** |
| 7 | 1991 | 10.6% | -0.2% | 3.8% | 5.0% | 20.3% |
| 8 | 1967 | 10.2% | -0.7% | 7.7% | -2.3% | 15.2% |
| 9 | 1961 | 9.9% | 1.1% | 2.5% | 4.3% | 18.7% |
| 10 | 1996 | 9.2% | 1.2% | 4.0% | 9.6% | 26.0% |
| 11 | 1995 | 8.4% | 9.6% | 5.1% | 6.8% | 33.5% |
| 12 | 2012 | 8.1% | -2.5% | 4.3% | -2.5% | 7.2% |
| 13 | 1954 | 8.0% | 9.9% | 8.1% | 12.2% | 44.0% |
| 14 | 1983 | 8.0% | 8.1% | 0.9% | 2.1% | 20.3% |
| 15 | 1971 | 7.8% | -1.5% | -0.4% | 0.3% | 6.1% |
| 16 | 1979 | 7.1% | -2.3% | 4.3% | -4.5% | 4.2% |
| 17 | 1964 | 6.6% | 2.2% | 5.3% | -0.1% | 14.6% |
| 18 | 1999 | 6.6% | 12.1% | -5.8% | 11.2% | 25.2% |
| 19 | 2011 | 6.4% | 0.8% | -12.1% | 12.0% | 5.5% |
| 20 | 1989 | 5.8% | 6.4% | 10.4% | 2.2% | 27.0% |
| 21 | 1972 | 5.7% | -1.2% | 2.6% | 7.0% | 14.6% |
| 22 | 1951 | 5.3% | -2.1% | 11.8% | -0.7% | 14.4% |
| 23 | 1956 | 4.8% | -3.7% | -3.6% | 5.1% | 2.3% |
| 24 | 1963 | 4.7% | 3.6% | 3.7% | 4.1% | 17.0% |
| 25 | 1985 | 4.6% | 5.4% | -0.5% | 16.4% | 27.7% |
| 26 | 1981 | 4.1% | -2.7% | 13.0% | 2.9% | -9.2% |
| 27 | 2010 | 4.1% | -10.0% | 10.4% | 7.3% | 11.0% |
| 28 | 1993 | 4.1% | 2.4% | 1.1% | 5.6% | 13.7% |
| 29 | 2002 | 3.8% | -11.2% | -17.9% | 9.9% | -16.8% |
| 30 | 2006 | 3.7% | 0.4% | 4.7% | 6.7% | 16.3% |
| 31 | 1959 | 3.1% | 7.0% | -1.9% | 7.5% | 16.4% |
| 32 | 1950 | 3.0% | 1.5% | 8.2% | 4.0% | 17.6% |
| 33 | 1958 | 2.5% | 7.0% | 11.3% | 9.7% | 34.0% |
| 34 | 1988 | 2.5% | 7.7% | -1.3% | 2.6% | 11.8% |
| 35 | 1992 | 2.1% | 2.6% | -1.4% | 0.9% | 4.2% |
| 36 | 1997 | 2.1% | 16.5% | 3.6% | -0.5% | 22.6% |
| 37 | 1965 | 1.7% | -2.4% | 7.2% | 4.2% | 10.9% |
| 38 | 2016 | 1.5% | N/A | N/A | N/A | N/A |
| 39 | 1955 | 1.3% | 10.2% | 3.4% | 4.7% | 20.8% |
| 40 | 1952 | 0.1% | 1.8% | -1.3% | 7.9% | 8.4% |

| Key Statistics | | | | | |
|---|---|---|---|---|---|
| | Average | 2.6% | 1.8% | 4.6% | 16.4% |
| | # Up | 27 | 25 | 32 | 37 |
| | # Down | 12 | 14 | 7 | 2 |
| | % Up | 68.4% | 63.2% | 81.6% | 94.9% |

Source: Breakpoint Trading

Though history does not always repeat, the table to the left illustrates a few interesting statistics. In every year since 1950 when the stocks (Dow Jones Industrial Average) posted positive gains for the first quarter of the year, the market has closed the year with a positive return 95% of the time – or 37 out of 39 years. In the past forty years, when the market has posted a positive first quarter, the annual return has been over 16%. We'll see if 2016 results follow these favorable odds.

