ENDOWMENT
WEALTH MANAGEMENT

Quarterly Economic & Market Update
2nd Quarter 2016

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Our sole mission is to provide wealth sustainability for individuals, families, endowments, foundations, and retirement plans through the implementation of our 3-D Endowment Investment Philosophy.

Important Information

Performance quoted is past performance and cannot guarantee comparable future results; current performance may be higher or lower.

Results shown assume the reinvestment of dividends.

An investment cannot be made directly in an index.

Investments with higher return potential carry greater risk for loss.

Investing in small companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

Foreign securities have additional risks, including exchange rate changes, political and economic upheaval, the relative lack of information about these companies, relatively low market liquidity and the potential lack of strict financial and accounting controls and standards.

Investing in emerging markets involves greater risk than investing in more established markets such as risks relating to the relatively smaller size and lesser liquidity of these markets, high inflation rates, adverse political developments and lack of timely information.

Fluctuations in the price of gold and precious metals often dramatically affect the profitability of the companies in the gold and precious metals sector. Changes in political or economic climate for the two largest gold producers, South Africa and the former Soviet Union, may have a direct effect on the price of gold worldwide.

Stock Market

- record new highs
- driven by earnings turnaround
- following the anniversary of $USD surge
- and energy prices bottoming
- stocks are fully-, but not over-valued
- margins are likely sustainable
- Fed is accommodative
- inflation is tame
- lack of irrational exuberance

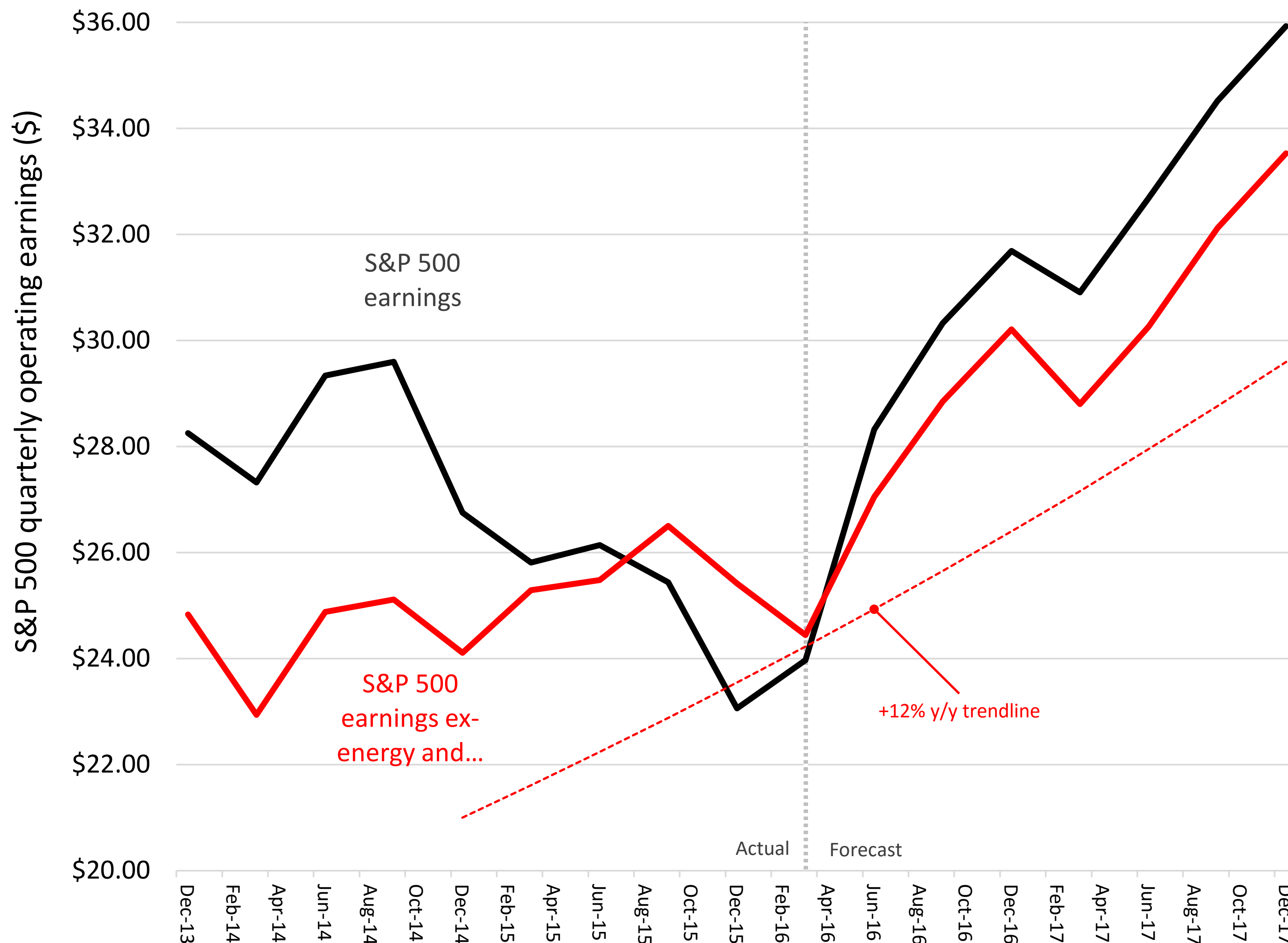
S&P 500 vs. 17X actual and estimated earnings

This is not a forecast or prediction.
It's simply a calculation of 17X actual and estimated S&P 500 earnings.

[1] 2015 (actual), 2016 (estimated) and 2017 (estimated) bottom-up S&P 500 operating earnings per share as of June 29, 2016: for 2015, $117.46; for 2016(e), $118.62; for 2017(e), $135.63. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S survey of consensus estimates. Standard and Poor's for index price data through June 30, 2016; and actual earnings data through 2014.

Earnings recession

S&P 500 earnings and forecasts – with and without energy + materials



According to Standard & Poor's forecasts, *earnings are on a +12% growth trajectory through the end of 2017.*

+12% might be too optimistic but just half of that would be fine.

Source: Standard & Poor's. Earnings estimates are based on the Capital IQ consensus forecast. Actual data through Q1 2016. Data as of June 30, 2016.

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U.S. Dollar index

$USD stabilization for over a year.

"… no model projecting directional movements in exchange rates is significantly superior to tossing a coin."

-- Alan Greenspan[1]

Source: Federal Reserve major currencies index. Data through June 2016. Federal Reserve, Remarks by Chairman Alan Greenspan before the Economic Club of New York, March 2, 2004.

Earnings recession

S&P 500 earnings & the $USD

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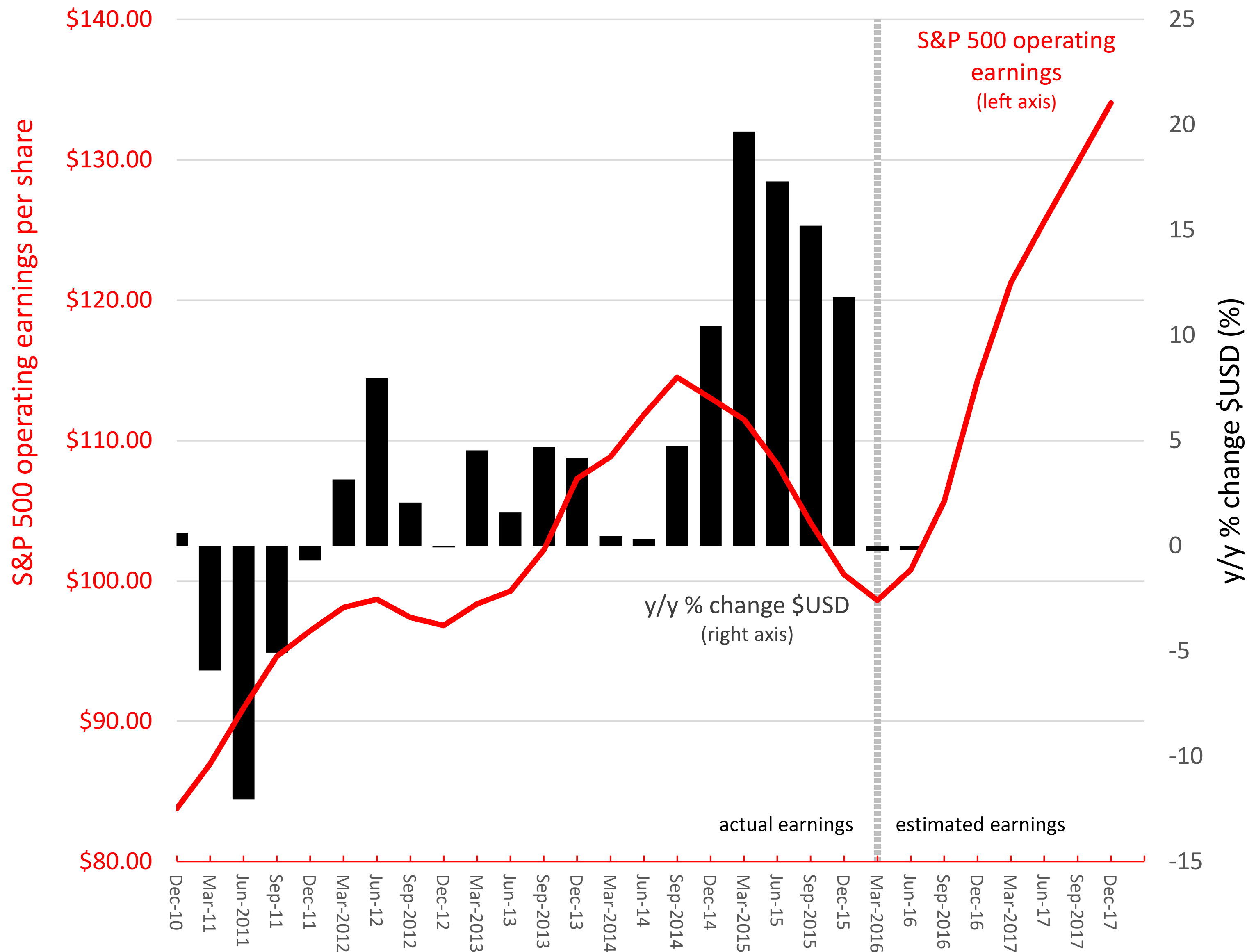
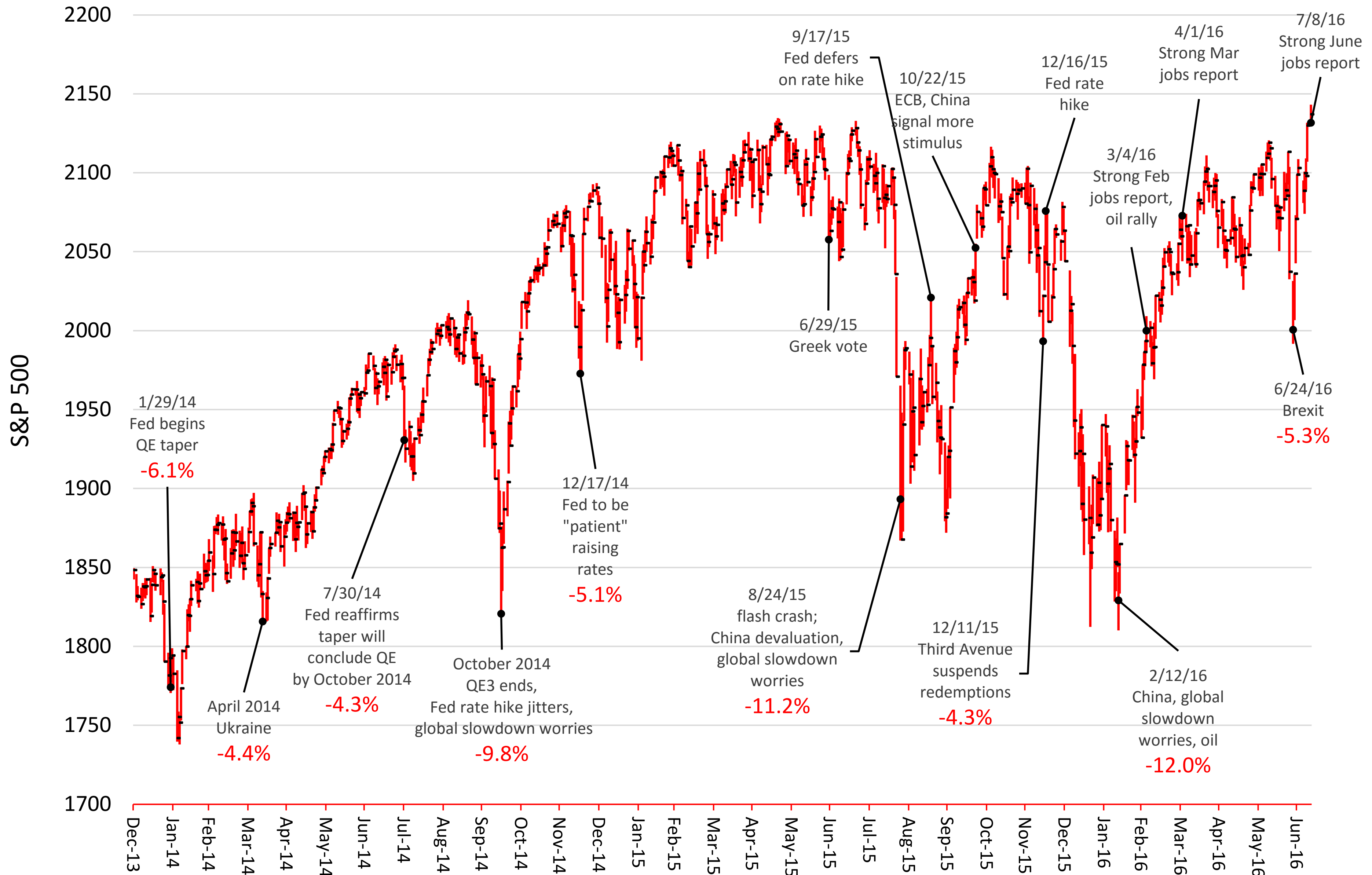


<u>2014-15 surge in the $USD was a key cause of the earnings recession</u>.

With $USD stabilization and rising oil prices earnings are forecast to surge in 2016 and 2017.

Sources: Federal Reserve and Standard & Poor's. Earnings estimates are based on the Capital IQ consensus forecast. Actual earnings data through Q1 2016; actual $USD data through Q2 2016.

Market data
S&P 500



Source: Standard & Poor's. data through July 11, 2016.

Stock market equilibrium

S&P 500 total return

Let's put it into perspective.

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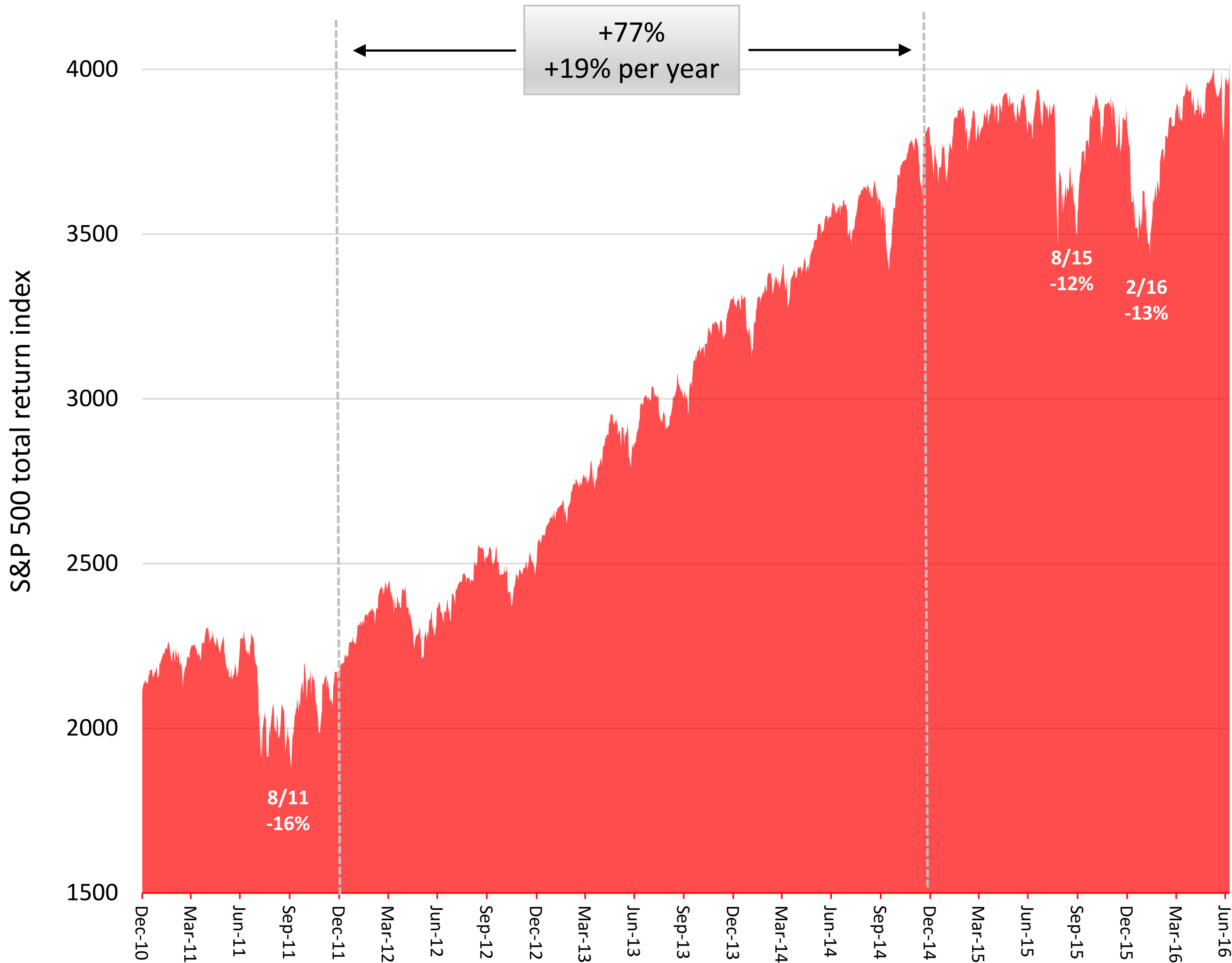

2015 and 2016-to-date have marked a leveling out in the stock market and two long-anticipated corrections following the extraordinary uninterrupted four-year recovery run.

The market's relentless, low-volatility surge higher was driven by a post-recession reversion back to normal valuation.

See next slide.

Source: Standard & Poor's Corporation. Data through July 8, 2016. [1]Total return includes dividends reinvested.

