Q1 2016 LOOK AHEAD

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Wall Street Parlor Tricks

- Last year's predictions overestimated economic rally and overestimated interest rates.

	S&P 500	S&P 500 Price Return (%)	GDP Growth	Unemployment	10-Year Treasury Rate
Avg Est (Jan 2015)	2208.50	7.27%	3.05%	5.6%	2.96%
Actual	**2043.94**	**-0.73%**	**2.6%***	**5.0%***	**2.24%**

*Year-over-Year GDP growth through Q3 2015. Unemployment rate as of November 2015.

2016 Guesses

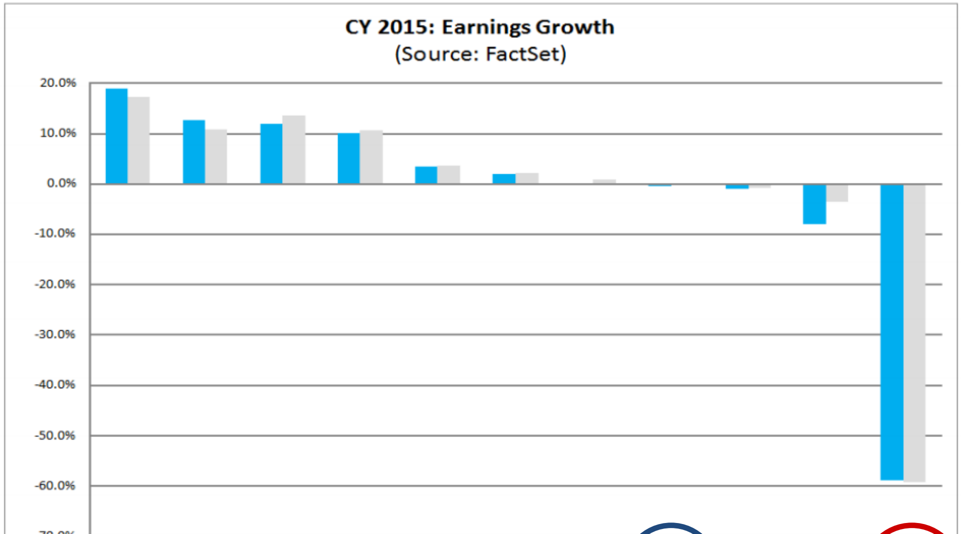
Firm	Predicted S&P 500 Target	Predicted S&P 500 Price Return (%)	Predicted GDP Growth	Predicted 10-Year Treasury Rate
Federated Investors	2500	22.1%	2.60%	2.50%
JP Morgan Chase	2200	7.4%	2.30%	2.75%
Barclays	2200	7.4%	2.50%	2.60%
Columbia Management	2200	7.4%	2.50%	2.40%
Morgan Stanley	2175	6.2%	1.90%	2.70%
BlackRock	2175	6.2%	2.60%	2.75%
Goldman Sachs	2100	2.5%	2.30%	3.00%
BofA Merrill Lynch	2200	7.4%	2.50%	2.65%
Average	**2218.75**	**8.34%**	**2.40%**	**2.67%**

Agency	Global Growth	Developed Market	Emerging Market
World Bank (As of 1-16)	2.9%	4.8%	2.1%
IMF (As of 10-15)	3.6%	2.2%	4.5%
Average	**3.25%**	**3.5%**	**3.3%**

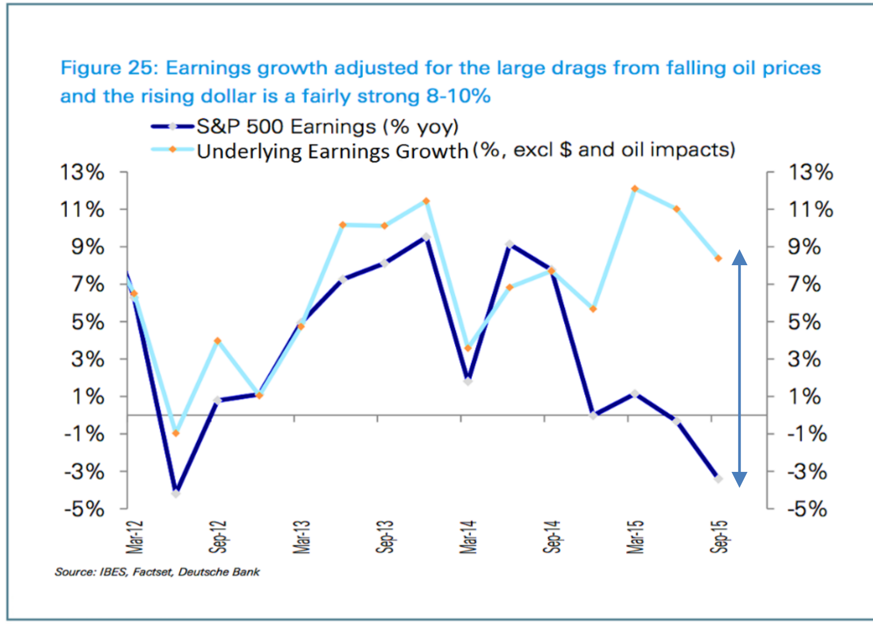
Sources:
Phillips & Company. (Jan 2015). Q1 2015 Look Ahead.
Statista, forecast to the unemployment rate in the United States 2014-2025
Racanelli, V. (Dec 16, 2015). Outlook 2016: Barron's.
*IMF World Economic Outlook (WEO), October 2015
*The World Bank Global Economic Prospects, January 2016