**Important Items to Monitor This Year:**

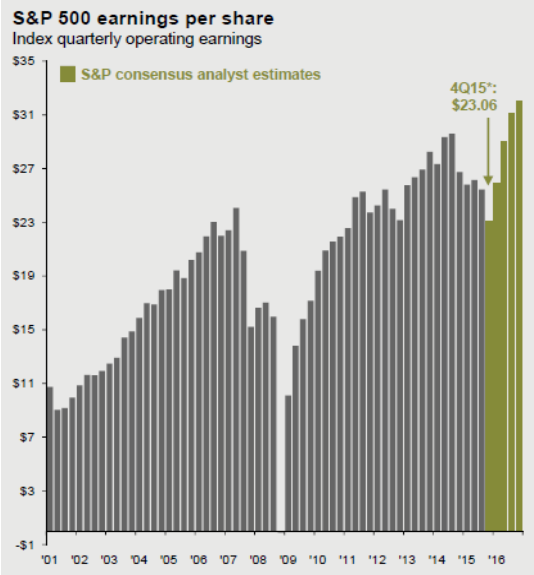
- **Global & US Economic Growth**: It is important to keep a sharp eye on Gross Domestic Product (GDP) numbers as these figures are the prime determinant of the corporate earnings that drive stock prices. This week the International Monetary Fund (IMF) cut its global economic growth rate for 2016 from 3.4% to 3.2% and predicted that the global economy would grow 3.5% in 2017, down from its prior 3.6% estimate. In historical terms this is not a stellar global growth rate, but neither is it a disastrous expectation. U.S growth is expected to be in the 2.4% range. Growth in the Eurozone and Japan is likely to remain modestly positive, and there are some bright spots in the emerging markets as well. This week we heard particularly good news as China (the largest emerging market) reported exports jumped 11.5% year over year in March – the first increase since June 2015 – and a huge improvement over the February report. This surprisingly upbeat Chinese trade data offered hope that Asia's biggest economy is stabilizing.

- **Commodity Prices**: A steady improvement in the prices of major commodities such as crude oil, copper and iron ore is essential to the ongoing recovery and the pricing of financial assets. As mentioned above, the price of crude has seen a firm bounce as West Texas Intermediate (WTI) Crude has broken above its 200 day moving average trend line for the first time in two years (see chart below). This positive trend in crude should continue to buoy battered energy sector equity prices which are a large weighting in the S&P 500 index. The continued hint of a recovery in the massive Chinese economy is very helpful to the price of commodities, equity prices of metals and mining companies and natural resource centric emerging market economies broadly. This week iron ore


Source: Bloomberg

prices surged to the highest level since the huge price spike in early March, as steel mill profit margins have risen to levels not seen in years. Chinese copper imports also jumped 36% to a record high as the price increased almost 11% from its 2016 low.

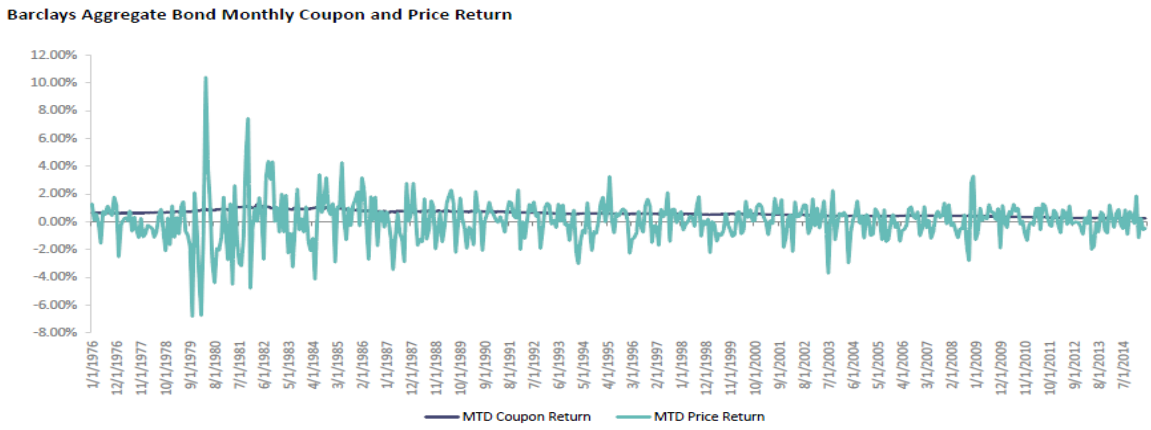
- **Earnings & Equity Prices:** Given the moderate growth of the world and U.S. economy, the stabilization of commodity prices and a lower U.S. Dollar, we expect S&P 500 corporate earnings growth in the 5-6% range over the next several years. If we expect stock prices to track earnings growth, and we add a 2% expected dividend yield to this growth rate, we can expect a 7-8% total return for stocks. However, in the short term, the market's continued rally into earnings season is indicating that current earnings estimates may be conservative. To provide further detail into the positive earnings pattern of the S&P 500, we note that Standard & Poor's projects an earnings estimate of $119.38 per share for 2016 and a robust rise in 2017 to the $137.59 level. The estimated rebound is solidly positive as this quarterly earnings graph also suggests. We are now beginning to get a good glimpse into earnings as 43% of the S&P 500 will report quarterly earnings by April 22nd. The early reports have been modestly positive, especially in the beaten down banking sector.




