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This year began with a decided down draft for the markets. An improvident rate increase by the Federal Reserve of 25 basis points in December sent an already weak market into a tailspin. Indeed, the indices dropped nearly ten percent into correction territory, the worst start for the markets in history. The market bottomed this year on February 11 and then began an upward climb. Stocks leading the way were interest- sensitive Utilities, because bond yields had dropped so low. Also strong were the previously beaten down Energy stocks. They recovered on the theory that they had dropped so far that they would not go down further, and were due for a recovery. Although this does not always work as an investment strategy, in this case it did. Despite a slowing growth rate for petroleum worldwide, Energy is up 15.3% for the year through July 12.

Lagging stocks have been Health Care and Consumer Discretionary, which are pillars of our portfolios. Health Care was a leading sector in 2015 through the fall, when prescription pricing became a political football and stock prices tumbled. Health Care had been a leading performer for years for us because the population is aging and people are using more health care. This sector has the added benefit of being defensive when other sectors swoon, but that defense failed us. We liked consumer stocks because with the decline in gasoline prices, consumers had more money to spend. But lack of confidence in the economic outlook by consumers trumped economics. In line with the capital preservation orientation of our clients, our portfolios had a defensive tilt to buffer against a market decline.

All was not lost, since we had positive returns as the market suffered many setbacks. When the British voted to leave the European Union, the market took another dive. Hardest hit were European and British equities. Since we had brought our money back to the U.S. sometime ago, we performed relatively well as the U.S. was sought out as a safe sanctuary for stocks. Indeed, U.S. fixed income securities rose as investors sought a safe haven. As fixed income rose, yields on fixed income dropped. Yields dropped so low that they had never been lower in the history of the U.S. But the flood of money kept coming, since yields in foreign bonds were negative. As a result of the low bond yields, investors sought out U.S. equities for their safe haven qualities and their opportunity for increased returns. The result was that both U.S. fixed income and U.S. equities were good performers relative to foreign markets.

While good for returns, all the money flowing to the U.S. distorted the market. The price of both bonds and equities rose, an unusual event in itself, since they usually are inversely correlated, making both expensive. But compared to non-U.S. investments, they seemed safer. Our earlier decision to move money to the U.S. proved right.

The markets are facing many headwinds. Terrorist attacks are becoming common. Attacks against police are frequent. We seem unable to stop either. About seventy five percent of those polled in the U.S. think the country is going in the wrong direction. Usually this is bad news for the party in power, but President Obama maintains an over 50% approval rating. Since there is such a high wrong direction rating, it is no surprise that protest candidates have done so well.

Now we move into last innings of the Presidential race. The Republican convention is first up. Normally a Presidential candidate gets a bounce out of a convention, because the party looks unified and confident. It is uncertain if the Republicans will get any bounce this year, because the party is seriously divided. At least 17 Senators, four governors and the last two Republican nominees for president are staying away. GOP fund raising is seriously lacking, and its organization is practically nonexistent.

The Democrats on the other hand appear to have largely consolidated behind their front runner. They have a huge fund raising advantage and a strong national organization. As of this writing, it appears that the advantage is with the Democrats in the Presidential race, but that the Republicans will maintain control of Congress even though they lose about 18 House seats and a few Senate seats.

If that is so, then we once again we will have a divided government, the government is ungovernable, and that may not be a bad thing.

Our rather messy electoral contest is to be contrasted with the British elections for Prime Minister, just completed. The day after Brexit, David Cameron, the British PM, resigned. His party, the ruling party, immediately had a nominating election. Several candidates announced, and some thought to be candidates stood down. Within a week the ruling party nominee was decided. The vote was held, and the new PM Theresa May was elected. Cameron congratulated her, praised her, and vacated 10 Downing Street, the PMs Residence, leaving behind only the cat. New PM May met with the Queen, curtsied, and was asked by the Queen to form a government (which of course was already formed), and so PM May became only the second female PM in British history, following Margaret Thatcher. So in less than two weeks, PM May took her position alongside Angela Merkel, Chancellor of Germany, placing women in leading roles in two of the largest economies in the Euro sphere. Should Hillary Clinton become U.S. President, women would truly be getting their due.

Our plan is to continue to proceed with an emphasis on U.S. investments. Since both bonds and stocks are surging, it is hard to know where to put the emphasis, but we have chosen equities. Stocks and bonds won't continue to trade in tandem, so one has to give. We think equities will be the place to be for the time being. It is interesting to note that stocks and bonds rarely go down together. Only three times in the last ninety years have both stocks and bonds gone down together for two months. Only once in ninety years have they both gone down for three months. We will, however, continue to maintain a defensive bias in our portfolios, as we feel a day of reckoning is coming. We just don't know when, and since no one will ring a bell to tell us, market history and the recent market highs tell us to continue to invest and remain diversified.

Call if you have any questions.

Best,

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