Stock market equilibrium

Valuation – S&P 500 P/E ratio

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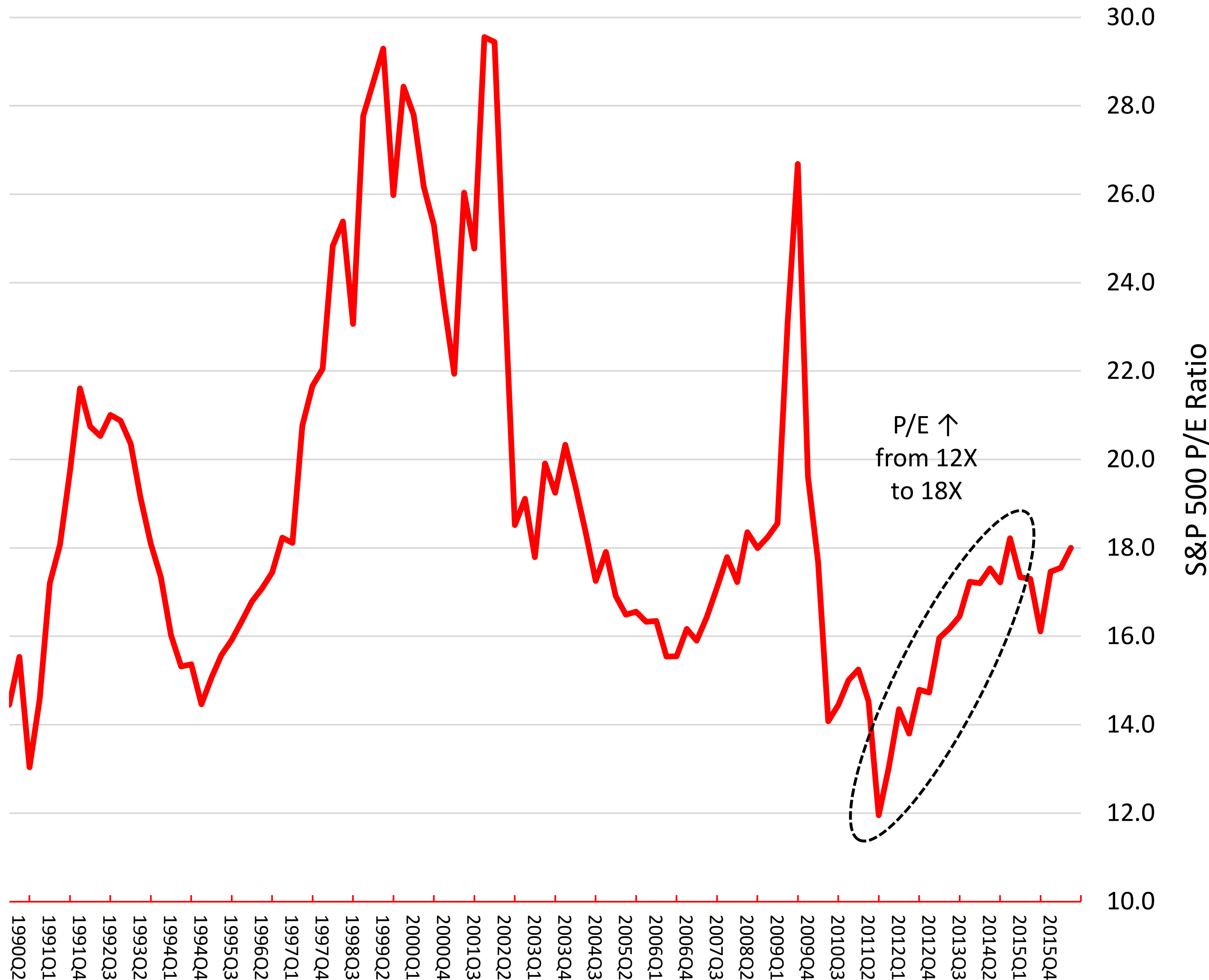


Post-recession, the stock market's P/E ratio took three years to revert back to normal.

That sustained upward re-valuation pressure helps to explain the market's relentless, low-volatility three-year surge higher.

With that re-valuation tailwind now past, the stock market has been more susceptible to volatility.

Sources: Standard & Poor's Corporation. P/E ratio calculated on operating earnings. Stock price data through June 30, 2016. Latest data point: 2099 ÷ trailing earnings of $116.61 through 3/31/16 = 18.0X.

Valuation

S&P 500 P/E ratio vs. inflation

S&P 500 P/E ratio
(right axis)

17.9X

Inflation
(left axis)

Personal Consumption Expenditures Deflator
(y/y % change)

24.0
19.0
14.0
9.0
4.0
-1.0

S&P 500 P/E Ratio

30.0
20.0
10.0
0.0
-10.0
-20.0
-30.0

12/31/1960 06/30/1962 12/31/1963 06/30/1965 12/31/1966 06/30/1968 12/31/1969 06/30/1971 12/31/1972 06/30/1974 12/31/1975 06/30/1977 12/31/1978 06/30/1980 12/31/1981 06/30/1983 12/31/1984 06/30/1986 12/31/1987 06/30/1989 12/31/1990 06/30/1992 12/31/1993 06/30/1995 12/31/1996 06/30/1998 12/31/1999 06/30/2001 12/31/2002 06/30/2004 12/30/2005 06/30/2007 12/31/2008 06/30/2010 12/31/2011 6/30/2013 12/31/2014 6/30/2016

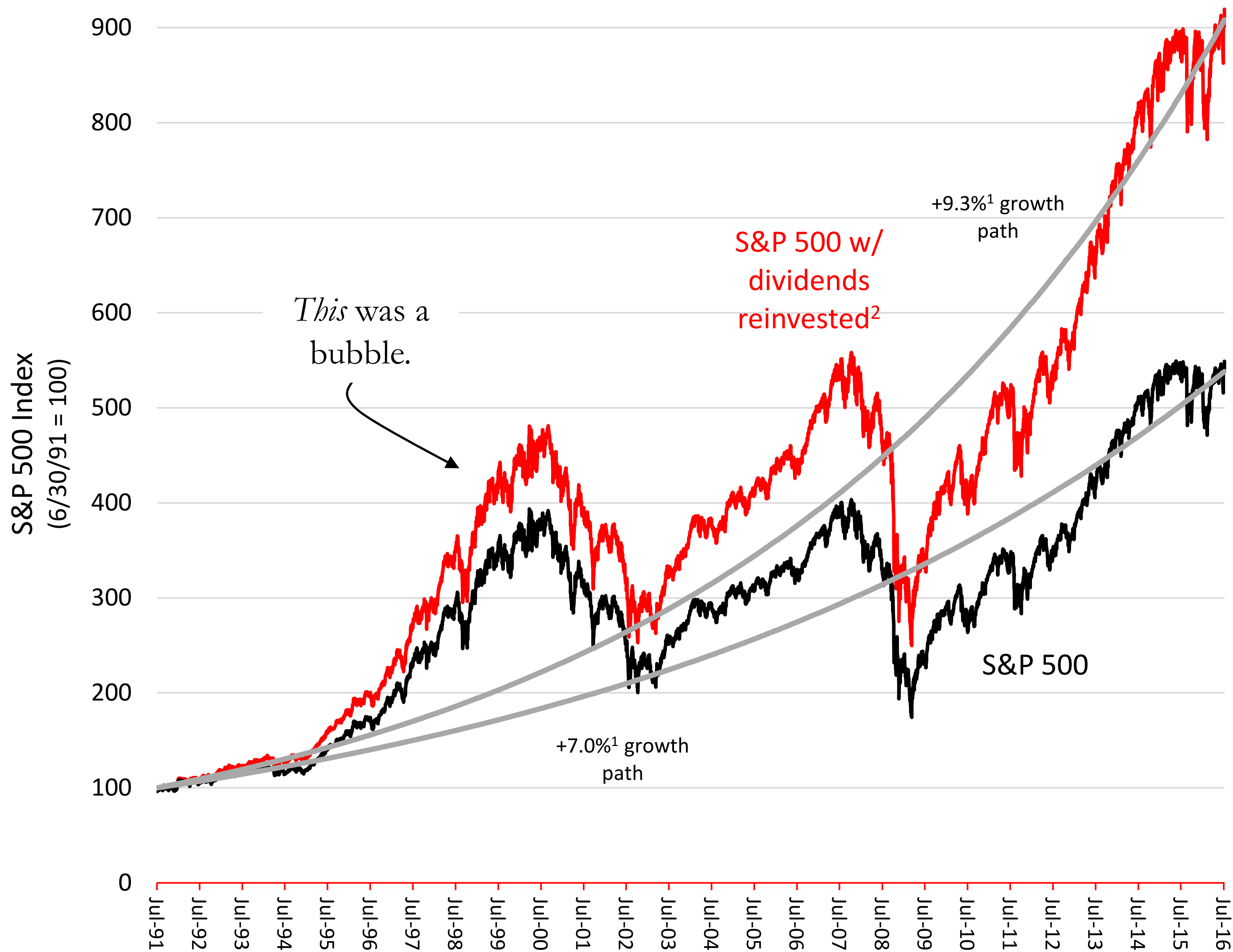
The S&P 500's latest P/E ratio (6/30/16) on trailing 12-months operating earnings is 18.0X.

It is 15.5X on consensus bottom-up 2017 operating earnings.

Sources: Standard & Poor's Corporation and Thomson Reuters I/B/E/S earnings estimates, BEA. Stock price data through June 30, 2016; inflation data through Q1 2016. Top panel, latest data point: 2099 ÷ trailing earnings of $116.61 through 3/31/16 = 18.0.

Stock market arithmetic

Total return = 7.0% earnings-driven price + 2.3% dividends reinvested



The 2011-2014 run higher put these two indices slightly above their long-term trajectories. Today they are in line.

+9.3% per year S&P 500 total return over the last 25 years is right in line with the stock market's long-term returns going back to 1926, or back even further to 1871.[3]

Source: Standard and Poor's. Data through July 8, 2016.[1] Compound annual growth rate. [2] S&P 500 total return index. [3] per Professor Jeremy Siegel's seminal *Stocks for the Long Run*, first published in 1994.

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Economy

- Q1 GDP – weakness from "I" investment
- strong growth in: personal income, DPI, real DPI, real DPI per capita, retail sales
- strong household balance sheets, savings rate and record low household financial obligations ratio
- rising LEI, rebounding PMIs, strong hiring, record high job openings, declining unemployment rate, record low weekly unemployment claims, strong car sales, rising housing starts
- no inflation threat

Economic data

Contributions to GDP growth: C + I + G + Net Exports

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% change at annual rate

Personal consumption expenditures

Gross private domestic investment

3-quarter inventory correction

average = 0.7%

Government consumption and gross investment

recovering

Net exports of goods and services

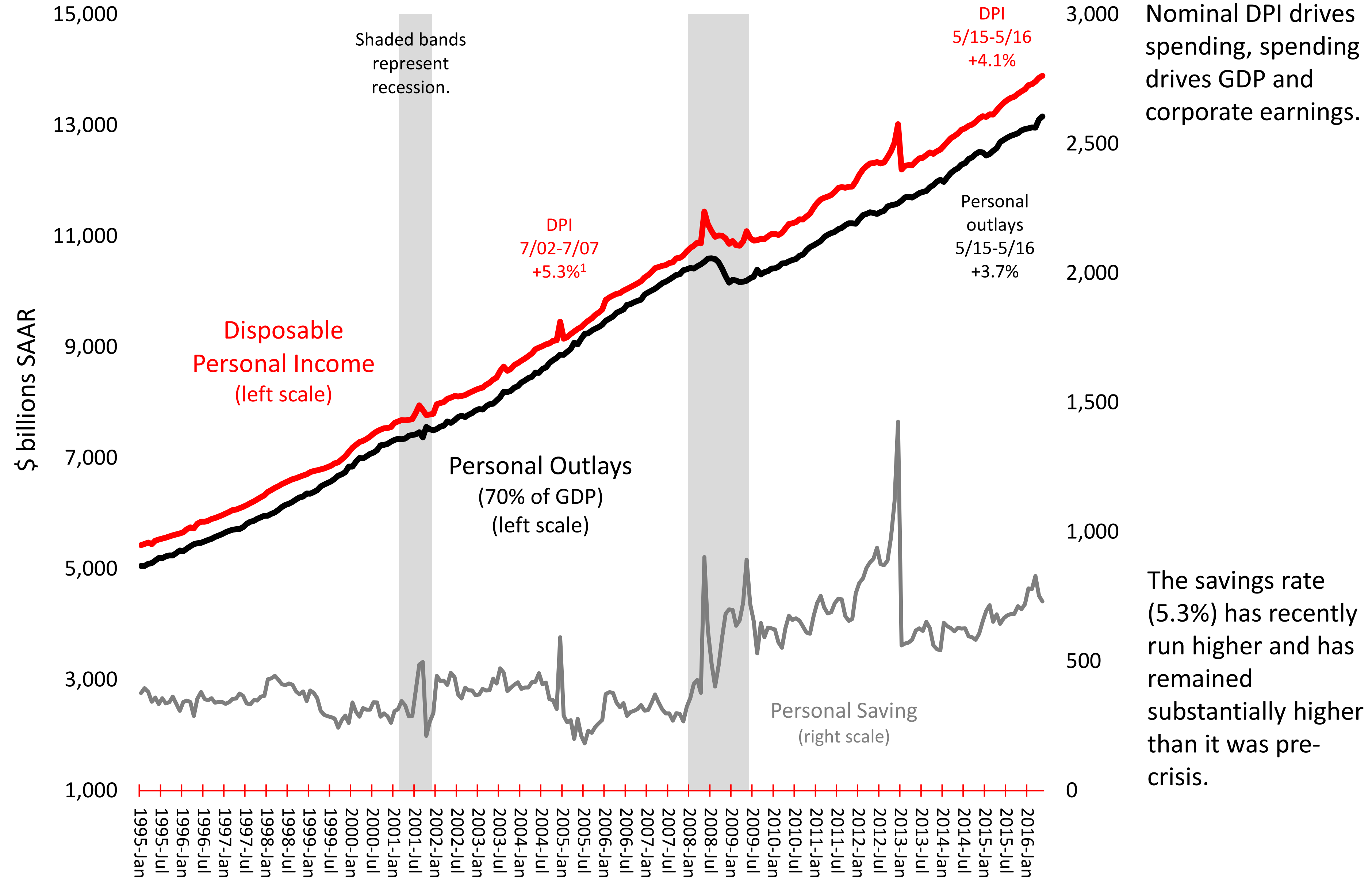
Q1 ΔGDP	
Consumption	+1.0%
Investment	-0.3%
Government	+0.1%
Net Exports	+0.2%
Total	+1.1%

Don't be surprised if we get a +3.0% quarter this year.

Source: Bureau of Economic Analysis, data through March 2016.

Economic data – consumer spending

Consumer income, spending and saving



Source: Bureau of Economic Analysis, monthly data through May 2016. [1]Compound annual growth rate.

Economic data – consumer spending

Real consumer income and spending

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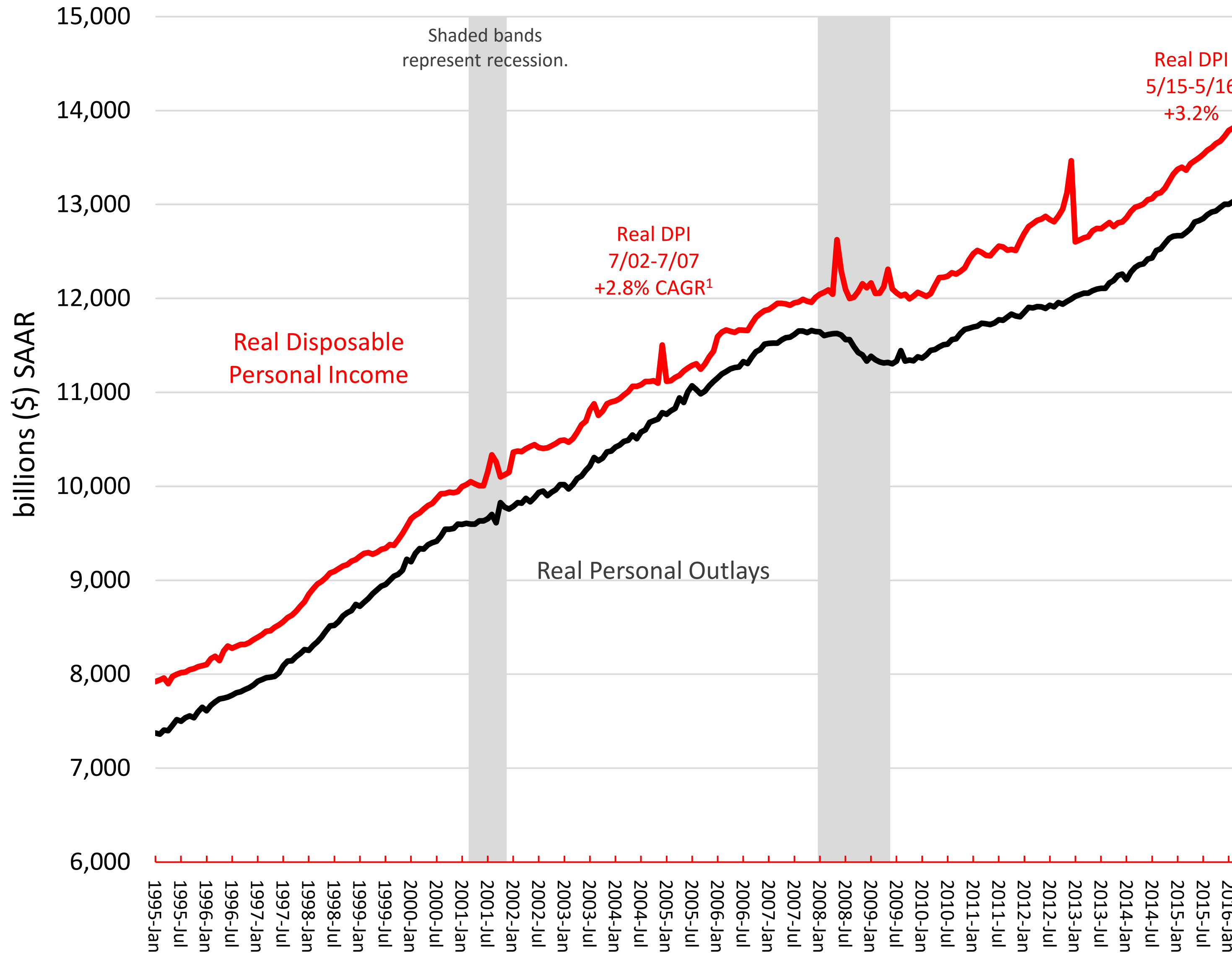


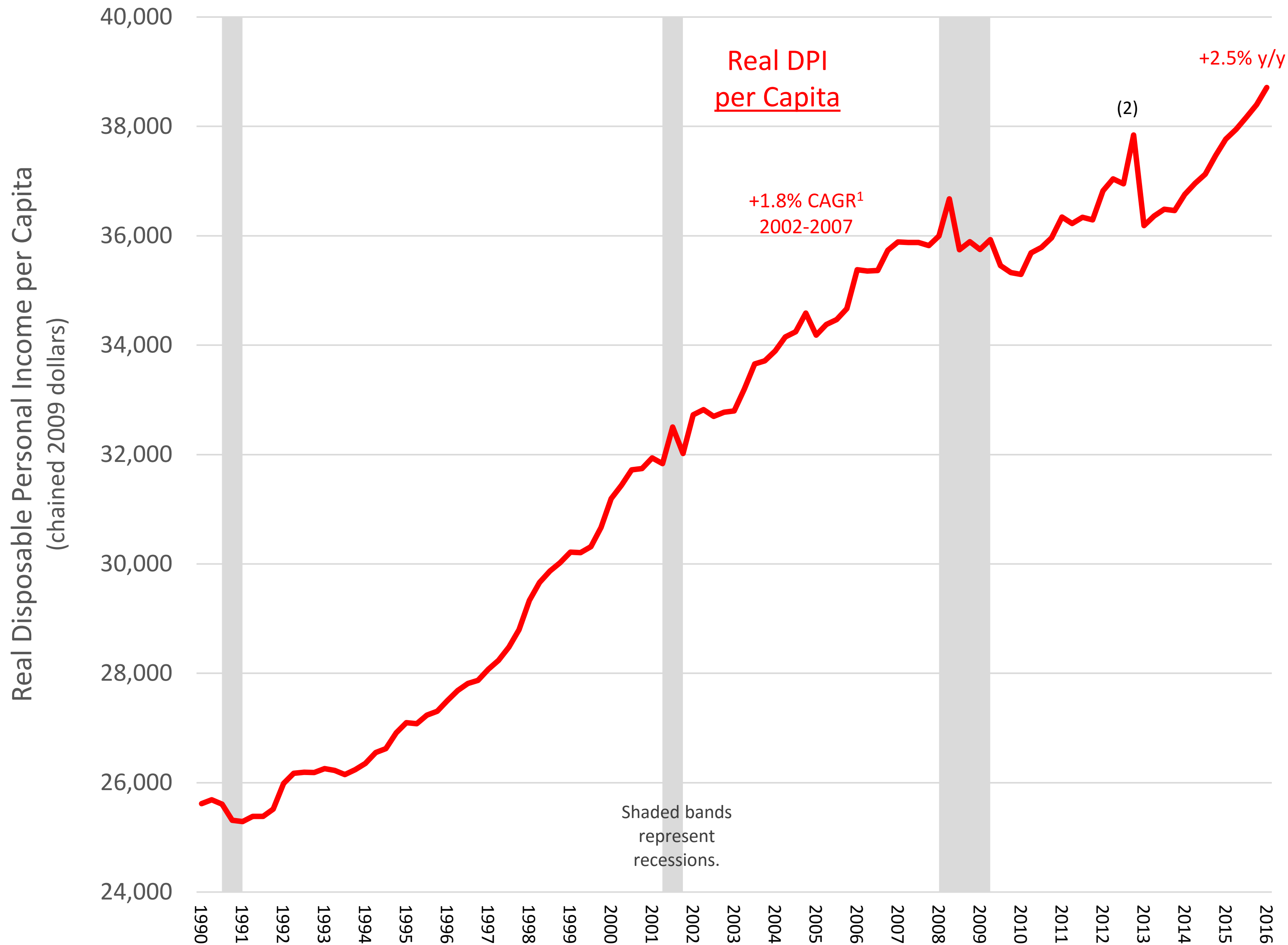
Growing faster than pre-recession.