Source: JPMorgan Guide to the Markets

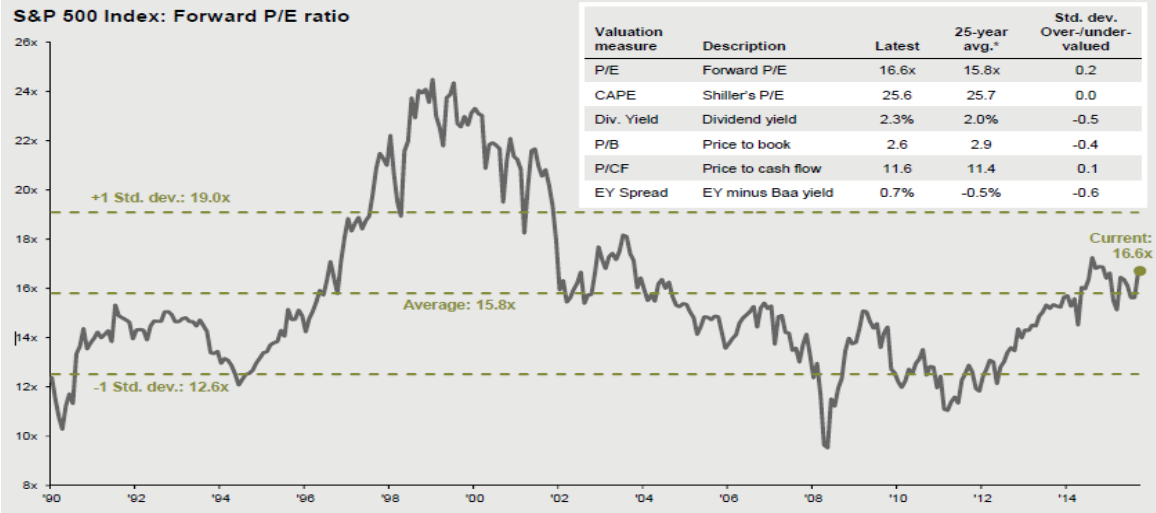
Beyond the borders of the U.S., there are also reasons to be optimistic about corporate earnings. The recent positive economic statistics from the Chinese economy in March were well received. Additionally, the unemployment rate in Europe fell to 10.3% in February, its lowest level since 2011. The jobless rate in Germany held at a low 4.3%, while unemployment in Spain fell more than expected in March. These green shoots of slow but positive economic growth should translate to gradual yet steady corporate earnings growth.

- **Interest Rates & Bond Prices:** Due to the aforementioned slower growth in the U.S. and World economies, the U.S. Federal Reserve is now expected to promote only two small interest rate hikes this year, down from an estimated four increases over the course of 2016. While we are now done with Quantitative Easing (QE) here in the U.S., the European and Japanese Central Banks are still engaged in significant QE operations that will continue to pressure their interest rates lower. In a "lower for longer" interest rate environment, we expect there will be little price appreciation in bond prices from these levels. Instead, we expect bond returns to match their current yield as they have historically (see the chart below). Since 1976 over 99% of the total return of the Barclays Aggregate Bond Index has come from the bond's coupon. Current yields are in the 2.5-3.0% range on many of the quality bond vehicles we employ at Sandy Cove Advisors, thus we expect investor returns to match these levels.