Earnings Recession For Sure

The Energy Sector has been the main detractor from earnings



	Telecom Services	Health Care	Financials	Consumer Disc.	Info. Technology	Utilities	Consumer Staples	S&P 500	Industrials	Materials	Energy
Today	18.9%	12.5%	11.9%	10.0%	3.4%	1.9%	-0.1%	-0.6%	-1.0%	-8.1%	-58.8%
30-Sep	17.1%	10.8%	13.5%	10.5%	3.6%	2.1%	0.8%	-0.3%	-0.8%	-3.7%	-59.1%



Earnings Recession

Time Period	1 Year
Average EPS Contraction	13.24%
Price Correction	8.60%

http://seekingalpha.com/article/2978956-the-earnings-recession-of-2015-stock-market-in-danger
http://www.factset.com/websitefiles/PDFs/earningsinsight/earningsinsight_12.31.15
http://www.businessinsider.com/chadha-earnings-growth-adjusted-for-oil-dollar-fairly-strong-2015-10

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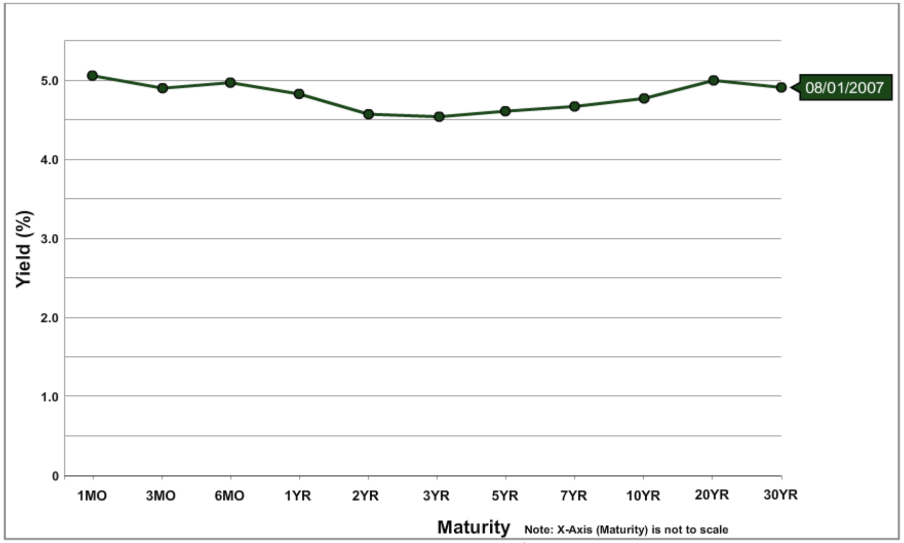
Economic Recession – Possible but Not Likely

The Yield Curve as a Leading Indicator

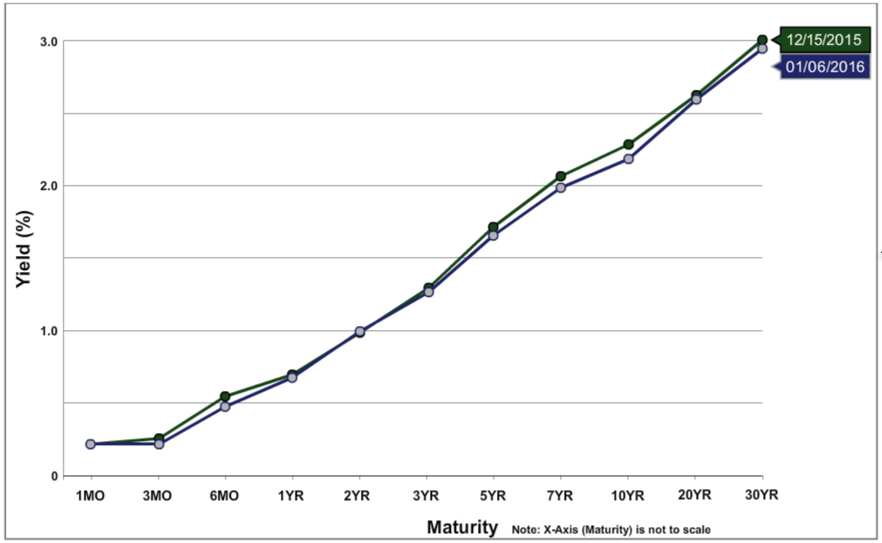
Every Recession since 1969 has been preceded by at least three monthly average inverted yield curves, in the 12 months leading up to the recession

