JRM Investment Counsel

An Independent Registered Investment Advisor Firm

Market Commentary
June 30, 2016

The S&P 500 return during the second quarter was 2.46%. The forward price earnings (PE) multiple was 16.6x at quarter end, slightly above its long term average. From its low in March 2009, when the forward PE was 10.3x, the S&P 500 has increased 210% excluding dividends. There is a high correlation between the forward PE multiple and subsequent returns, with higher multiples correlated strongly with lower subsequent returns and lower multiples correlated strongly with higher returns.

Developed international and emerging market equity valuations are modestly below their historical averages, and we expect better returns from these asset categories than the domestic equity market. For multiple asset class portfolios, we have gradually increased the allocation to developed international and emerging stock markets.

The Barclays Capital US Aggregate Bond Index return during the second quarter was 2.21%. US Treasury yields have declined significantly, with yields on longer maturities declining more than shorter maturities. The 10 year and 5 year Treasury yields decreased during the quarter from 1.78% to 1.47% and from 1.21% to 1.00%, respectively. Credit spreads tightened during the quarter but are better than a year ago.

Looking beyond our borders, interest rates are negative on $13 trillion of debt, and 75% of all foreign sovereign debt yields 1% or less. By comparison, our domestic yields are generous.

For the last 40 years, investment grade bonds have provided conservative investors with a compound annual yield of 7% with modest volatility. At current yields, it is highly unlikely bonds will return much more than the purchase yield.

The Master Limited Partnerships continued to recover from the decline last year, with the Alerian MLP Index increasing 17.4% during the quarter.

Given the current valuations of the equity and bond markets, we expect future returns for diversified portfolios to be lower than recent years, probably compounding around 4-6%

Historically, low fixed income yields reflect a lack of confidence in the economy, expectations that central banks will ease monetary policy, or a flight to safety from other asset categories. Our view is the economy will plod along at a low growth rate, and central banks will soon realize the economy is too fragile for normalizing monetary policy ***and*** that additional monetary policy actions will not effectively stimulate economic growth. The combination of slow growth, accommodative monetary policy, high debt levels, foreign investor demand for a positive yield and current demographic trends will constrain any upward movement in interest rates.

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There is a continuous barrage of negative financial market commentary about Brexit, economic stagnation, deflation, terrorism, and the unkept promises of broad economic prosperity. Congress is dysfunctional, monetary policy does not work, and either Donald Trump or Hillary Clinton will probably be our next President. One does not need to look far for a reason to not invest.

It is important to keep this in perspective, however, as over the past century the markets have managed to go up in value significantly in spite of plagues, multiple wars, recessions, the oil embargo, assassination of our President, impeachment of our President, and a host of other significant negative events. It is best to ignore this noise and instead maintain a diversified portfolio consistent with your financial goals and objectives.

We do not attempt to time the markets or rotate from one popular investment strategy to another. These strategies do not work and often cause investors to sell low and buy high, increase transaction costs and are tax inefficient. We do not know what the future will look like, but it is likely to be different than we expect.

Thanks again for your trust and confidence. Please do not hesitate to contact us if you have questions or would like to discuss your investment portfolio.

Sincerely,

Jack R. McDonnell
President & Founder

Phil T. McDonnell CRPC®
Vice President