Source: State Street Global Advisors, BarclaysLive

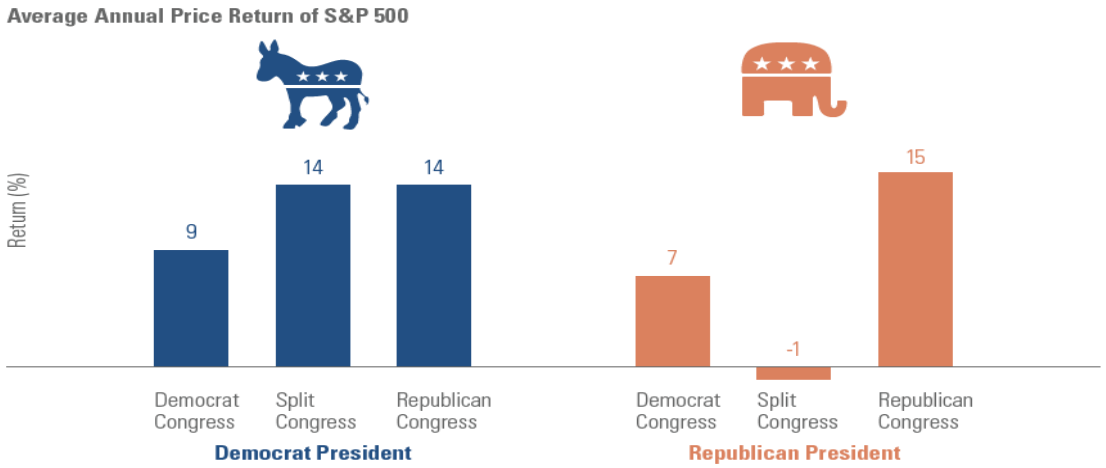
- **Valuations**: While the circumstances described above may read quite constructive, many of these positives are already reflected in equity valuations and bond prices. These full valuations keep our optimism in check. Currently equities trade at close to 17 times forward earnings which is a little expensive compared to their 15.8 average. In a low interest rate environment with moderate economic growth, we'd expect valuations to be at a premium, and they are as the chart below illustrates.




| Valuation measure | Description | Latest | 25-year avg.* | Std. dev. Over-/under-valued |
|---|---|---|---|---|
| P/E | Forward P/E | 16.6x | 15.8x | 0.2 |
| CAPE | Shiller's P/E | 25.6 | 25.7 | 0.0 |
| Div. Yield | Dividend yield | 2.3% | 2.0% | -0.5 |
| P/B | Price to book | 2.6 | 2.9 | -0.4 |
| P/CF | Price to cash flow | 11.6 | 11.4 | 0.1 |
| EY Spread | EY minus Baa yield | 0.7% | -0.5% | -0.6 |