The Great Recession



Inverted

Dec Fed Rate Hike Through Today



Normal

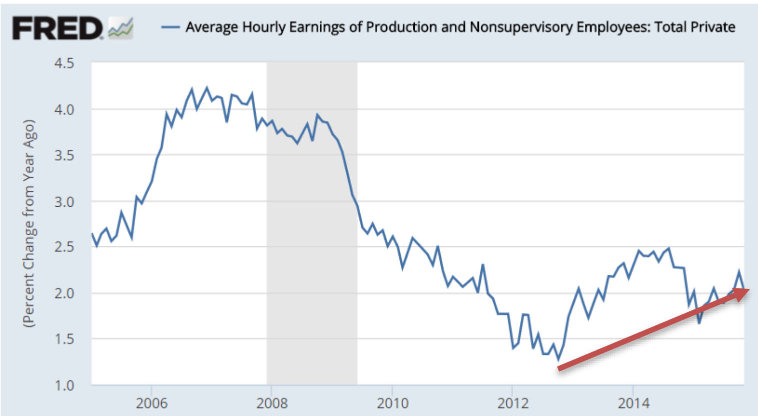
	Economic Recession
Time Period	Up to 2 Years
Average EPS Contraction	49.74%
Price Correction	29.59%

http://seekingalpha.com/article/2978956-the-earnings-recession-of-2015-stock-market-in-danger
https://www.newyorkfed.org/research/capital_markets/ycfaq.html
https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-Yield-Data-Visualization.aspx

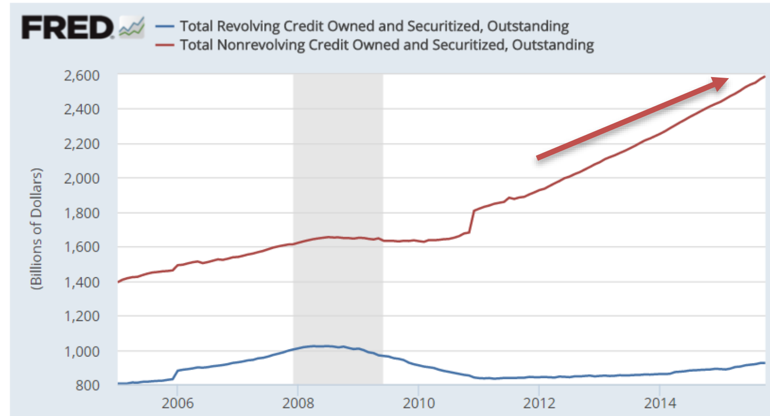
The U.S. Consumer Can Lift

Consumers have more to spend due to higher wages, increased credit, and increased personal savings