Income stagnation is a fiction

Source: Bureau of Economic Analysis, monthly data through May 2016. [1]Compound annual growth rate.

Economic data – consumer spending

Real per capita purchasing power



Real per capita after-tax income is growing faster than pre-recession.

Income stagnation is a fiction.

Source: Bureau of Economic Analysis, quarterly data through March 2016. [1]Compound annual growth rate. [2]Surge in compensation paid prior to 2013 tax hike.

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Neiman Reports 81% Drop In Profit

BY SUZANNE KAPNER AND TESS STYNES

Neiman Marcus Group Ltd.'s profit fell 81% on lower sales in the latest quarter as the luxury department store joined a long list of retailers reporting weak results.

Mall-based luxury retailer **Hudson's Bay** Co. last week reported weaker-than-expected sales for its latest quarter, hurt by declines at its Saks Fifth Avenue chain.

Last month, **Nordstrom** Inc. cut its annual guidance and said bigger discounts were necessary to clear inventory in the first quarter.

For the period ended April 30, Neiman Marcus said revenue decreased 4.2% to $1.17 billion from $1.22 billion a year earlier. Comparable revenue, which includes sales at stores open at least a year and online sales, declined 5%.

In all, Neiman Marcus reported a profit of $3.8 million, down from $19.8 million a year earlier.

Neiman Marcus Chief Executive Karen Katz said the challenging retail climate went beyond a strong dollar that has chased away foreign tourists and softness in the oil patch, where the Dallas-based company has several stores.

"While it is difficult to pinpoint the specific reasons why, our sense is that the overall economic outlook combined with uncertainty related to the continued fluctuations of the U.S. stock market and the coming presidential elections are tempering our customers' overall enthusiasm for shopping," Ms. Katz said.

Neiman Marcus in October delayed its plans for an initial public offering, citing stock-market volatility and a slump in stocks of other luxury-goods purveyors. The company, which had filed to go public in August, was bought in 2013 by Ares Management LLC and Canada Pension Plan Investment Board in a roughly $6 billion buyout.

Cash and cash equivalents fell to $76 million at the end of the period, down from $82 million a year ago. The company had $545 million available on a revolving credit line.

Gross margin decreased by 1.7 percentage points as a result of higher markdowns to clear excess inventory.

Merchandise inventories rose 2%, but Ms. Katz said the company was working to reduce those levels going forward.

Dismal comp store sales for Neiman, Macy's, Nordstrom, Kohl's, Gap … but, overall retail sales are booming.

Major retail channel shift continues.

Source: *The Wall Street Journal*, June 15, 2016.

Economic data

Retail sales

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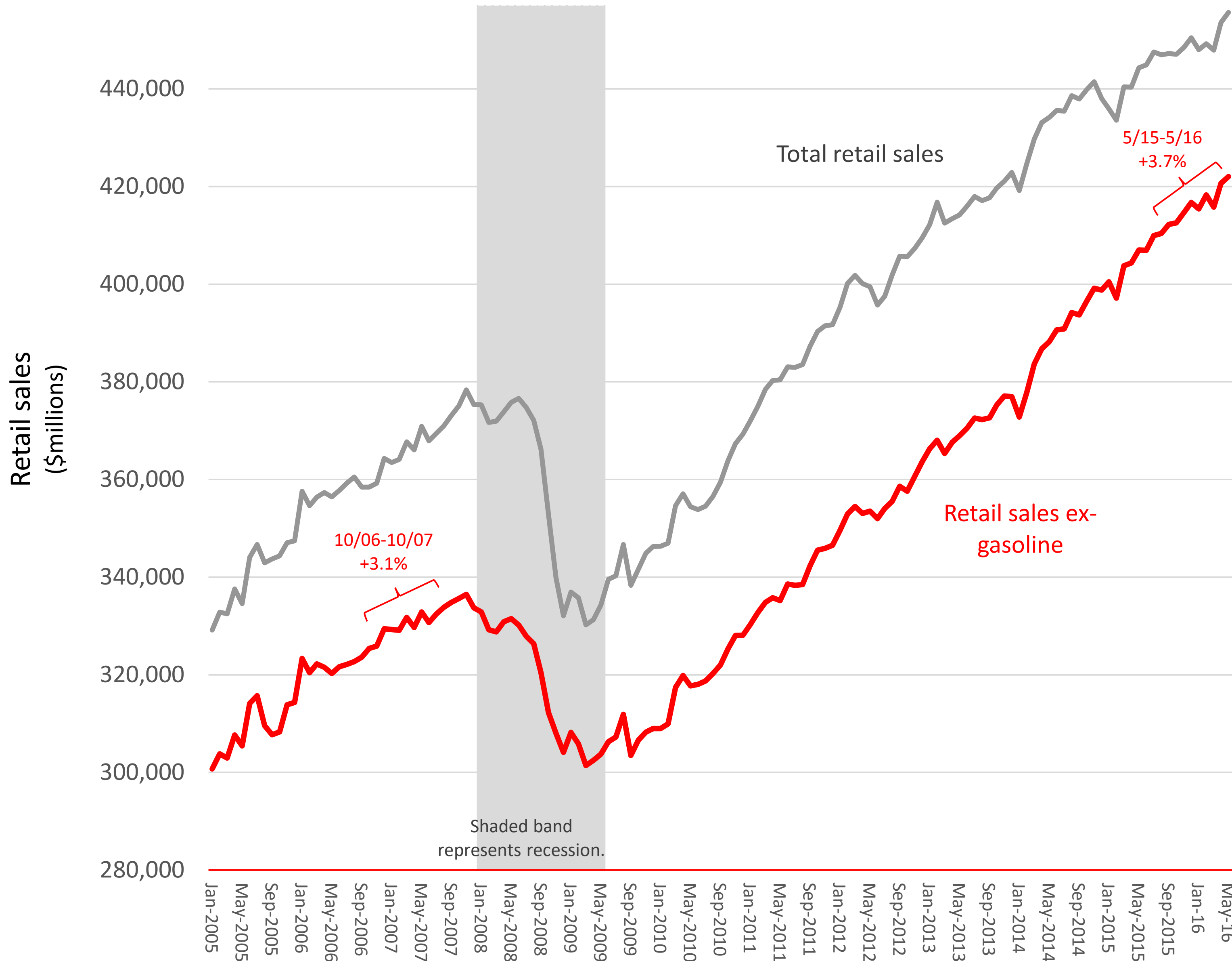


Source: U.S. Census Bureau. Data through May 2016.

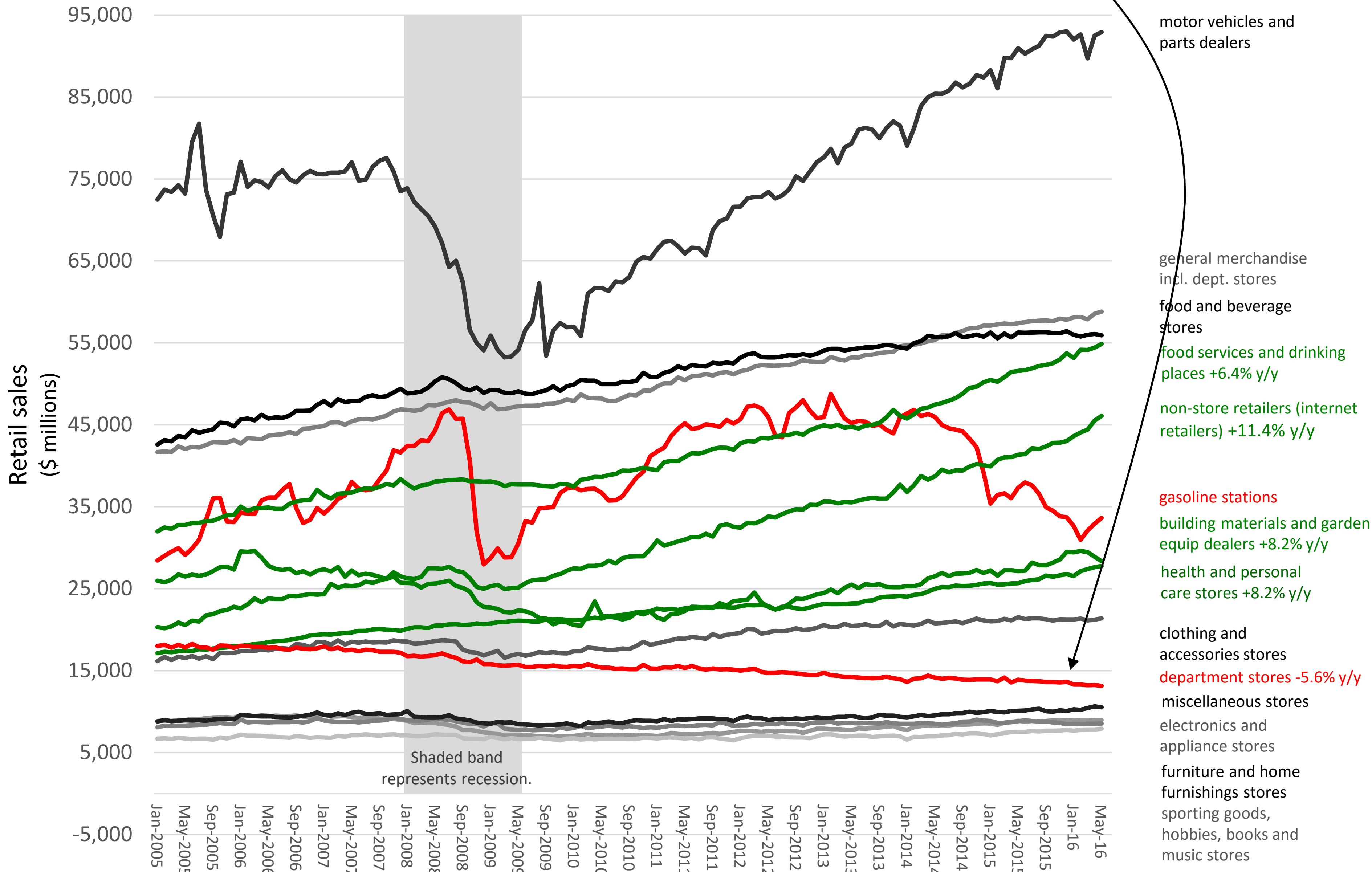
<u>Booming trend in retail sales growth</u>.

Despite soft comp-store sales at Macy's, Nordstrom, Kohl's, Gap and more.

Economic data

Retail sales by category

Dying retail format: Macy's, Gap, Nordstrom, et al



Source: U.S. Census Bureau. Data through May 2016.

Consensus GDP forecast

Steady expansion expected

Actual and Forecast

Real GDP Q/Q % change(annualized)

9.0
7.0
5.0
3.0
1.0
-1.0
-3.0
-5.0
-7.0

1997-I, 1997-IV, 1998-III, 1999-II, 2000-I, 2000-IV, 2001-III, 2002-II, 2003-I, 2003-IV, 2004-III, 2005-II, 2006-I, 2006-IV, 2007-III, 2008-II, 2009-I, 2009-IV, 2010-III, 2011-II, 2012-I, 2012-IV, 2013-III, 2014-II, 2015-I, 2015-IV, 2016-III(E)

3-quarter average +2.4%

Q1 2011 Japan tsunami

Q4 2012 Hurricane Sandy

Q1 2014 East Coast winter

Q1 2015 East Coast winter, West Coast dock strike

The 70 economists surveyed in early June see an average +2.4% rate of quarterly GDP growth ahead, in line with the +2.5% actual two-year GDP growth.

Despite Q1 weakness it's a Goldilocks forecast ... healthy economic growth with benign inflation.

Sources: Bureau of Economic Analysis, actual data through March 2016; *The Wall Street Journal* survey taken June 2016.

U.S. index of leading economic indicators

Peak:	01:3	07:12
Trough:	01:11	09:6

The Conference Board Leading Economic Index® (LEI) for the United States
The Conference Board Coincident Economic Index® (CEI) for the United States

Index (2010=100)

135
130
125
120
115
110
105
100
95
90

LEI
CEI

Shaded areas
represent recession.

May '16

99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16

The LEI ticked down in May but continues to trend higher, suggesting continued growth ahead.

This chart shows how the LEI has definitively rolled over well in advance of the last two recessions.

The Conference Board Leading Economic Index® (LEI) components: 1) average weekly hours worked, manufacturing; 2) average weekly initial unemployment claims; 3) manufacturers' new orders – consumer goods and materials; 4) ISM index of new orders; 5) manufacturers' new orders, nondefense capital goods; 6) building permits – new private housing units; 7) stock prices, S&P 500; 8) Leading Credit Index™; 9) interest rate spread; 10-year Treasury less fed funds; 10) index of consumer expectations.

Source: ©The Conference Board. Data through May, released June 23, 2016.

World GDP growth forecasts – improving growth expected

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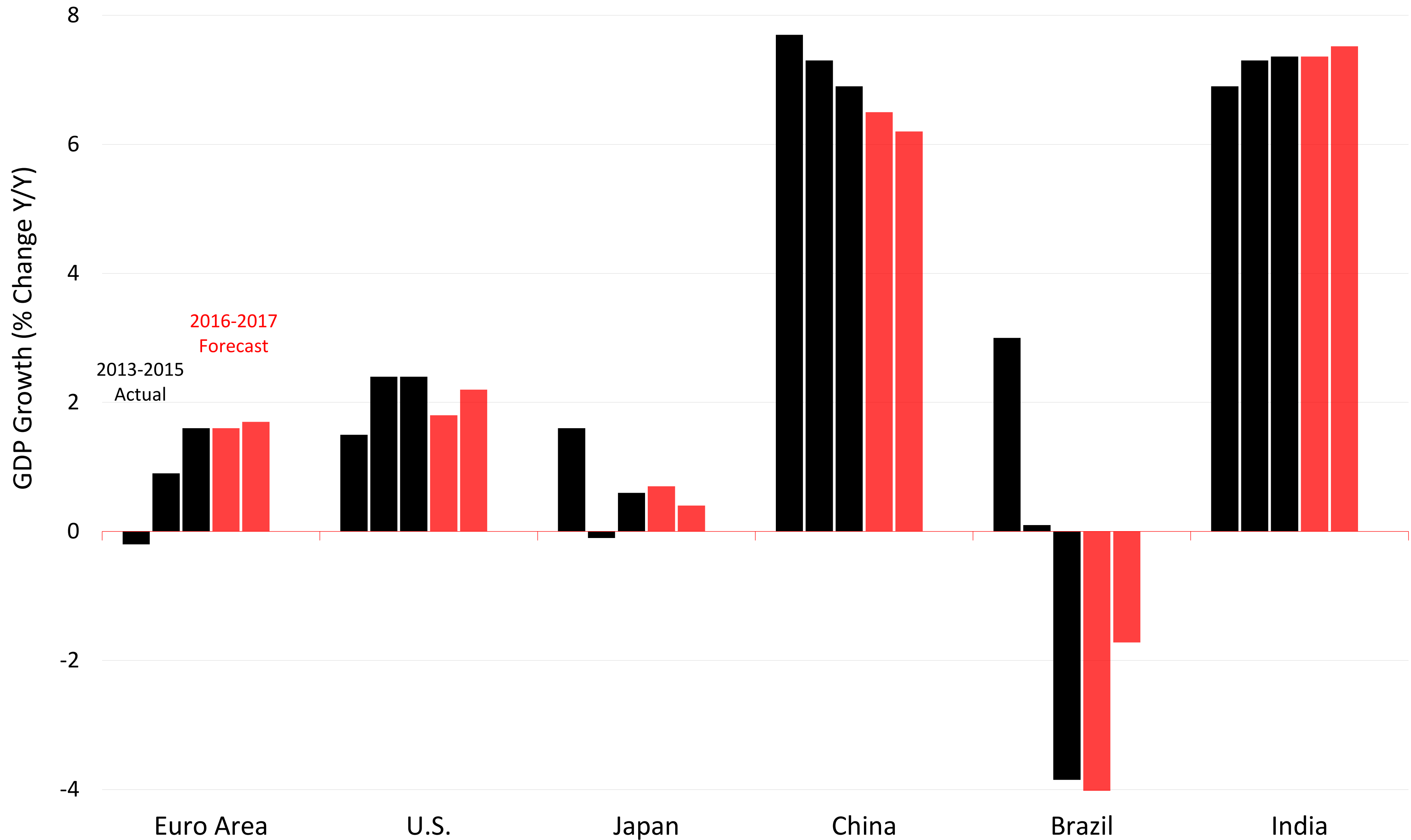

Source: OECD, *Economic Outlook*, June 2016.