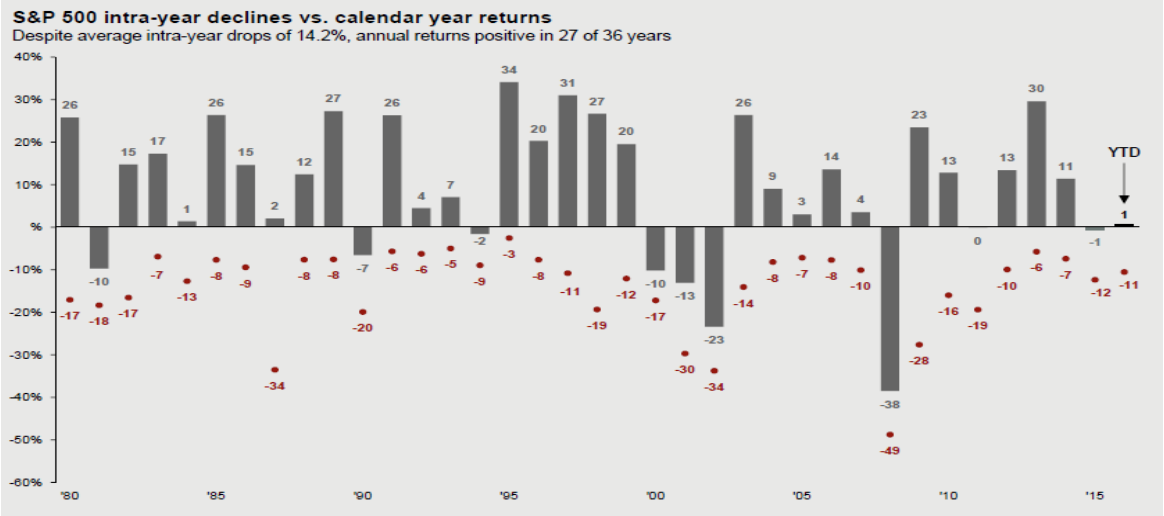
Source: JPMorgan Guide to the Markets

- **The Election:** It's difficult to avoid the media noise regarding the U.S. Presidential Election and many try to handicap the election's impact on asset prices. However, there are more relevant factors to consider when making investment decisions. According research by Goldman Sachs, though inconclusive, control of Congress may have as much influence on stock prices as control of the White House: "Instances of unified Republican government since World War II historically have delivered a 15% average annual return. Other partisan outcomes have coincided with less favorable returns. These data points are often interpreted to suggest an investment advantage for one outcome over another…. The relationship between election outcomes and market performance is extraordinarily weak, statistically speaking." Better to focus on economic trends and earnings first and foremost.




Source: Goldman Sachs

- **Volatility**: Below is one of our favorite tables which illustrates the fact that the average intra-year decline for the stock market has been 14.2% since 1980. This year's 11% drop was a bit sub-par. The message to keep in mind is that returns have been positive 75% of the time (27 of 37 years), but the ride can be bumpy.




Source: JPMorgan Guide to the Markets

## The Importance of Maintaining a Balanced Diversified Portfolio

The updated "Quilt Chart" below emphasizes the benefits of a well-diversified ("Asset Allocation") portfolio. While emerging markets, small cap equities and other asset classes can have wide return disparities from year to year, a well-diversified portfolio smooths out the bumps and gets you where you need to be over the long-term.