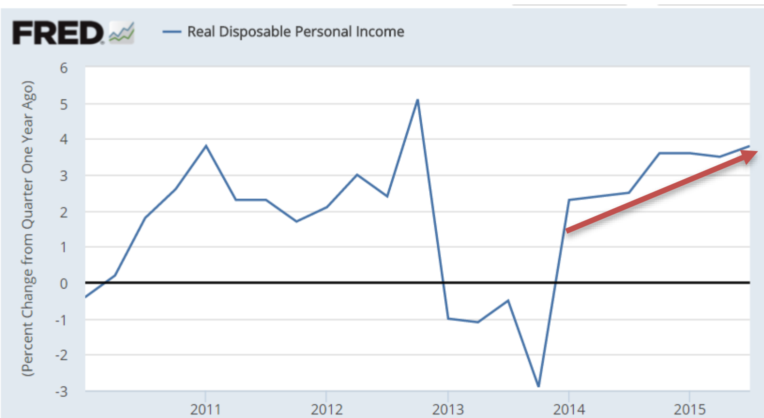
Average Hourly Earnings



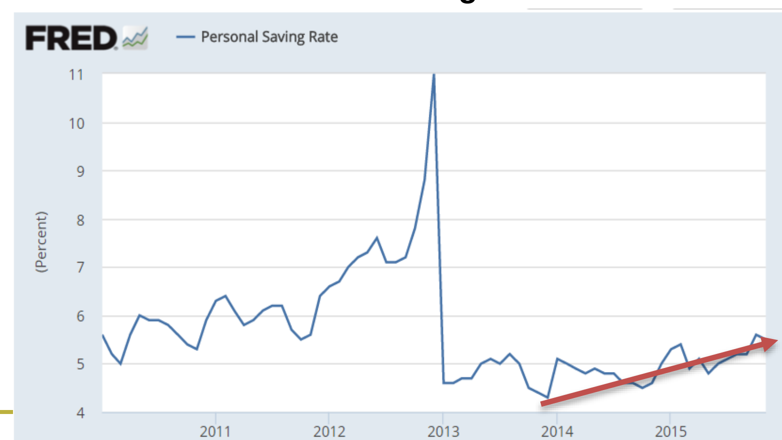
Credit



Real Disposable Income



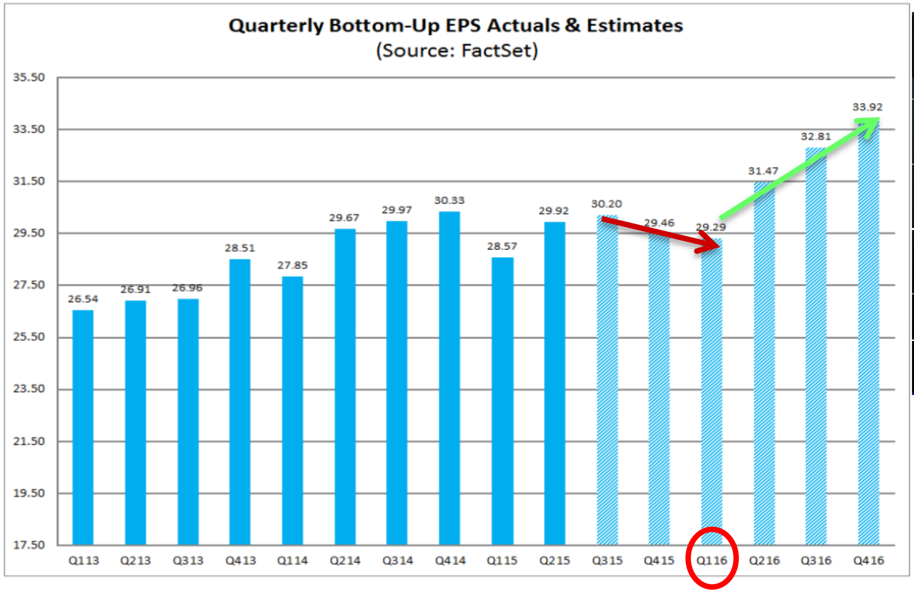
Personal Savings Rate



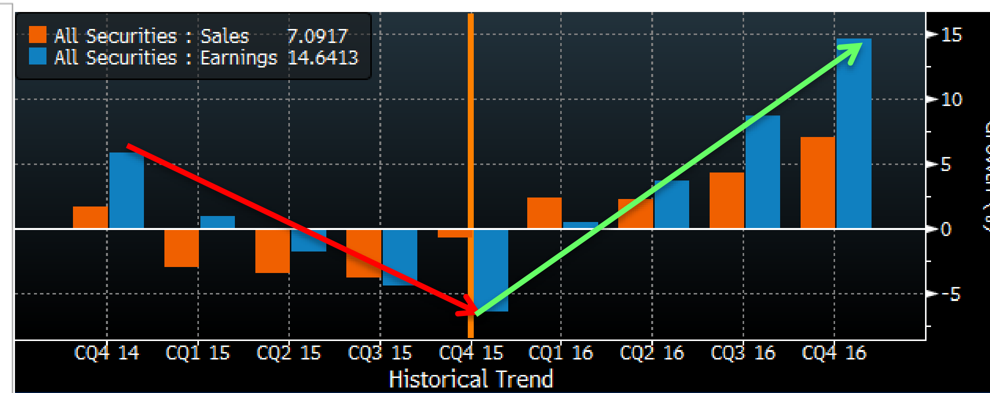
Sources:
St Louis Fed

Light at the of the Tunnel – Why We Don't Expect an Economic Recession

Earnings Recovery in Q2 2016



EPS growth should normalize in either Q3 or Q4



Volatility Follows Uncertainty

- The last time we had 3 consecutive quarters of negative earnings growth was 2009
- Year-over-year earnings expectations become easier to beat in 2016
- Equity markets will likely have some wild swings as we get comfortable with the new normal
- We are going to have to wait out one more earnings reporting season (Q4 2015) which is anticipated to have negative year-over-year earnings growth

Sources:
Bloomberg, LP
http://www.factset.com/websitefiles/PDFs/earningsinsight/earningsinsight_12.24.15/

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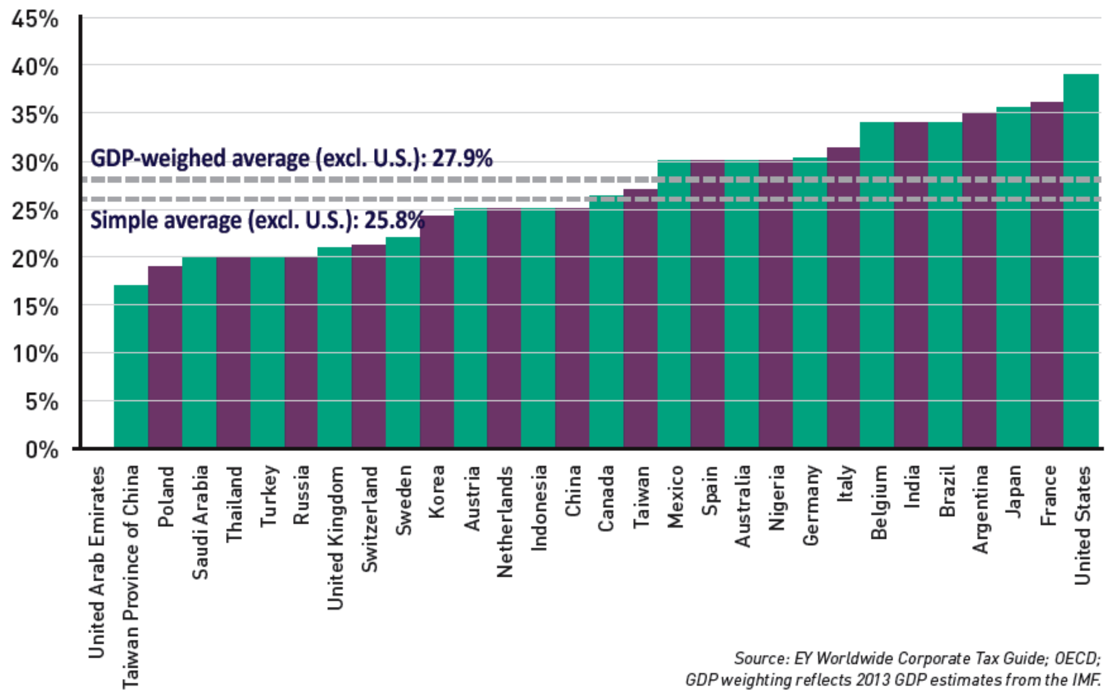
Fiscal Policy Finally – An Unexpected Benefit