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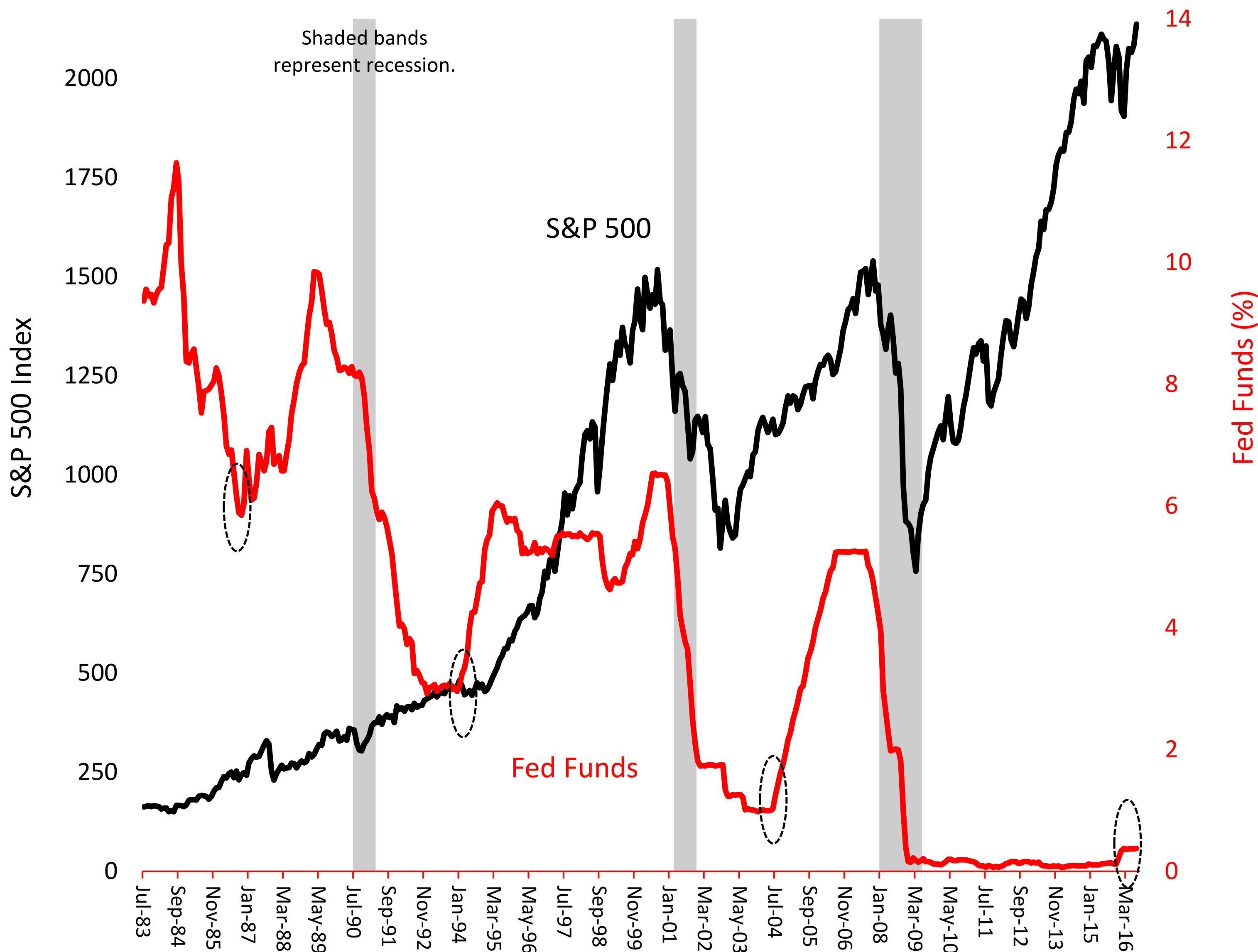
Fed policy

- first rate hikes have signaled stock market strength
- the Fed manages the yield curve
- the Fed has created every recession since the 1950s
- twin mandate points to continued dovish policy for now

Federal Reserve policy

… it's the *last* rate hike that matters



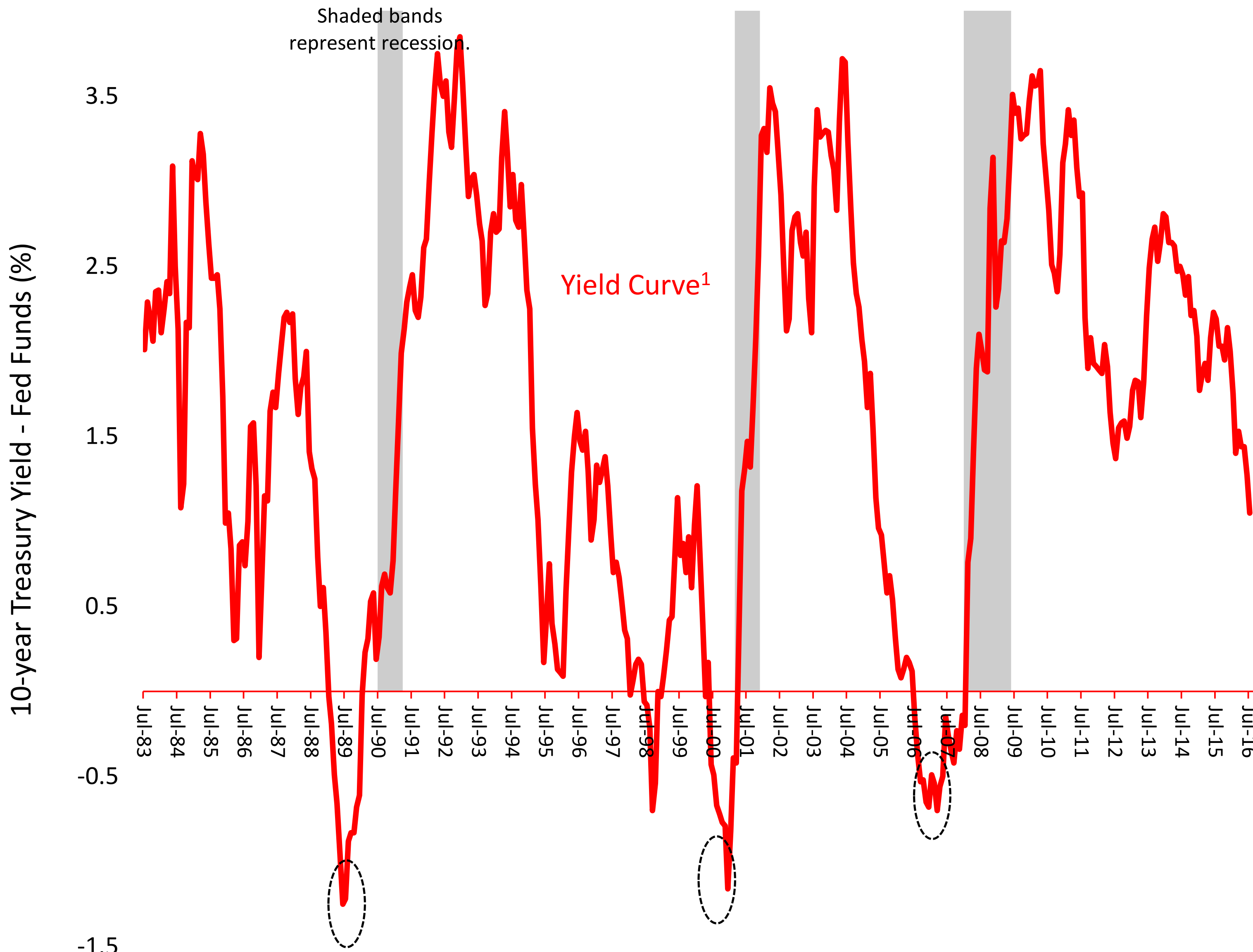
Initial fed funds rate hikes have caused the stock market to stutter.

<u>But, following the initial stutter stocks have continued higher even as the Fed has repeatedly hiked rates</u> … until fed funds have approximated bond yields.

Sources: NBER, Federal Reserve and Standard & Poor's. Data through July 11, 2016.

Federal Reserve policy

Fed's key policy lever is the yield curve



Steep yield curves – high bond yields compared to Fed Funds rates – are consistent with strong GDP growth.

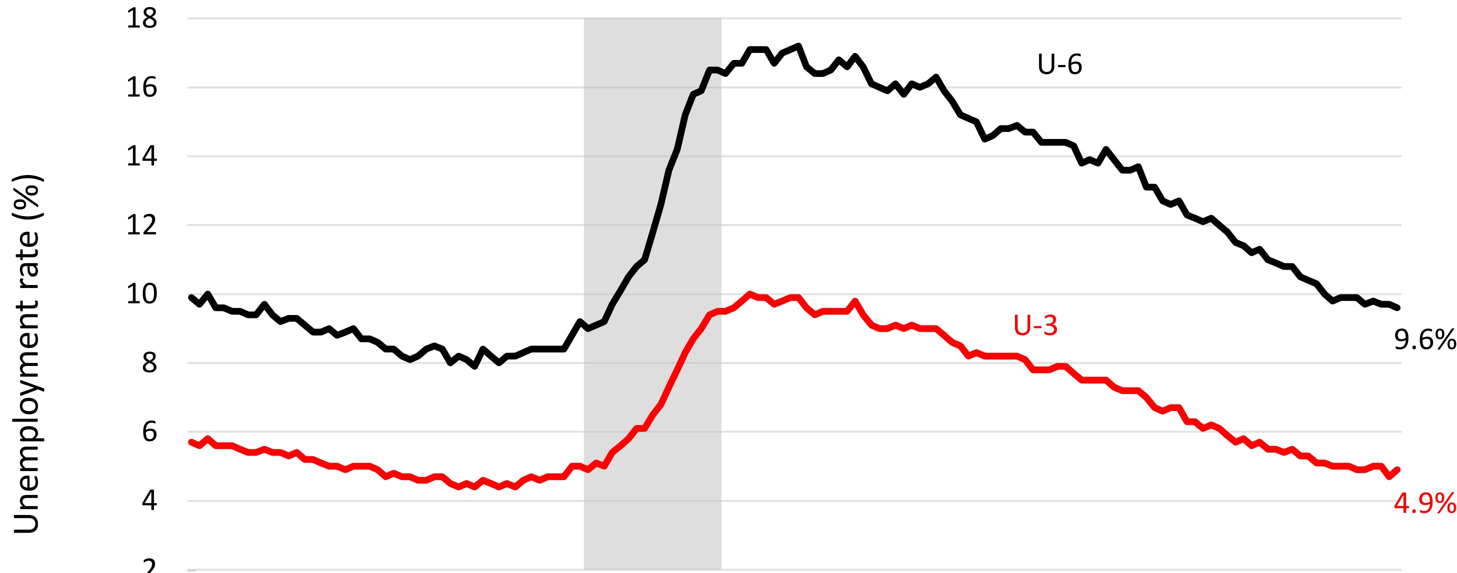
Flat or negative yield curves have preceded recessions.

Today the yield curve is positive but less than half as steep as immediately post-recession.

The Fed has been saying that rate hikes are likely to be very gradual from here.

Sources: NBER, Federal Reserve. Data through July 11, 2016. [1]The differential between the interest rate on Fed Funds (short term) and the 10-year Treasury bond (long term).

Dual mandate, dovish Fed



Fed's dual mandate:

- full employment
- 2% inflation

With inflation still well below 2% the Fed might stay very dovish for awhile yet. It may take until well into 2017 to regain full employment.

Price Index for Personal Consumption Expenditures
12-month percent change (%)

4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0

PCED

Core PCED

+0.9%

Fed's central tendency forecasts

2011 forecast (dotted)

June 2016 forecast (solid)

Shaded band represents recession.

Jan-04 Jun-04 Nov-04 Apr-05 Sep-05 Feb-06 Jul-06 Dec-06 May-07 Oct-07 Mar-08 Aug-08 Jan-09 Jun-09 Nov-09 Apr-10 Sep-10 Feb-11 Jul-11 Dec-11 May-12 Oct-12 Mar-13 Aug-13 Jan-14 Jun-14 Nov-14 Apr-15 Sep-15 Feb-16 Jul-16 Dec-16 May-17 Oct-17 Mar-18 Aug-18

See footnotes in the notes to the slide.

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Inflation

- PCED headline +1.1%, more in the core but still far from the Fed's +2% target
- employment costs steady and still tame
- productivity and declining unit labor costs
- how you experience inflation depends on what you consume

PCE – headline and core

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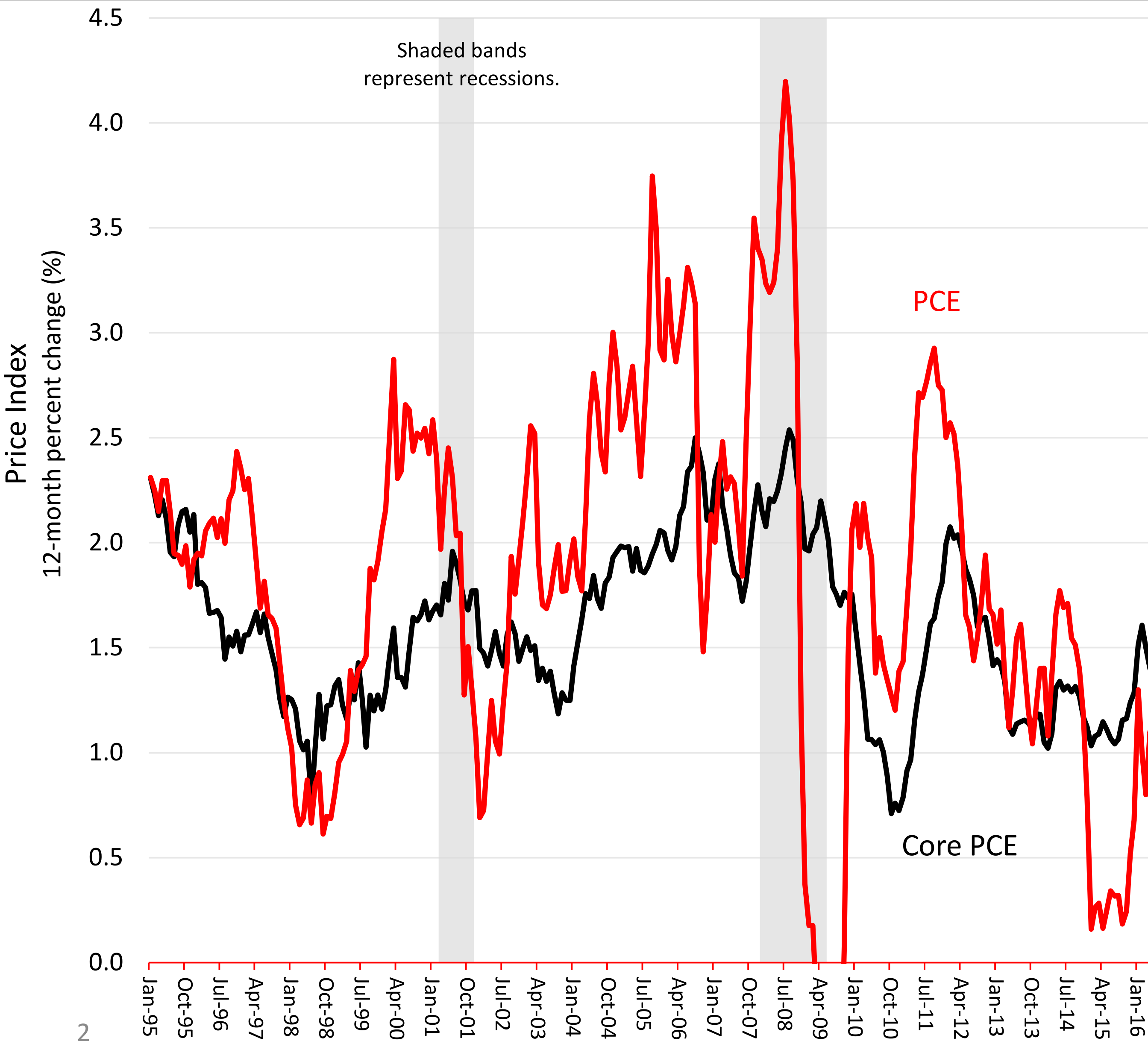

Headline inflation (PCE) has plunged and partially recovered with the plunge in gasoline, diesel and fuel oil prices.

Inflation ex-food and energy (core PCE) is higher than core but still below the Fed's 2% target.

2% target

+1.5% core

+0.9% headline

Source: NBER, Federal Reserve Bank of St. Louis. Data through May 2016.

Inflation by expenditure category

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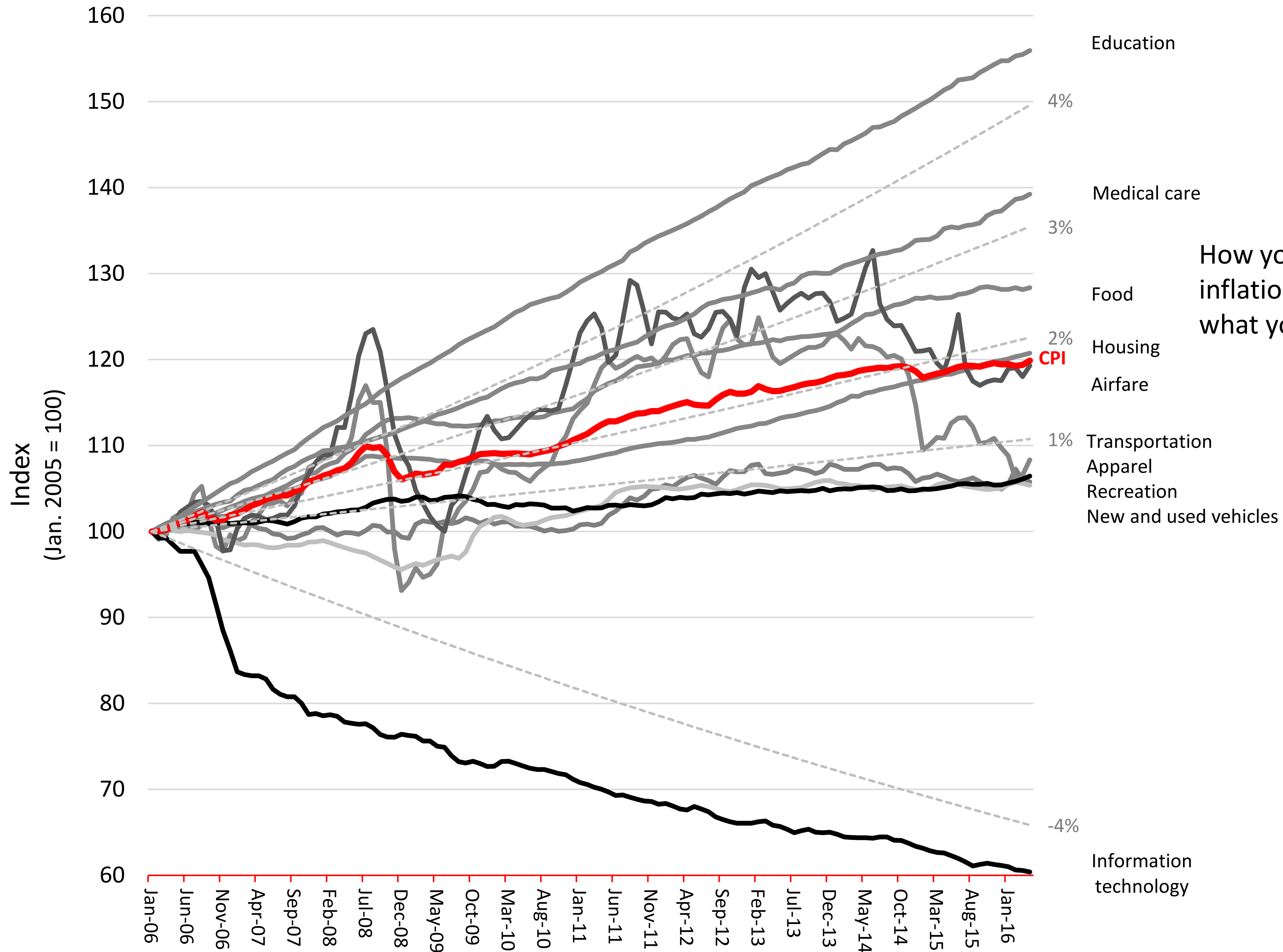

How you experience inflation depends on what you consume.