| 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | YTD | 2000 - 2015 Ann. | 2000 - 2015 Vol. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Comdty. 31.8% | REITs 13.9% | Comdty. 25.9% | EM Equity 56.3% | REITs 31.6% | EM Equity 34.5% | REITs 35.1% | EM Equity 39.8% | Fixed Income 5.2% | EM Equity 79.0% | REITs 27.9% | REITs 8.3% | REITs 19.7% | Small Cap 38.8% | REITs 28.0% | REITs 2.8% | REITs 5.8% | REITs 12.0% | EM Equity 25.4% |
| REITs 26.4% | Fixed Income 8.4% | Fixed Income 10.3% | Small Cap 47.3% | EM Equity 26.0% | Comdty. 21.4% | EM Equity 32.6% | Comdty. 16.2% | Cash 1.8% | High Yield 59.4% | Small Cap 26.9% | Fixed Income 7.8% | High Yield 19.6% | Large Cap 32.4% | Large Cap 13.7% | Large Cap 1.4% | EM Equity 5.8% | High Yield 7.9% | REITs 22.0% |
| Fixed Income 11.6% | Cash 4.1% | High Yield 4.1% | DM Equity 39.2% | DM Equity 20.7% | DM Equity 14.0% | DM Equity 26.9% | DM Equity 11.6% | Asset Alloc. -25.4% | DM Equity 32.5% | EM Equity 19.2% | High Yield 3.1% | EM Equity 18.6% | DM Equity 23.3% | Fixed Income 6.0% | Fixed Income 0.5% | High Yield 4.1% | Small Cap 6.6% | Small Cap 21.2% |
| Cash 6.1% | Small Cap 2.5% | REITs 3.8% | REITs 37.1% | Small Cap 18.3% | REITs 12.2% | Small Cap 18.4% | Asset Alloc. 7.1% | High Yield -26.9% | REITs 28.0% | Comdty. 16.8% | Large Cap 2.1% | DM Equity 17.9% | Asset Alloc. 14.9% | Asset Alloc. 5.2% | Cash 0.0% | Fixed Income 3.0% | EM Equity 5.9% | DM Equity 19.6% |
| High Yield 1.0% | High Yield 2.3% | Cash 1.7% | High Yield 32.4% | High Yield 13.2% | Asset Alloc. 8.1% | Large Cap 15.8% | Fixed Income 7.0% | Small Cap -33.8% | Small Cap 27.2% | Large Cap 15.1% | Cash 0.1% | Small Cap 16.3% | High Yield 7.3% | Small Cap 4.9% | DM Equity -0.4% | Large Cap 1.3% | Asset Alloc. 5.7% | Comdty. 18.7% |
| Asset Alloc. 0.0% | EM Equity -2.4% | Asset Alloc. -5.9% | Large Cap 28.7% | Asset Alloc. 12.8% | Large Cap 4.9% | Asset Alloc. 15.3% | Large Cap 5.5% | Comdty. -35.6% | Large Cap 16.5% | High Yield 14.8% | Asset Alloc. -0.7% | Large Cap 16.0% | REITs 2.9% | Cash 0.0% | Asset Alloc. -2.0% | Asset Alloc. 1.3% | Fixed Income 5.4% | Large Cap 16.7% |
| Small Cap -3.0% | Asset Alloc. -3.9% | EM Equity -6.0% | Asset Alloc. 26.3% | Large Cap 10.9% | Small Cap 4.6% | High Yield 13.7% | Cash 4.8% | Large Cap -37.0% | Asset Alloc. 25.0% | Asset Alloc. 13.3% | Small Cap -4.2% | Asset Alloc. 12.2% | Cash 0.0% | High Yield 0.0% | High Yield -2.7% | Comdty. 0.4% | Large Cap 4.1% | High Yield 11.5% |
| Large Cap -9.1% | Large Cap -11.9% | DM Equity -15.7% | Comdty. 23.9% | Comdty. 9.1% | High Yield 3.6% | Cash 4.8% | High Yield 3.2% | REITs -37.7% | Comdty. 18.9% | DM Equity 8.2% | DM Equity -11.7% | Fixed Income 4.2% | Fixed Income -2.0% | EM Equity -1.8% | Small Cap -4.4% | Cash 0.1% | DM Equity 2.8% | Asset Alloc. 11.2% |
| DM Equity -14.0% | Comdty. -19.5% | Small Cap -20.5% | Fixed Income 4.1% | Fixed Income 4.3% | Cash 3.0% | Fixed Income 4.3% | Small Cap -1.6% | DM Equity -43.1% | Fixed Income 5.9% | Fixed Income 6.5% | Comdty. -13.3% | Cash 0.1% | EM Equity -2.3% | DM Equity -4.5% | EM Equity -14.6% | Small Cap -1.5% | Cash 1.8% | Fixed Income 3.4% |
| EM Equity -30.6% | DM Equity -21.2% | Large Cap -22.1% | Cash 1.0% | Cash 1.2% | Fixed Income 2.4% | Comdty. 2.1% | REITs -15.7% | EM Equity -53.2% | Cash 0.1% | Cash 0.1% | EM Equity -18.2% | Comdty. -1.1% | Comdty. -9.5% | Comdty. -17.0% | Comdty. -24.7% | DM Equity -2.9% | Comdty. 0.8% | Cash 1.0% |

**Source: JPMorgan Guide to the Markets**

There's no better time to reassess your asset allocation than after a nice market rally. So, now is a good time to ask: Is your risk right sized for your temperament, your ability to sleep at night and your goals? A look at the chart below highlights the sharp rally we've experienced in the short term. Most would agree, it would be better to trim your risk into this continued April rally as opposed to selling into the grinding lows we saw in August and February. A client's asset allocation should be tied directly to their goals and objectives which can be fluid. Is it time to reassess or stay the course with you current plan?


*Published by Sandy Cove Advisors on April 20, 2016*


sandycove ADVISORS

37 Derby Street, Suite 5, Hingham, MA 02043
o: (617) 622-1500 | f: (617) 979-8727
www.sandycoveadvisors.com