1. Congress & the President signed a Federal budget for the first time in 6 years

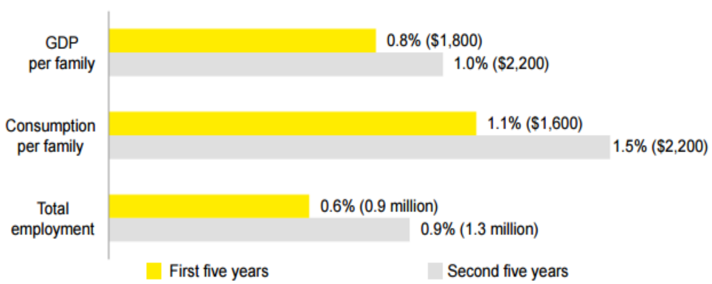
2. Congress agreed to return to normal order of 12-separately negotiated spending bills for the first time in 20 years

3. Likely fiscal stimulus
    1. Corporate tax reform
    2. Infrastructure spending



Source: EY Worldwide Corporate Tax Guide; OECD; GDP weighting reflects 2013 GDP estimates from the IMF.

Benefit to average American household with 5% reduction in Federal CIT



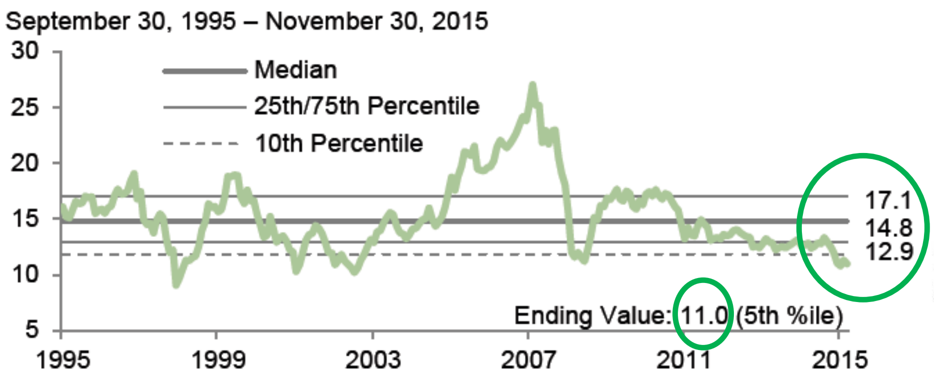
The U.S. corporate income tax (CIT) rate of 39.0%, including both federal and average state CIT rate, is 11.1% higher than the GDP-weighted average CIT rate across the top 30 world economies

Sources:
https://nrf.com/sites/default/files/Documents/retail%20library/NRF-2015-TaxReform-report_r3.pdf

Emerging Markets are Closer to a Bottom

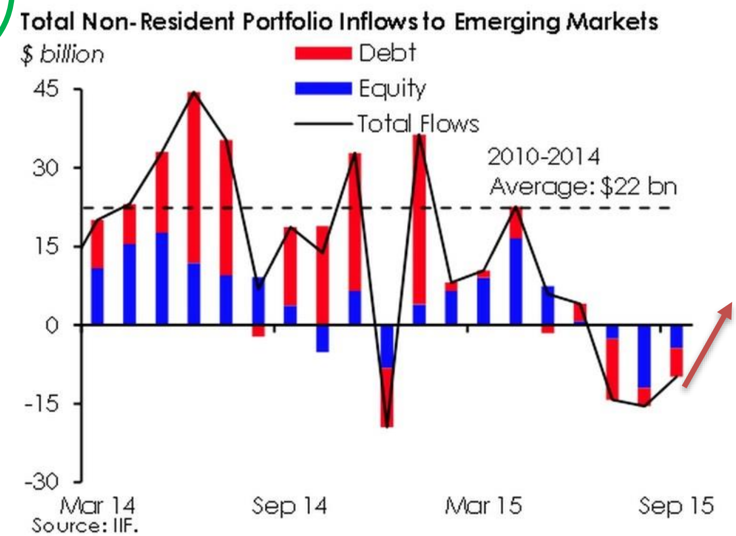
- Valuations put Emerging Markets in an oversold position
- Fund flows out of Emerging Market funds are starting to abate

MSCI Emerging Markets P/E



2015 saw the biggest EM fund outflows since 2008

MSCI Emerging Markets Fund Flows



China's devaluation of its currency, the yuan, was the catalyst for the sell-off

Sources:
JP Morgan, Guide to the Markets, Q1 2016
http://blogs.wsj.com/moneybeat/2015/08/28/for-emerging-markets-most-predictable-fund-flow-data-ever/