Source: BLS. Data through April 2016. Dotted lines indicate compound annual growth rate trajectories at rates indicated.

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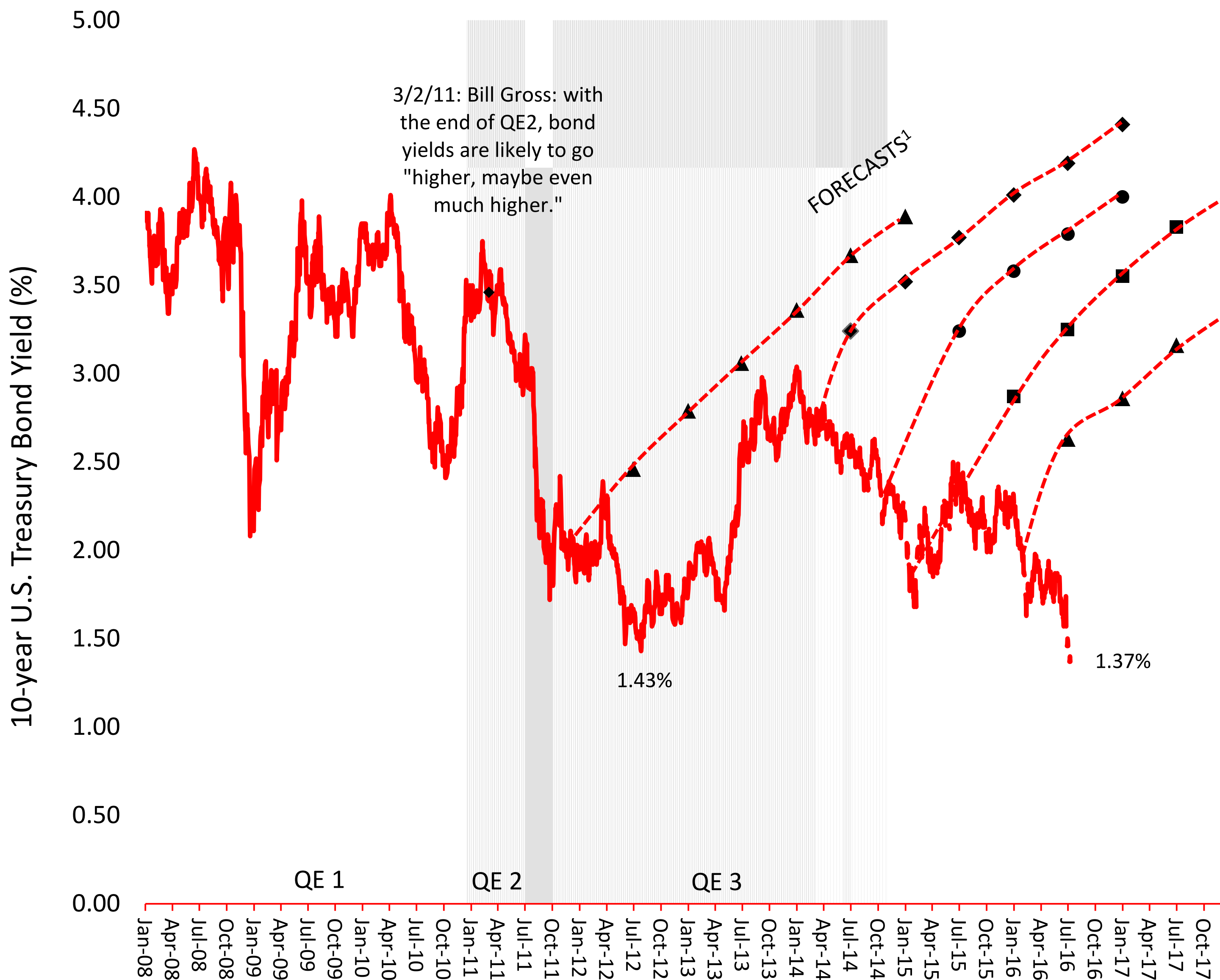
Bond Yields

- forecasts have grossly missed
- forecast for steady rise to 3.35%
- real yield suggests nominal yield could be higher
- pressure on yields from declining federal deficit
- pressure on yields from ECB's QE capping euro bond yields
- value in munis

Much lower than expected bond yields



<u>Forecasts have been consistently and horribly wrong.</u>

Where yields go from here depends on the inflation data and supply and demand for bonds.

<u>Inflation is very low and apt to remain so. The rate of net new supply of U.S Treasury bonds will be close to flat. The ECB is in the driver's seat with its QE.</u>

Source: Federal Reserve. Data through July 8, 2016.

[1] Average of economists' forecasts from *The Wall Street Journal* 's monthly surveys taken November 2011, January 2014, September 2014, January 2015 and December 2015.

U.S. Treasury bond yields – nominal and TIPS

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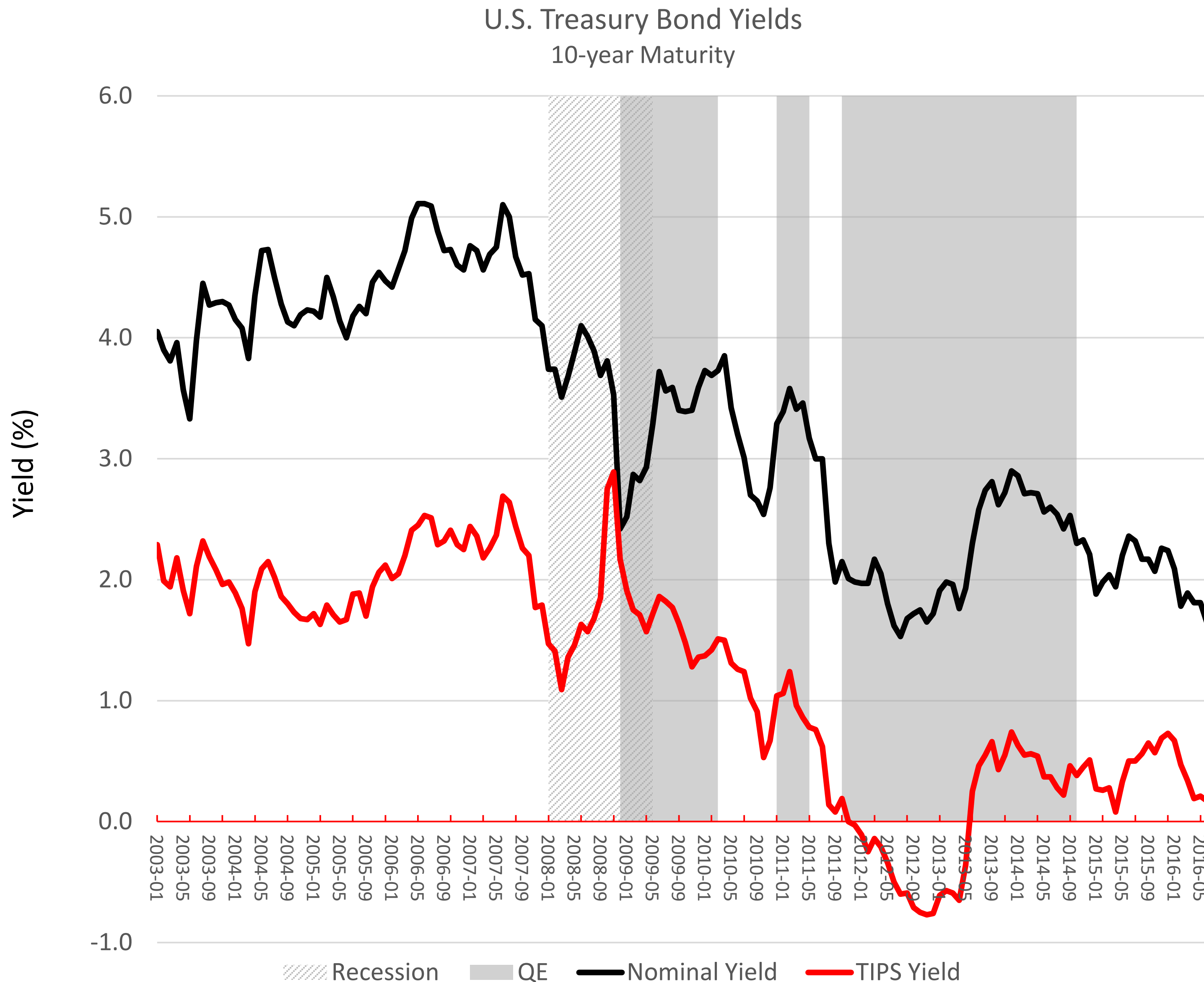


Quantitative easing (QE) has driven bond yields steadily lower.

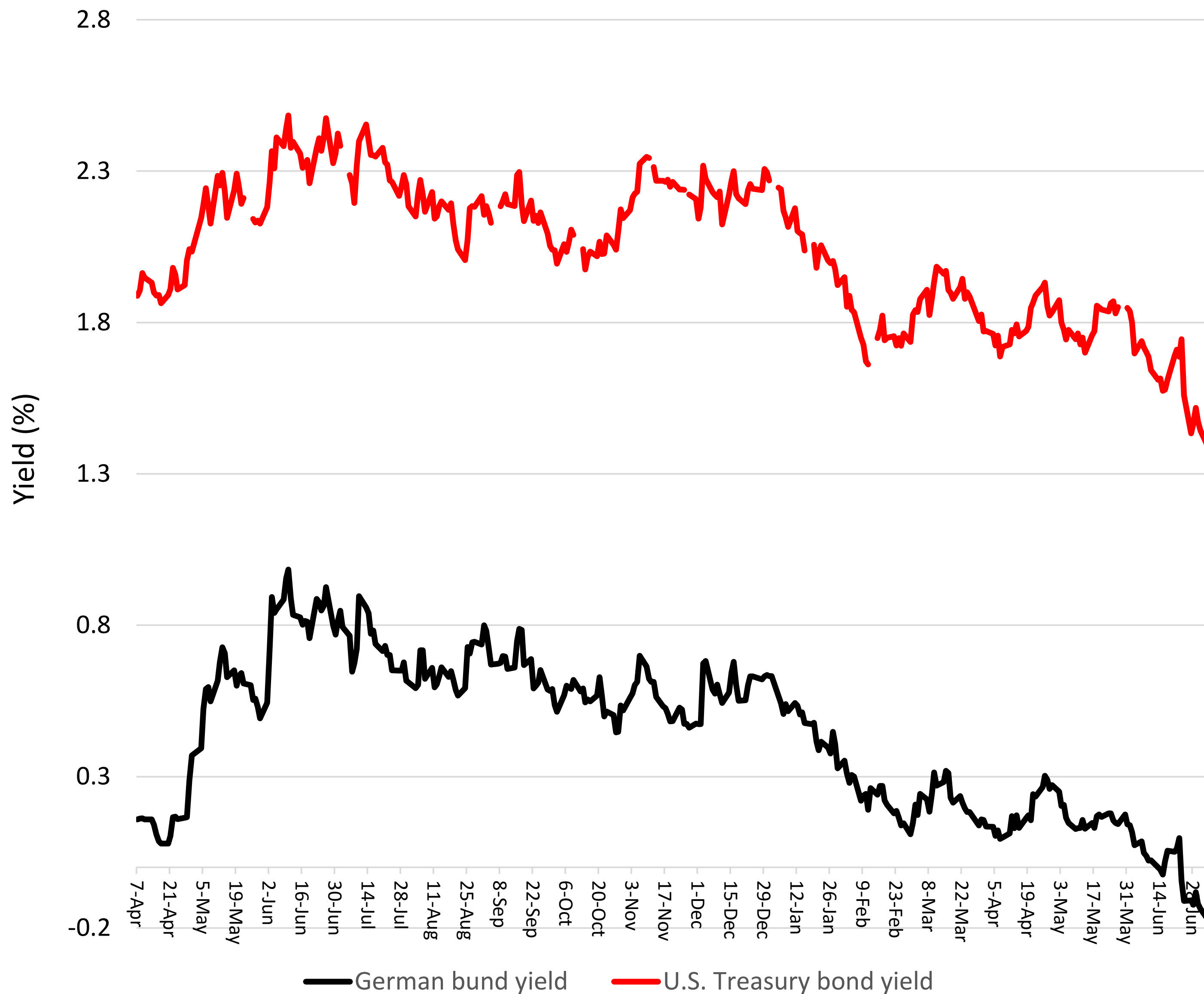
Although the Federal Reserve is no longer purchasing bonds (QE), the ECB is, having a like effect on U.S. bond yields.

See next chart.

Source: Federal Reserve. Data through July 5, 2016.

Bond yields – why so low?

U.S. Treasury bond yield vs. German bund yield



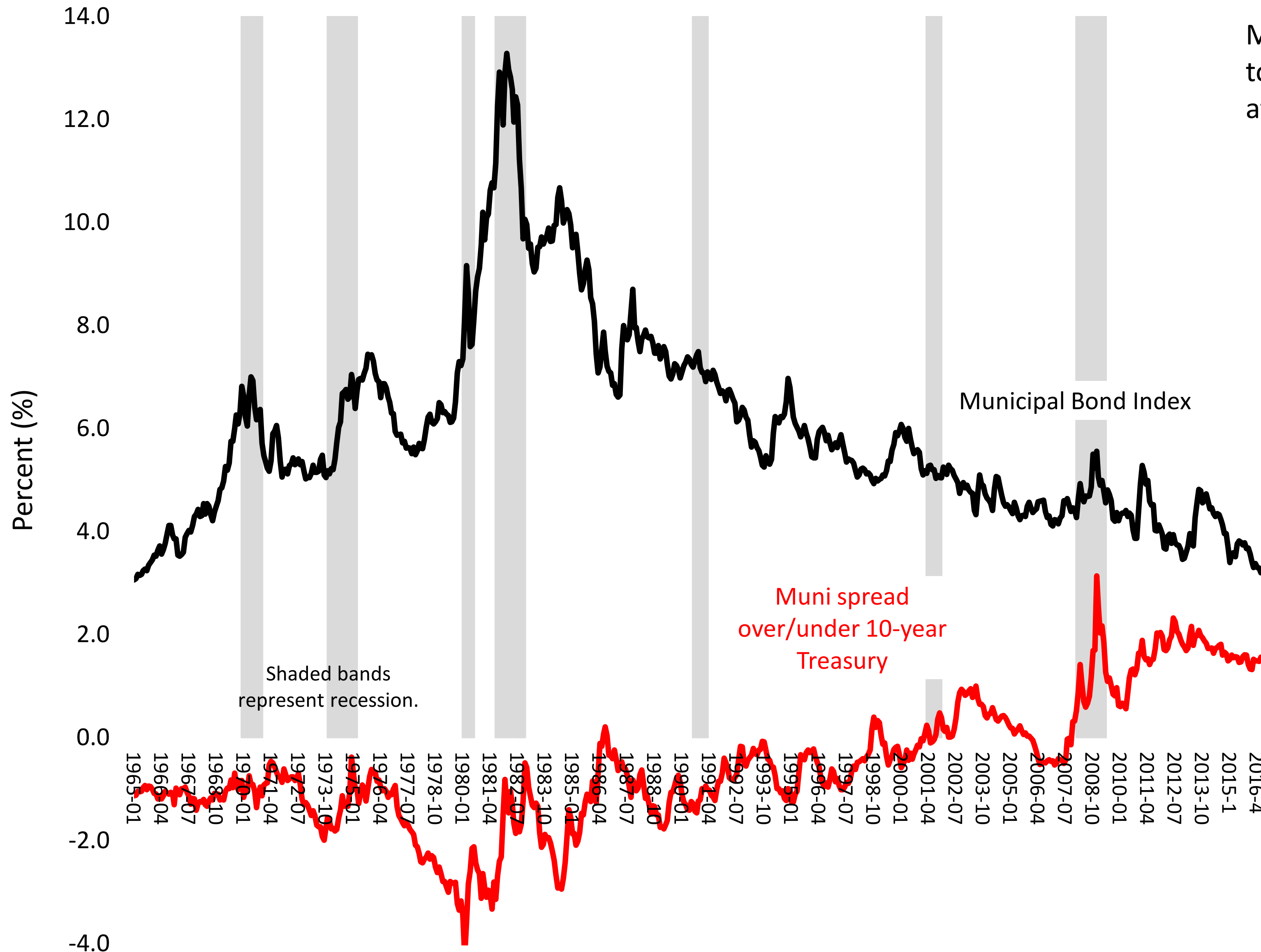
Yields moving in lock-step.

The ECB is in control of U.S. Treasury yields.

The ECB plans to continue their QE program until further notice.

Source: *The Wall Street Journal*. Data through July 6, 2016.

Municipal bonds



Municipals' spread-to-Treasuries is attractive.

Source: Federal Reserve, bond buyer GO 20-bond municipal bond index. Data through June 2016.

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Crude oil

- price rebound with cut in global supply
- 22 consecutive oversupply months
- still 0.7 mmbpd supply/demand imbalance
- U.S. rig count collapse, production down only slightly (so far)

World crude oil supply vs. consumption

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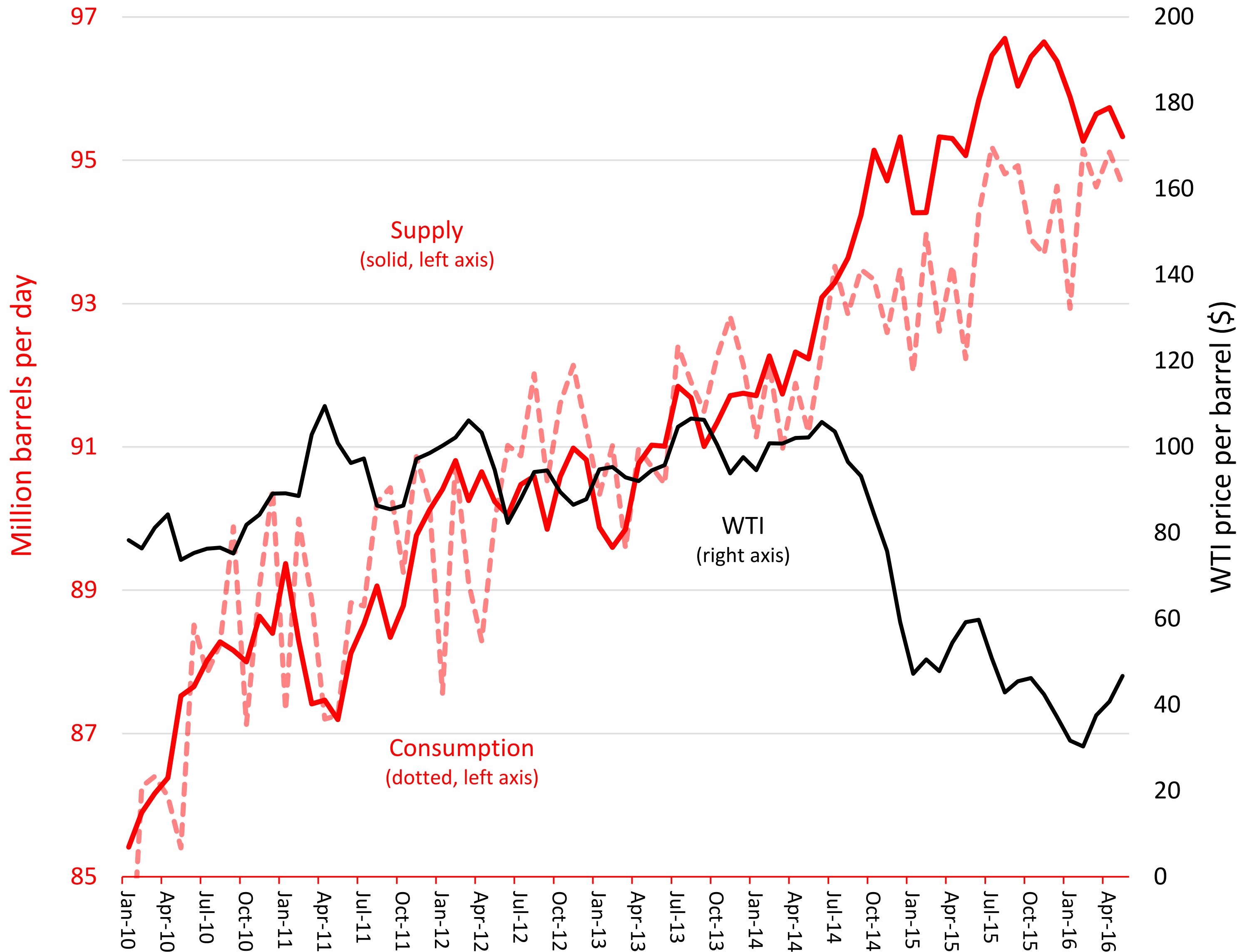

In 2014, 2015 and so far in 2016, global supply surged, outstripping demand growth, driving prices down.

Supply has now outstripped demand for 22 consecutive months.

<u>0.7 mmbpd oversupply.</u>

Source: U.S. Energy Information Agency, *Short-Term Energy Outlook*, June 2016, data through May 2016. Includes condensate and natural gas liquids.

Oil

U.S. drilling plunge

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Source: U.S. Energy Information Agency, Baker Hughes. Rig count through July 8, 2016. Crude oil production through July 1, 2016.

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Federal budget

- CBO's March 2016 forecast
- looks good for a few years …
- … but the entitlements problem hasn't gone away
- rising debt/GDP ratio
- low U.S. tax burden allows flexibility to solve long-term entitlements problem

Federal revenues and outlays – a rising spending problem

Widening, gap between outlays and revenues through 2026.

Outlays

Revenues

Average Outlays 1966 to 2015 (20.2%)

Average Revenues 1966 to 2015 (17.4%)

The ATRA[1] tax hikes of 2013 help push tax revenue up to 18% of GDP.

Percent of GDP (%)

25.0
23.0
21.0
19.0
17.0
15.0
13.0

Actual
Forecast

1966 1968 1970 1972 1974 1976 1978 1980 1982 1984 1986 1988 1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014 2016 2018 2020 2022 2024 2026

Source: Congressional Budget Office, *Updated Budget Projections: 2016 to 2026,* dated March 2016.
[1] American Taxpayer Relief Act.

Federal deficits % of GDP

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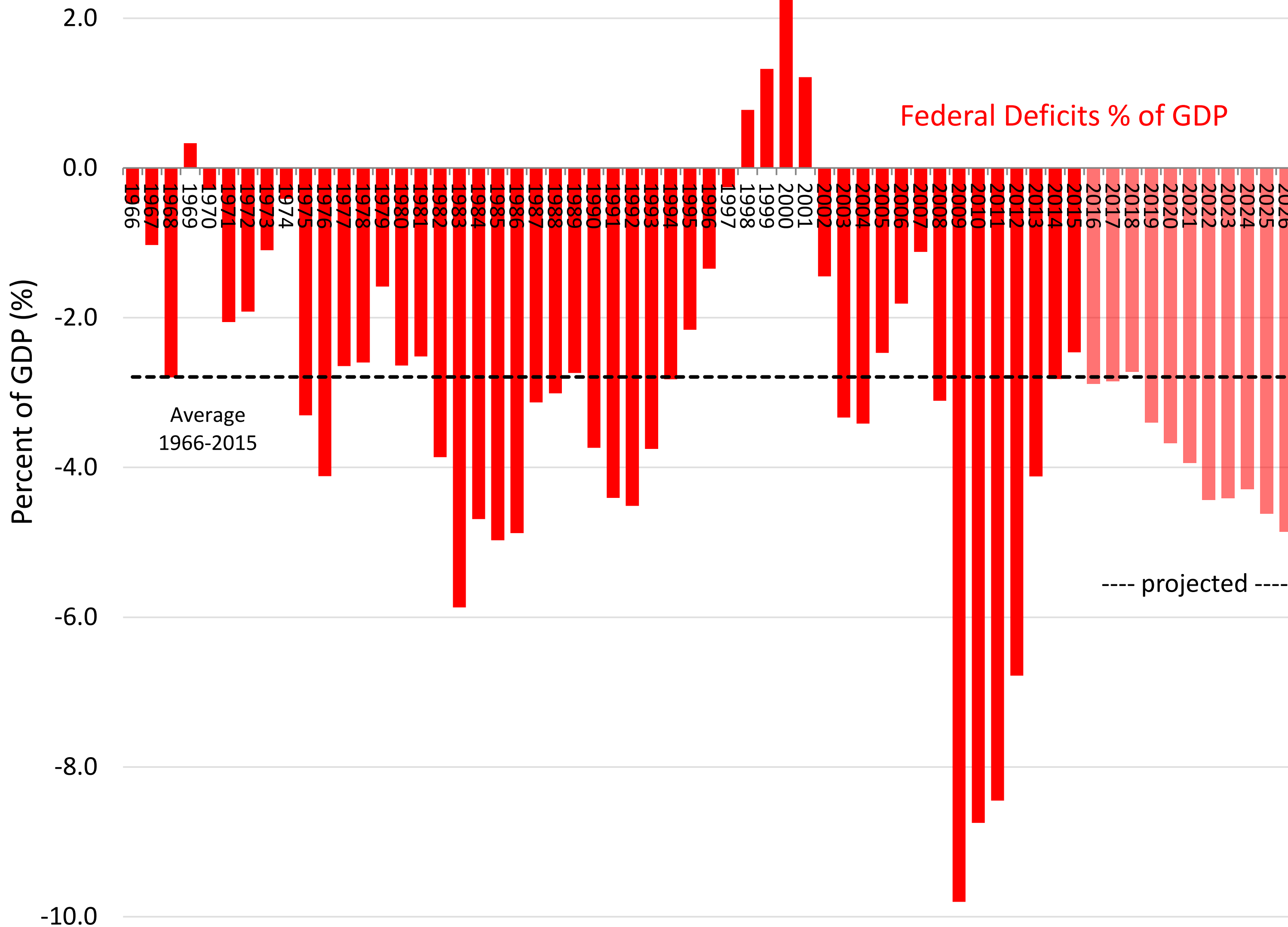

CBO is projecting low growth in federal borrowing requirements through 2018.

Source: Congressional Budget Office, *Updated Budget Projections: 2016 to 2026,* dated March 2016.

Federal deficit and debt

Government debt-to-GDP ratios (2011-2021)

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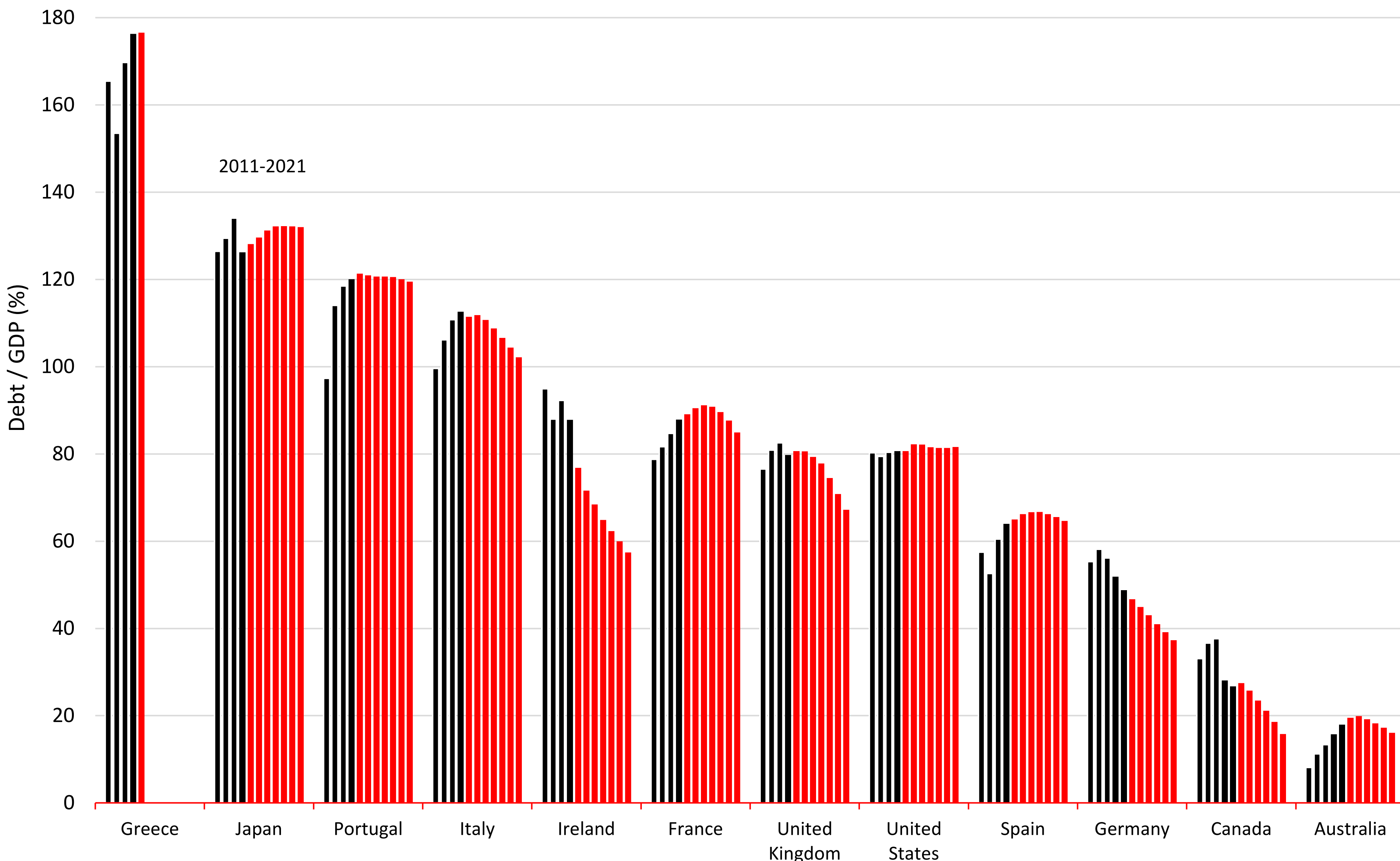
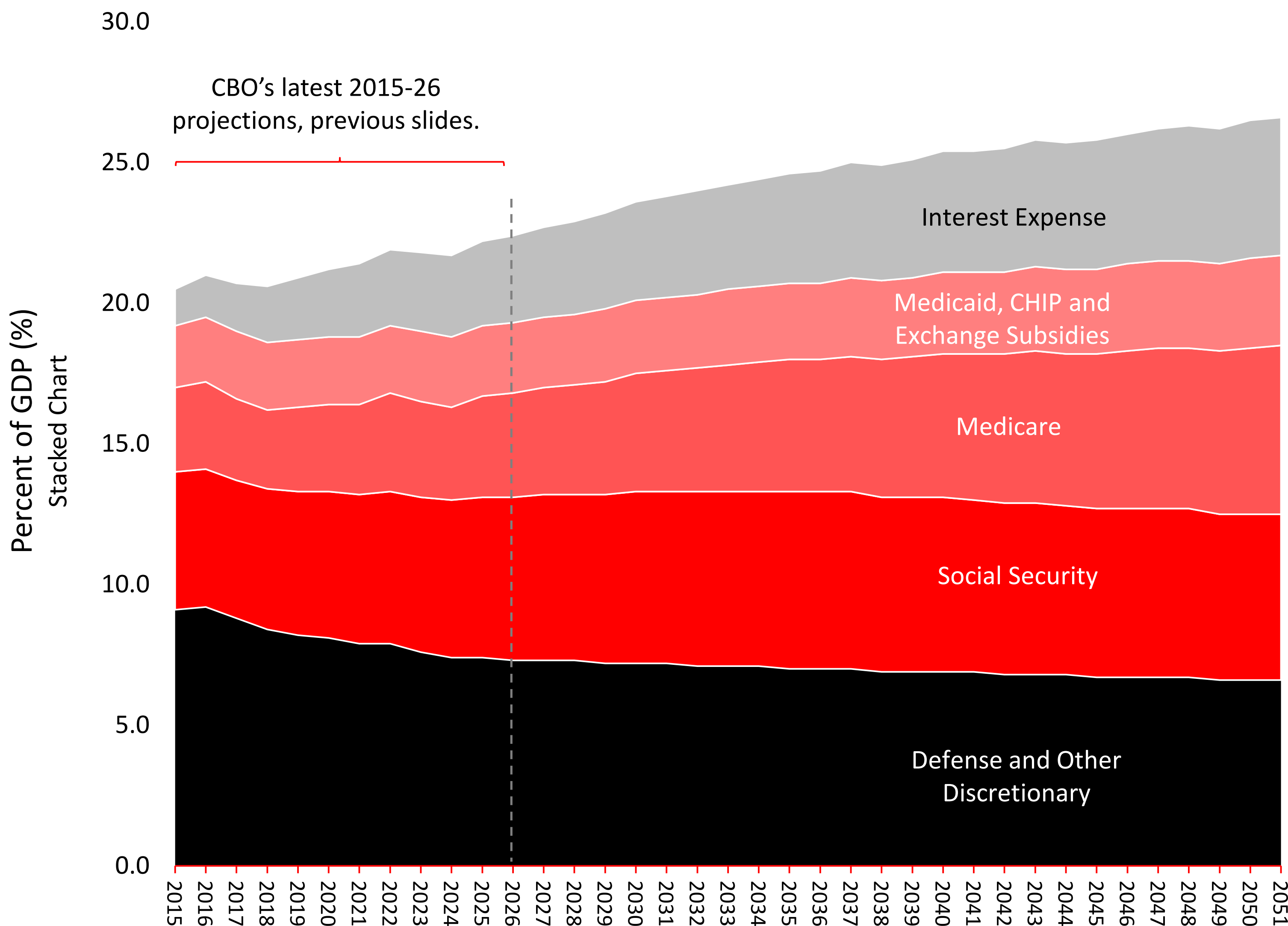


Source: IMF, World Economic Outlook Database, October 2014 and April 2016. Data for years (from left to right) 2011-2021. Actual (black) and forecast (red).

Projected federal spending[1] through 2050

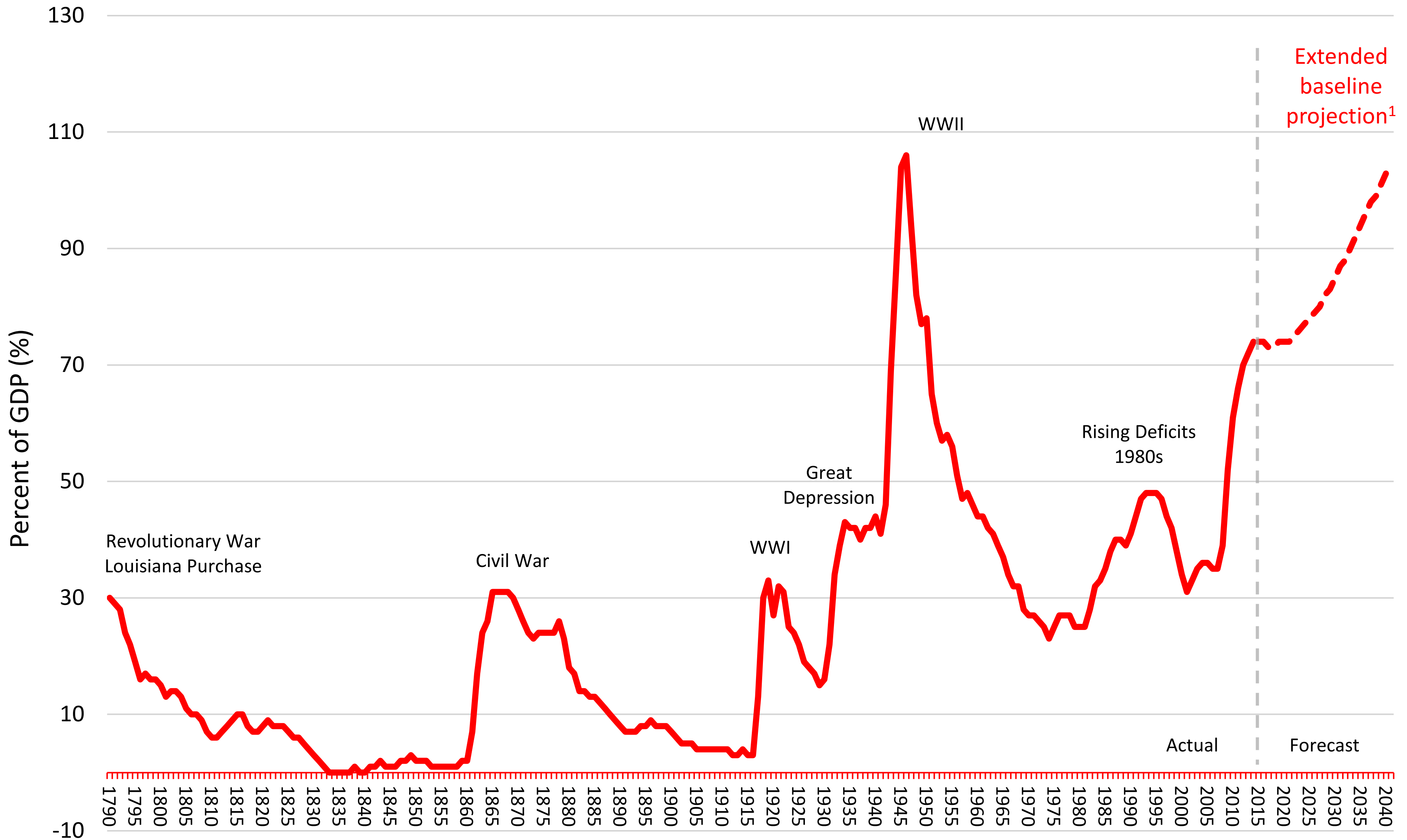


Entitlements are on autopilot and interest expense keeps growing as a share of total spending as the debt accumulates.