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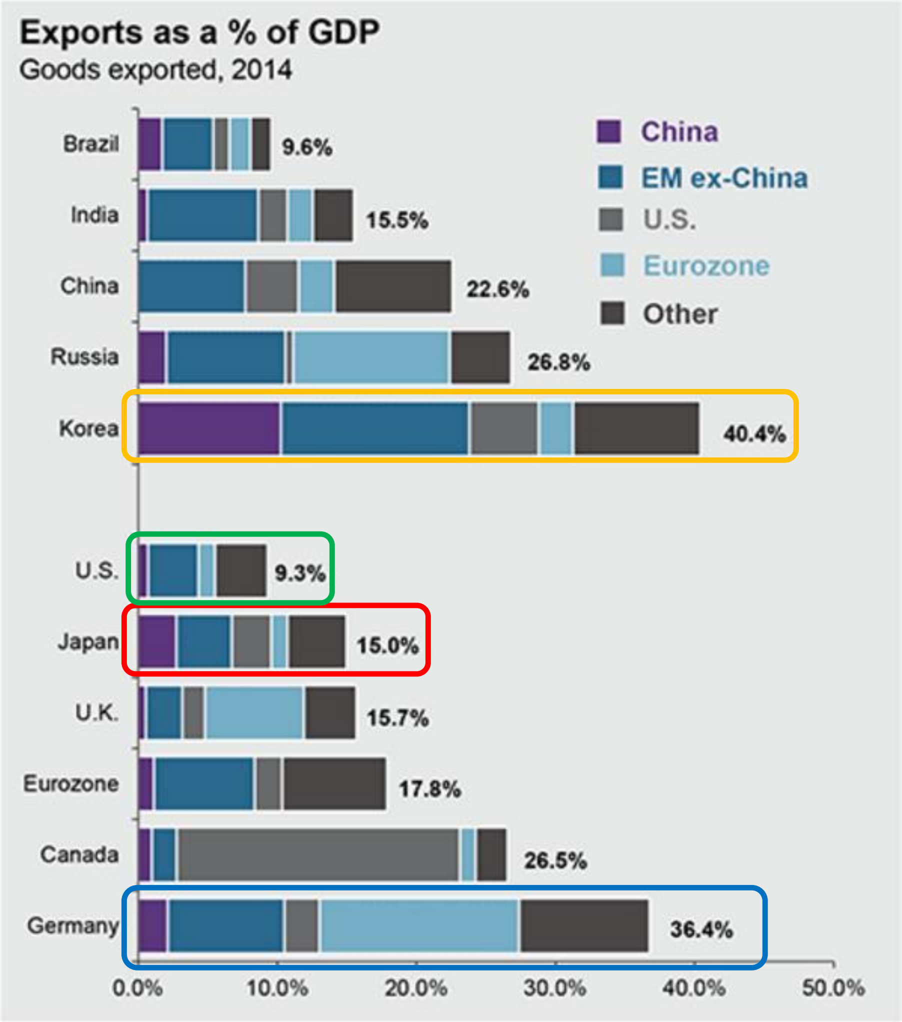
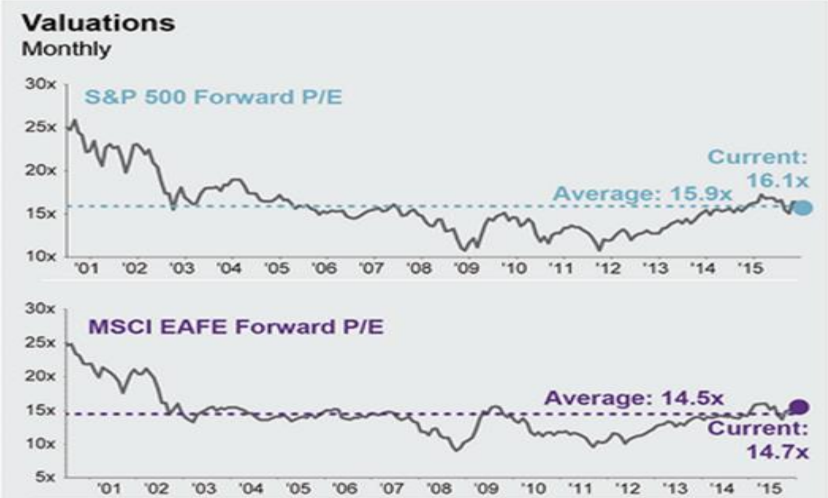
Benefiting from Strong U.S. Dollar