Source: Congressional Budget Office (CBO), *The 2015 Long-Term Budget Outlook*, June 2015. [1]CBO's 10-year and extended baselines are meant to serve as benchmarks for measuring the budgetary effects of proposed changes in federal revenues or spending. They are not meant to be predictions of future budgetary outcomes; rather, they represent CBO's best assessment of how the economy and other factors would affect revenues and spending if current law generally remained unchanged.

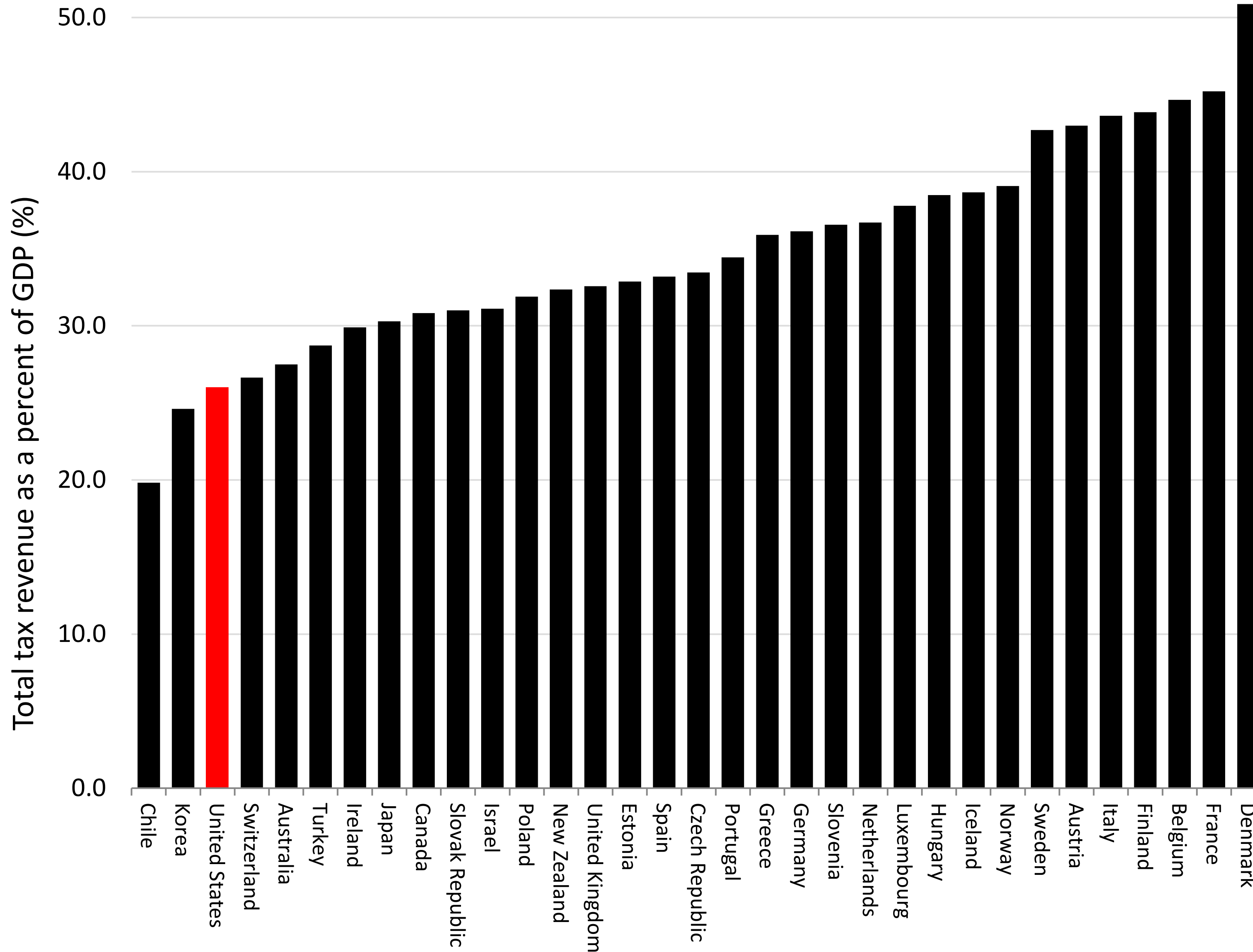
Federal deficit and debt

Federal debt % of GDP through 2040



Source: Congressional Budget Office (CBO), *The 2015 Long-Term Budget Outlook*, June 2015. [1]CBO's 10-year and extended baselines are meant to serve as benchmarks for measuring the budgetary effects of proposed changes in federal revenues or spending. They are not meant to be predictions of future budgetary outcomes; rather, they represent CBO's best assessment of how the economy and other factors would affect revenues and spending if current law generally remained unchanged.

Taxes % of GDP – comparison



While the U.S. has the highest corporate tax rate, the U.S. has one of the lowest total tax burdens among developed economies.

The U.S.'s comparatively low tax burden allows flexibility in solving its long-term entitlement spending problem.

Source: OECD, Revenue Statistics, 2015 Edition. 2014 data for all countries except 2013 data for Australia, Japan, Netherlands and Poland. Does not include non-OECD countries such as China, Brazil, India and Russia. Includes all forms of taxes: federal, state and local; income taxes, sales taxes, VAT taxes, estate taxes, property taxes, etc.

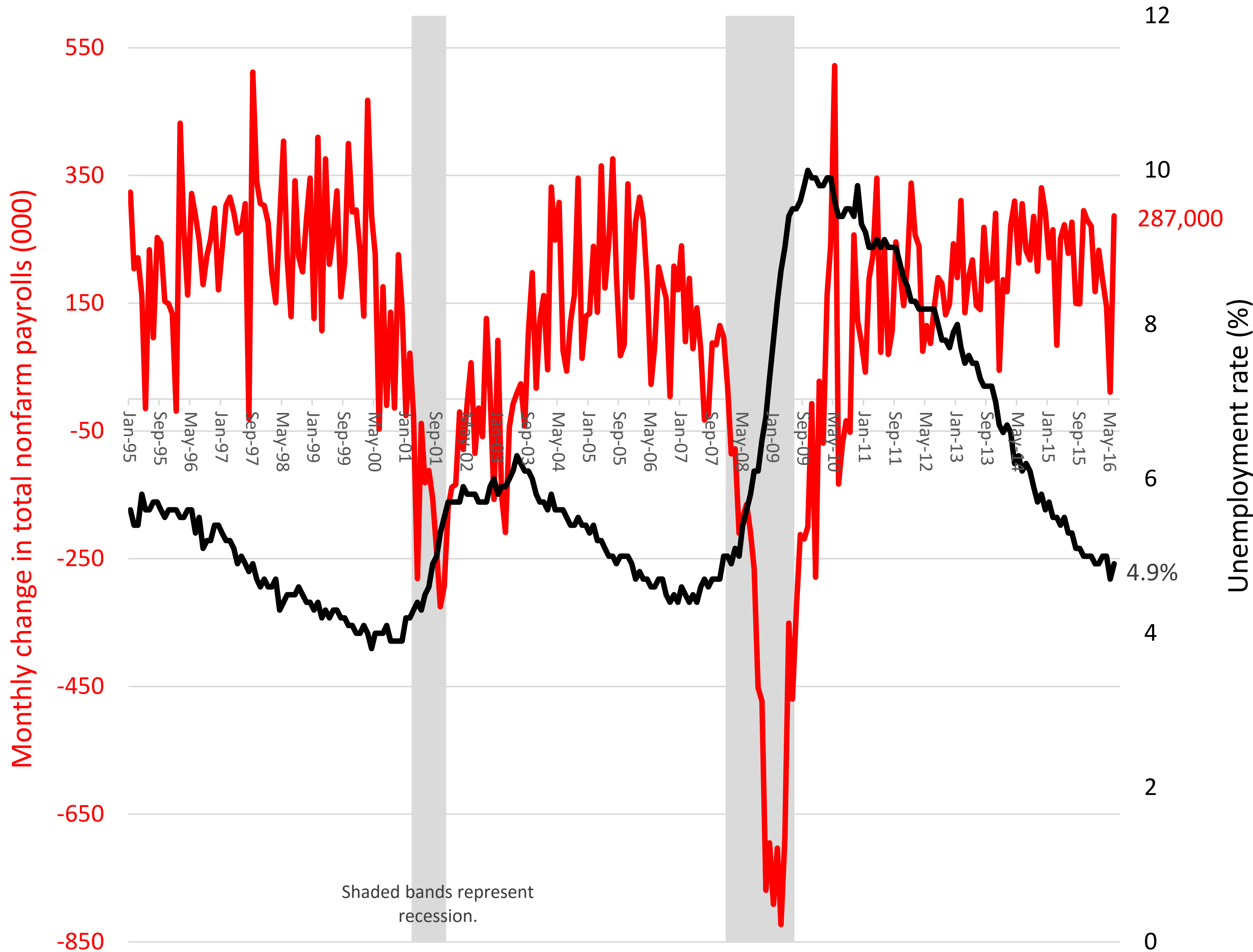
ENDOWMENT WEALTH MANAGEMENT

Jobs

- job formation has not been “anemic”
- new jobs will be limited at full-employment
- good news in full-time employed
- record job openings
- strong relative U.S. job formation forecast long-term
- strong real wage and income growth
- mean and median incomes bottomed
- myth: “… but we’re not creating good jobs”

Net new job formation and the unemployment rate

ENDOWMENT WEALTH MANAGEMENT



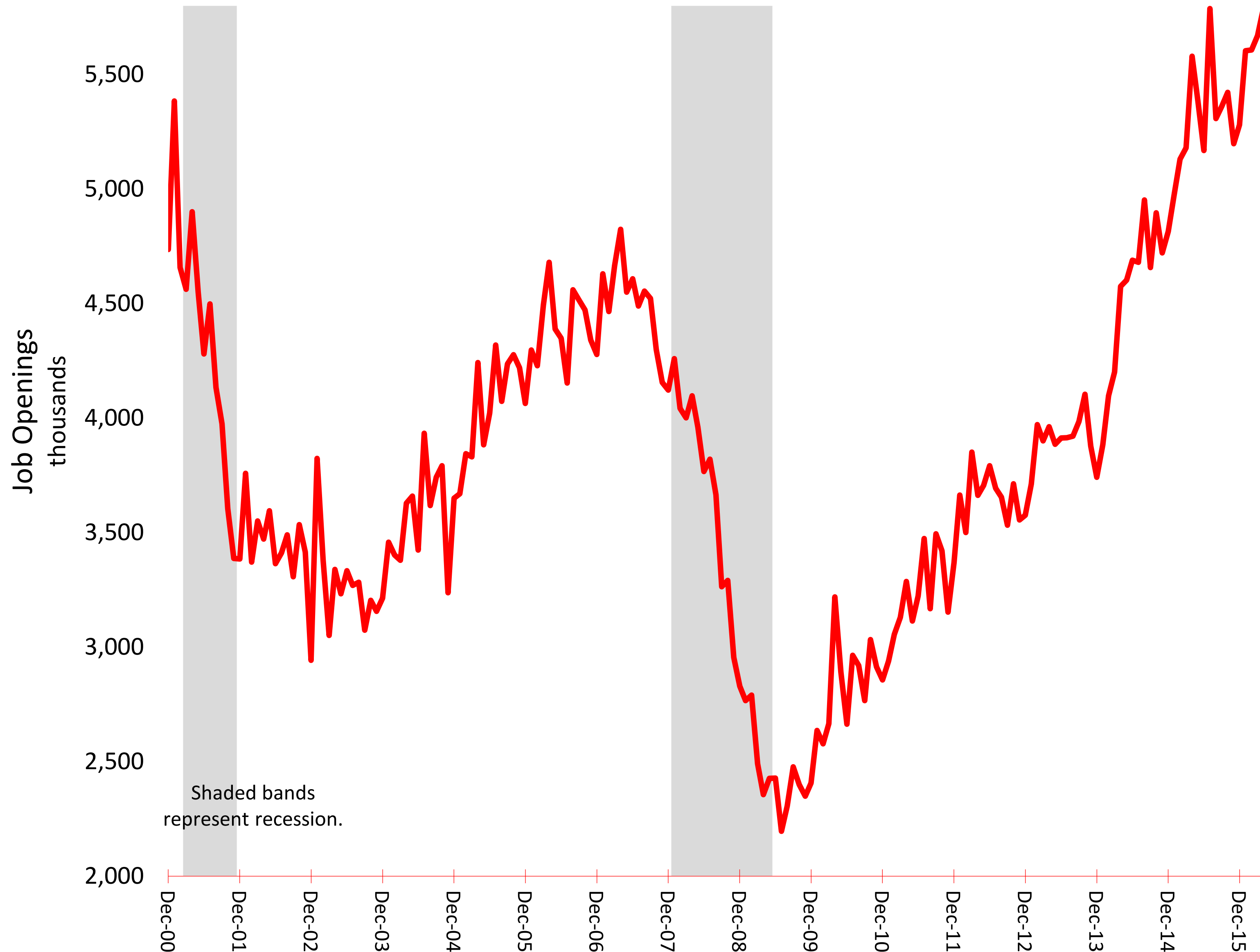
Job growth stronger for longer in this recovery due to the depth of the last recession.

Job growth will decline as the unemployment rate sinks further.

Source: Bureau of Labor Statistics. Data through June 2016.

Job openings – record high

ENDOWMENT WEALTH MANAGEMENT

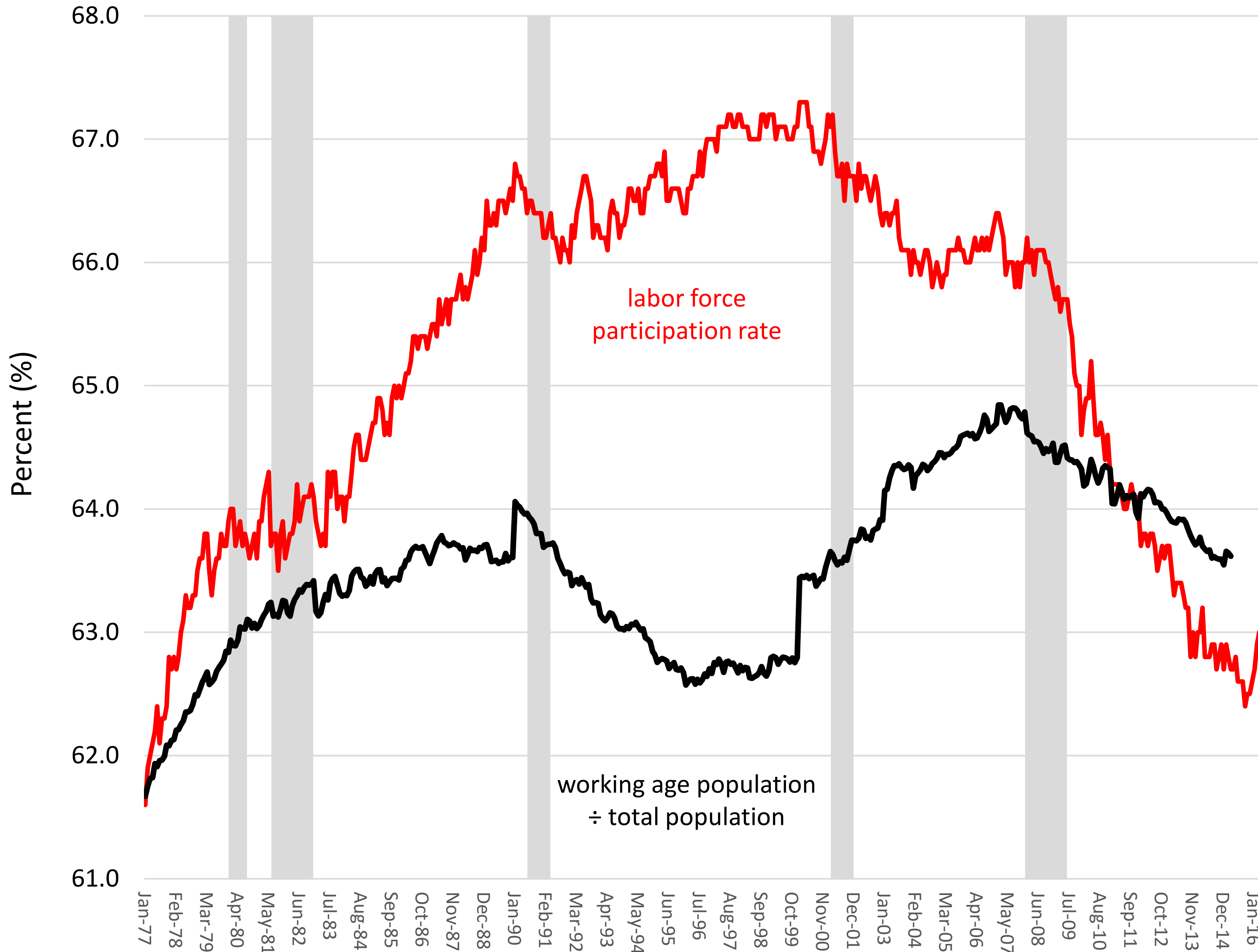


April job openings at record high.

Job growth is slumping as employers can't find enough workers.

Source: U.S. Department of Labor, NBER. Data through April 2016, released June 8, 2016.