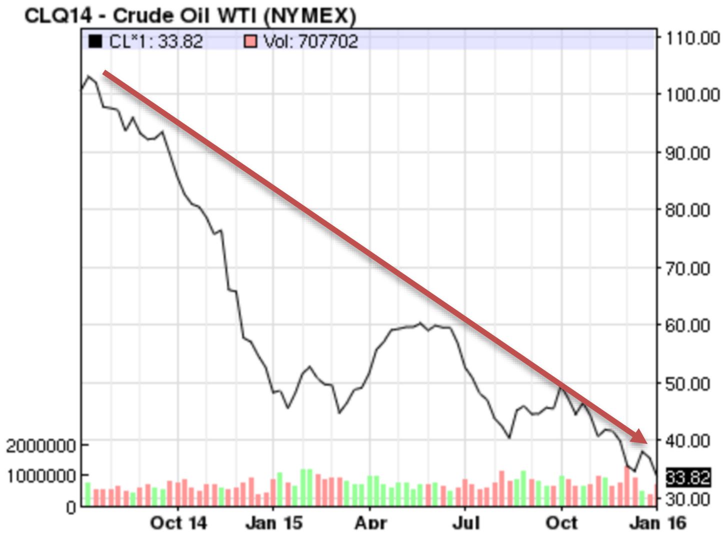


Larger developed export markets have benefited from a strong U.S. Dollar in 2015

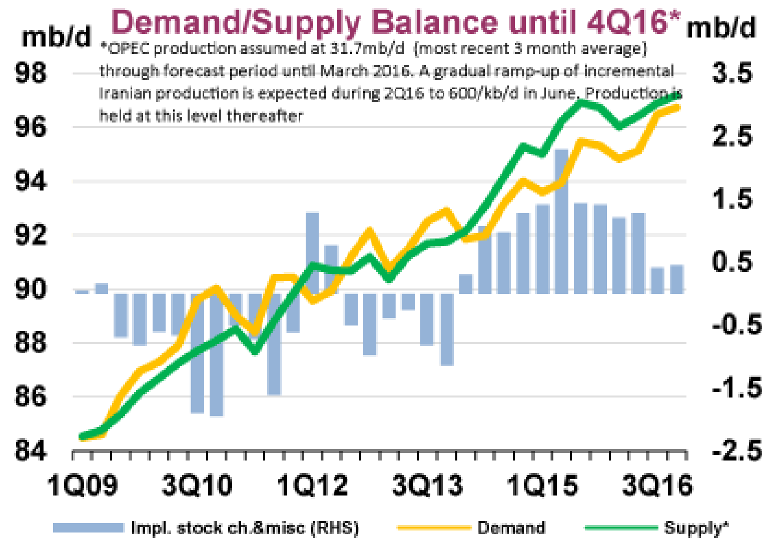
Sources:
JP Morgan Asset Management. (January 5, 2016). “3Q 2015 Guide to the Markets”
Google Finance

Oil

18 Months of Price Decline



More Supply and More Demand for 2016:



- Saudi Arabia could run out of cash in five years or less if oil stays below $50 a barrel
- Iran's production cost is as low as $1-$1.50 a barrel
- The U.S. started exporting oil, after a 40 year ban, on December 31, 2015
- Expect global destabilization until OPEC cuts production sometime in 2016
- Per barrel oil prices will continue downward trend, bottoming out in 2016

Sources:
http://money.cnn.com/2016/01/05/news/saudi-arabia-oil-budget-gas/
http://www.nasdaq.com/markets/crude-oil.aspx?timeframe=18m
http://www.forbes.com/sites/timworstall/2015/12/31/conocophillips-will-ship-first-us-crude-after-end-of-export-ban-any-why-we-lifted-it-anyway/

Mean Reversion Dashboard

Style Current P/E as a % of 20yr Avg. P/E

	Value	Blend	Growth
Large	105.8%	93.8%	86.4%
Mid	111.2%	104.8%	87.1%
Small	109.0%	99.6%	88.3%

Regional Fwd P/E as a % of 10yr Avg. Fwd P/E

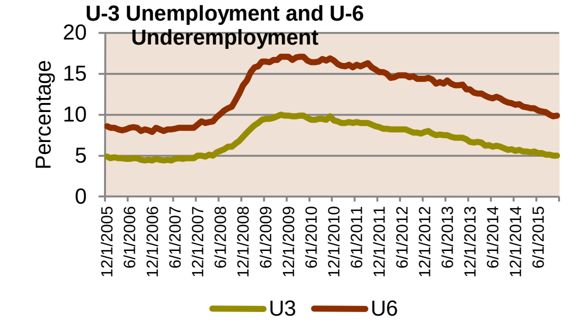
ACWI	EAFE Index	EM Index	United States	Germany	U.K.	China	Brazil	India	Russia
96.60%	106.14%	92.12%	104.90%	111.15%	133.08%	65.92%	83.97%	110.64%	106.25%

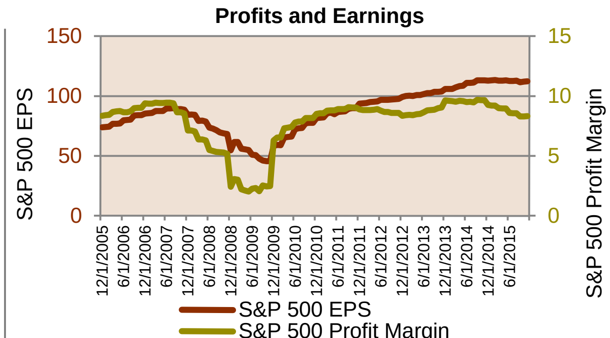
Sector Trailing P/E as a % of 20yr Avg. P/E

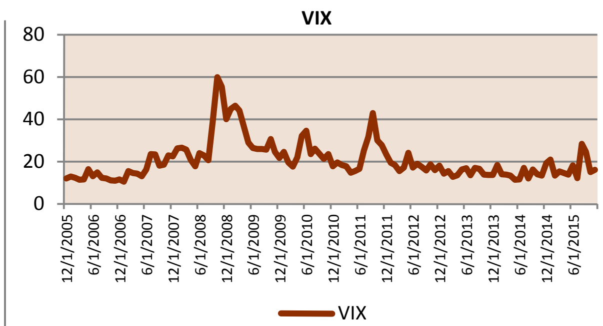
Financials	Technology	Health Care	Industrials	Energy	Cons. Discr.	Cons. Staples	Telecom	Utilities	Materials
86.4%	75.7%	93.3%	90.2%	101.1%	112.3%	102.3%	112.5%	109.9%	94.8%

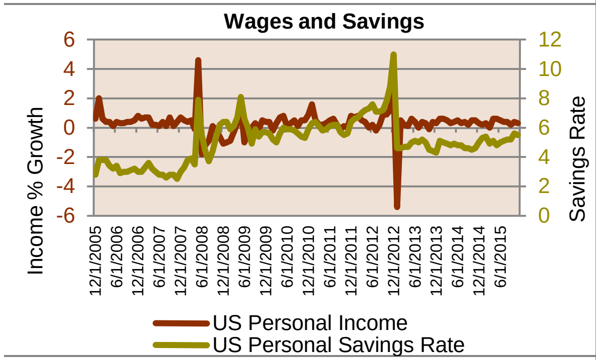
Source: JP Morgan Asset Management. (January 05, 2016). "1Q 2016 Guide to the Markets", p. 9-10, 54-55. JP Morgan sources data from MSCI, FactSet, Standard & Poor's, Russell Investment Group, and J.P. Morgan Asset Management. Trailing P/E ratios are bottom-up values defined as month-end price divided by the last 12 months of available reported earnings. Historical data can change as new information becomes available. Past performance is not indicative of future returns.

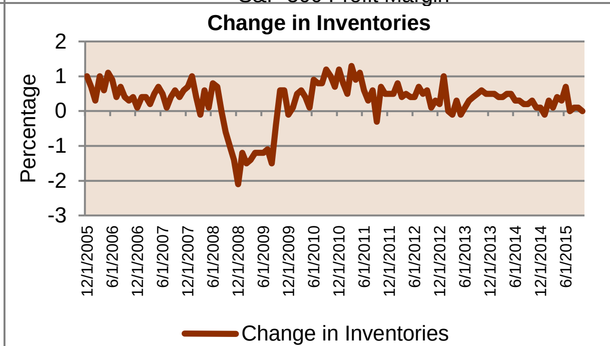
Economic Dashboard

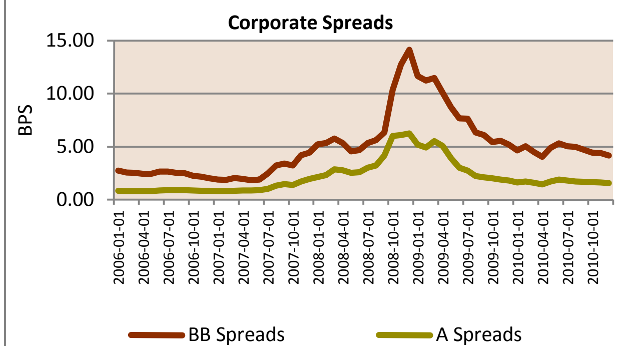


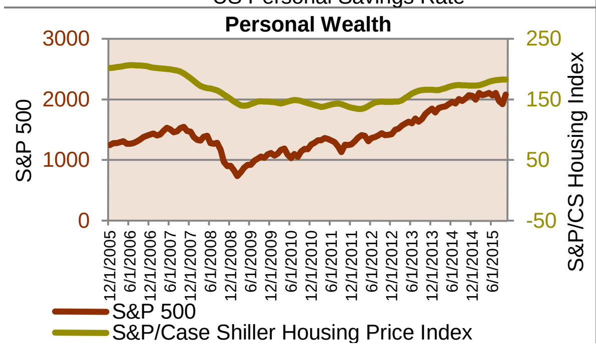


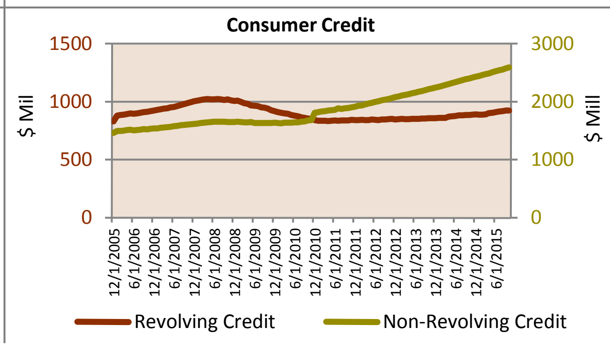


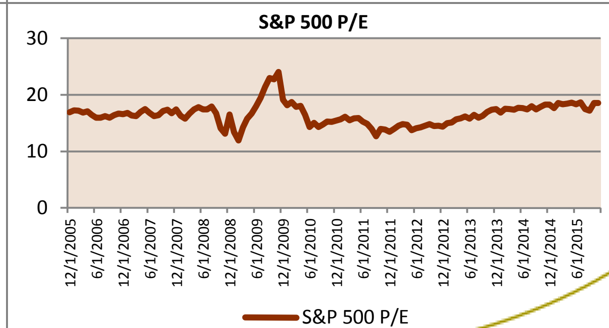












Source: Bloomberg LP and Federal Reserve. Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented. Data retrieved on 1/07/2016.

Recommendations

Summary:

- We expect the earnings recession to abate in 2016
- Continue to monitor data for economic recession indicators, however unlikely
- **Earnings are the critical factor**. Expectations are low with a chance to surprise to the upside, especially in the second half of 2016
- Dollar hedging may be an unspoken opportunity to exceed expectations
- Emerging markets continue to offer better valuations and potential for long-term growth

Recommendations:

- Equal weight Developed Markets with Emerging Markets – using a Dollar hedge
- Tilt to Large Cap growth as we anticipate an end of the earnings recession
  - Focus on Financials that benefit from a rising Federal interest rate
  - Technology
- Allocate back to High Yield as the stress of energy firm defaults adversely impacts the entire High Yield sector

Source:

Phillips & Company

THANK YOU