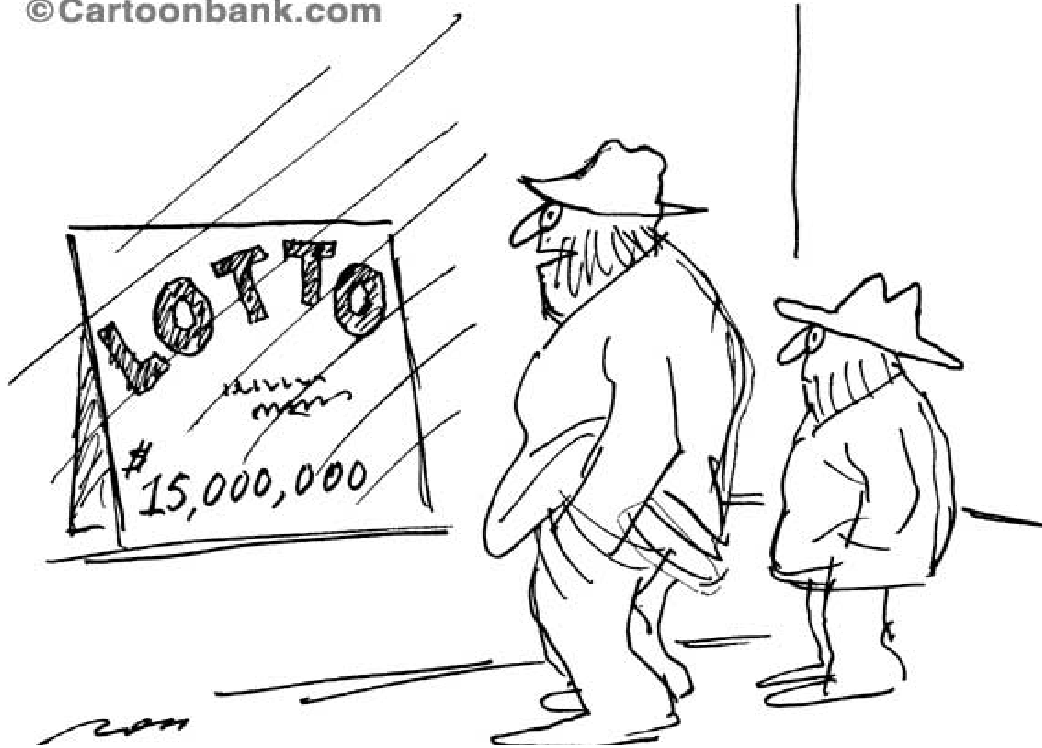
Labor force participation rate[1]



Participation rate is in a structural decline driven partially by demographics.

Recessions drive cyclical slides in the participation rate.

Source: Bureau of Labor Statistics, Federal Reserve Bank of St. Louis. Participation rate data through June 2016. Working age population: aged 15-64, data through March 2015. [1]Labor force participation rate: the proportion of the civilian noninstitutional population 16 years of age and older either at work or actively seeking work.



"Winning is crucial to my retirement plans."

Wall Street's sector calls for 2016 – should you take their advice?

Junk Bond Meltdown • 7 | 4 Bargains in Retail • 26 | The Mess at Third Avenue • 50 | Dow Down 3.3% on Week • M3

BARRON'S

Our 10 Favorite Small-Cap Stocks
Page 30

The Dow Jones Business and Financial Weekly Vol. XCV No. 50 barrons.com December 14, 2015 $5.00

OUTLOOK 2016

WHAT'S AHEAD FOR STOCKS, BONDS, AND THE ECONOMY

WALL STREET'S TOP STRATEGISTS see stocks rising 10% in 2016, propelled by modest profit growth. Their favorite sectors: financials and tech.

Source: *Barron's*, December 14, 2015.

Wall Street's sector calls for 2016 – should you take their advice?

Barron's 2016 Forecast[1]

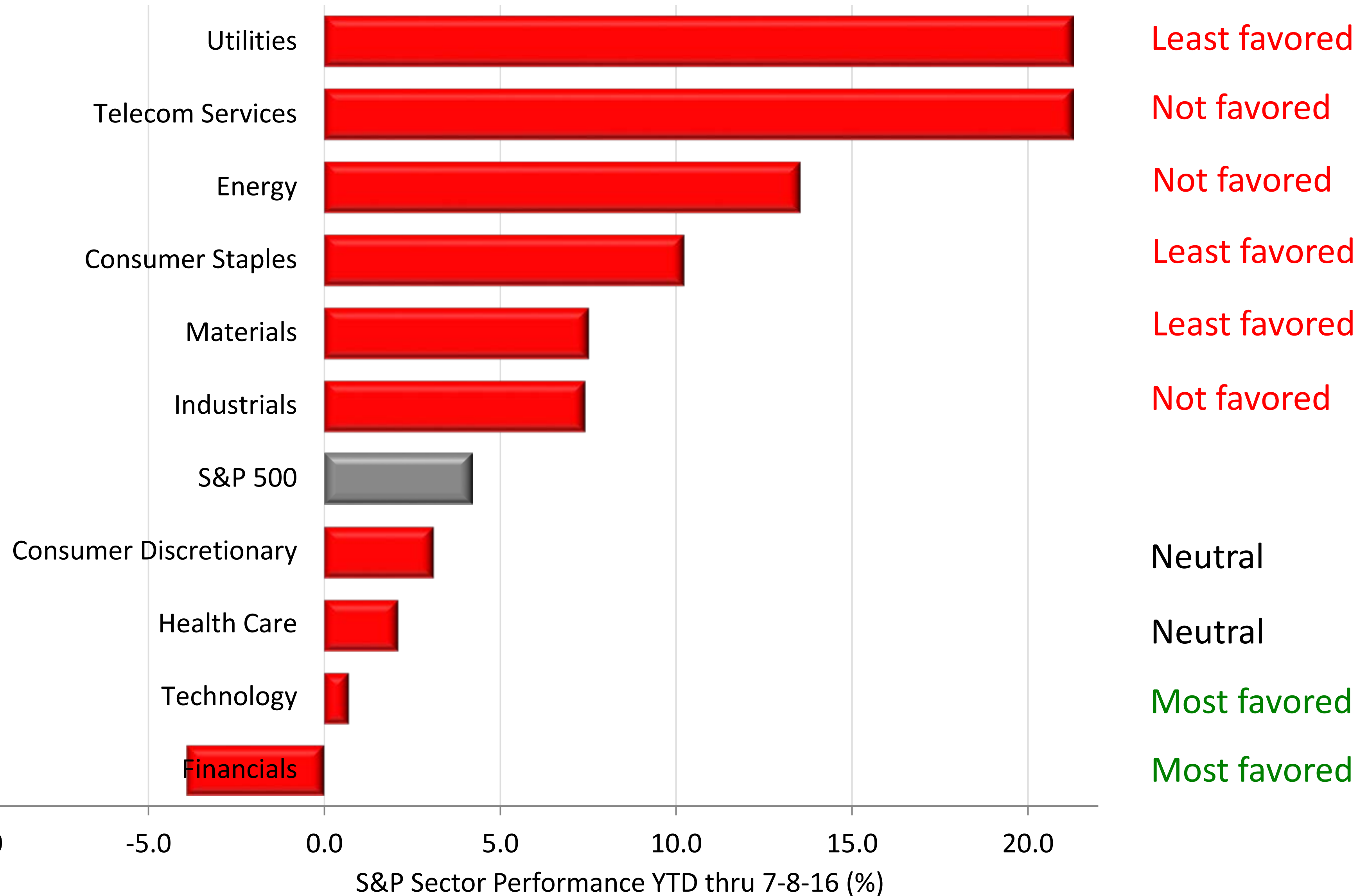
Survey of 10 stock market strategists' sector picks and pans for 2016

	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Telecom Services	Utilities
Federated Investors			-	+	+	+	+	-		
Blackrock		-		+			+			-
Barclays Capital		-	-	+						
Columbia Management							+	-		-
Goldman Sachs		-	-	+			+	-		-
JPMorgan Chase			+	+		-	+		-	-
Citi Research	-		+	+	-		+	-		
Morgan Stanley	+	-	-	+		-				
Prudential				+			+	-		-
BofA Merrill Lynch										
Net (+/-)	0	-4	-2	+8	0	-1	+7	-5	-1	-5

[1] Published December 14, 2015.

S&P 2016 sector returns YTD – the strategists[1] are a disaster

ENDOWMENT WEALTH MANAGEMENT



Source: Standard and Poor's

[1] From *Barron's* survey of 12 Wall Street strategists, published December 14, 2015.

Tactical asset allocation funds

Fortunately, in February 2012, the research company Morningstar decided to update a previous study of tactical asset allocation funds. While this update added only 17 months of data to the original study, it was an ideal time to check on the performance of these funds, because the new period covered the rally of 2010, a sharp correction and the continuation of a rally again.

To demonstrate whether tactical asset allocation funds were able to deliver on their promise during this volatile period, Morningstar compared the results of 210 tactical asset allocation funds against the performance of a simple default investment choice, the Vanguard Balanced Index Fund. This fund has a fixed allocation of 60 percent stocks and 40 percent bonds, and the managers make no attempt to change that allocation based on the direction they think markets are headed.

So how did these 210 fancy market-timing funds perform against a diversified, very low-cost choice that anyone can own? Well, the study didn't tell us anything we didn't already know:

"We found that tactical funds generally struggled to deliver competitive risk-adjusted returns when compared with a traditional balanced fund. With a few exceptions, they gained less, were more volatile, or were subject to just as much downside risk as a 60 percent-40 percent mix of U.S. stocks and bonds."

When we actually look at the results instead of the marketing claims of these funds, it turns out that tactical asset allocation is just like market timing — because just like market timing, it doesn't work.

This is why, as a plethora of other studies show, beating the market by timing its ups and down is so difficult. According to investment research firm Morningstar, more than 90% of "tactical-allocation" mutual funds—which attempt to jump in and out of various asset classes at opportune times—underperformed a passive benchmark index over the past decade.

"The only value of stock forecasters is to make fortunetellers look good."
– Warren Buffet

"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."
– Peter Lynch

Source: *The New York Times*, January 27, 2014. *The Wall Street Journal*, November 8-9, 2014.

Modern Portfolio Theory = Asset Allocation

ENDOWMENT WEALTH MANAGEMENT

Modern portfolio theory was introduced by Harry Markowitz with his paper "Portfolio Selection," which appeared in the 1952 *Journal of Finance*.

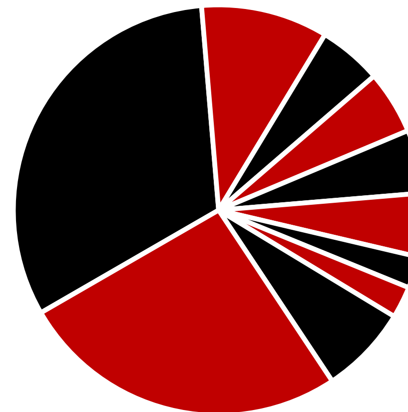
Thirty-eight years later, he shared a Nobel Prize with Merton Miller and William Sharpe for what has become a broad theory for portfolio selection.

<u>Modern Portfolio Theory</u>

Diversify

Optimize

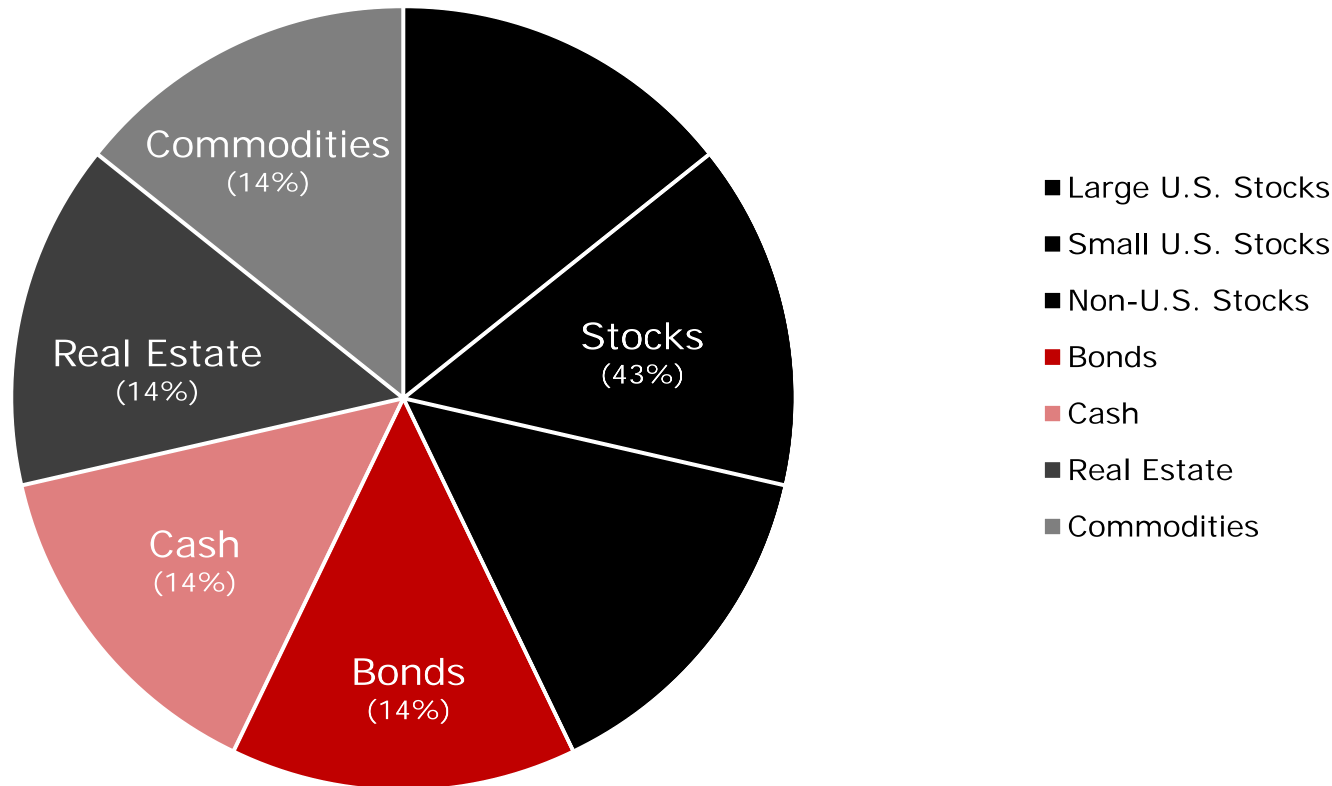
Rebalance



Asset allocation and diversification do not guarantee a profit or eliminate the risk of loss.
Source: Riskglossary.com

Asset Allocation — An Example

Let's construct a global balanced portfolio using 7 asset classes …



Source: ©2012 The 7Twelve ™ Portfolio powerpoint presentation, by Craig Israelsen. Used with permission. Indexes used in this illustration: Large-cap US equity represented by the S&P 500 Index. Small-cap US equity represented by the Ibbotson Small Companies Index from 1970-1978, and the Russell 2000 Index starting in 1979. Non-US equity represented by the MSCI EAFE Index. Real estate represented by the NAREIT Index from 1970-1977 and the Dow Jones US Select REIT Index starting in 1978.Commodities represented by the Goldman Sachs Commodities Index (GSCI). As of February 6, 2007, the GSCI became the S&P GSCI Commodity Index.U.S. Aggregate Bonds represented by the Ibbotson Intermediate Term Bond Index from 1970-75 and the Barclays Capital Aggregate Bond index starting in 1976. Cash represented by 3-month Treasury Bills.

Asset Allocation — An Example

[1]Compound annual growth rate.

Past performance is not a guarantee of future results. An investment cannot be made directly in the indexes used in this illustration.
Source: ©2016 The 7Twelve ™ Portfolio powerpoint presentation, by Craig Israelsen. Used with permission. Indexes used in this illustration: Large-cap US equity represented by the S&P 500 Index. Small-cap US equity represented by the Ibbotson Small Companies Index from 1970-1978, and the Russell 2000 Index starting in 1979. Non-US equity represented by the MSCI EAFE Index. Real estate represented by the NAREIT Index from 1970-1977 and the Dow Jones US Select REIT Index starting in 1978.Commodities represented by the Goldman Sachs Commodities Index (GSCI). As of February 6, 2007, the GSCI became the S&P GSCI Commodity Index.U.S. Aggregate Bonds represented by the Ibbotson Intermediate Term Bond Index from 1970-75 and the Barclays Capital Aggregate Bond index starting in 1976. Cash represented by 3-month Treasury Bills.

Asset Allocation — MPT has delivered

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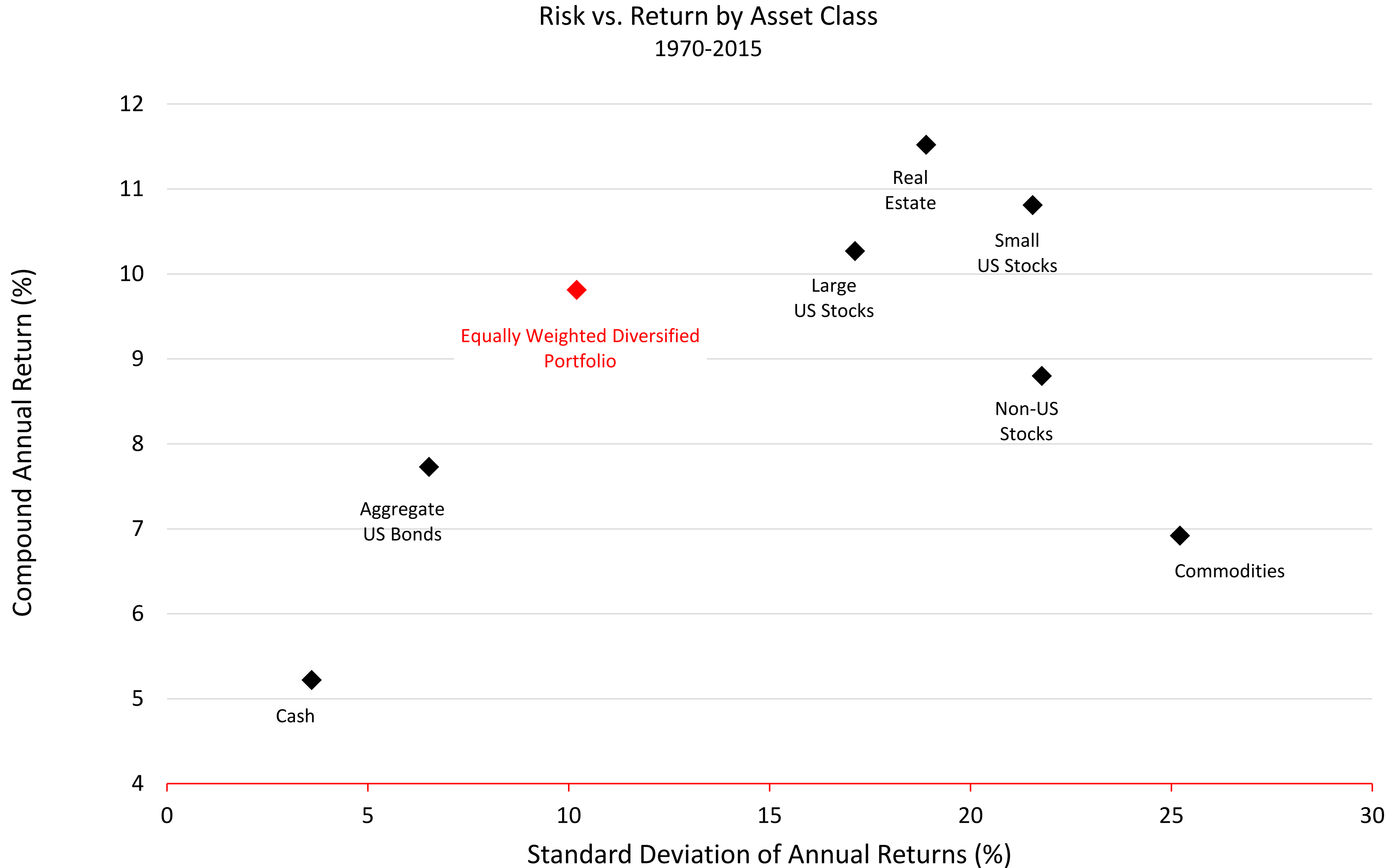
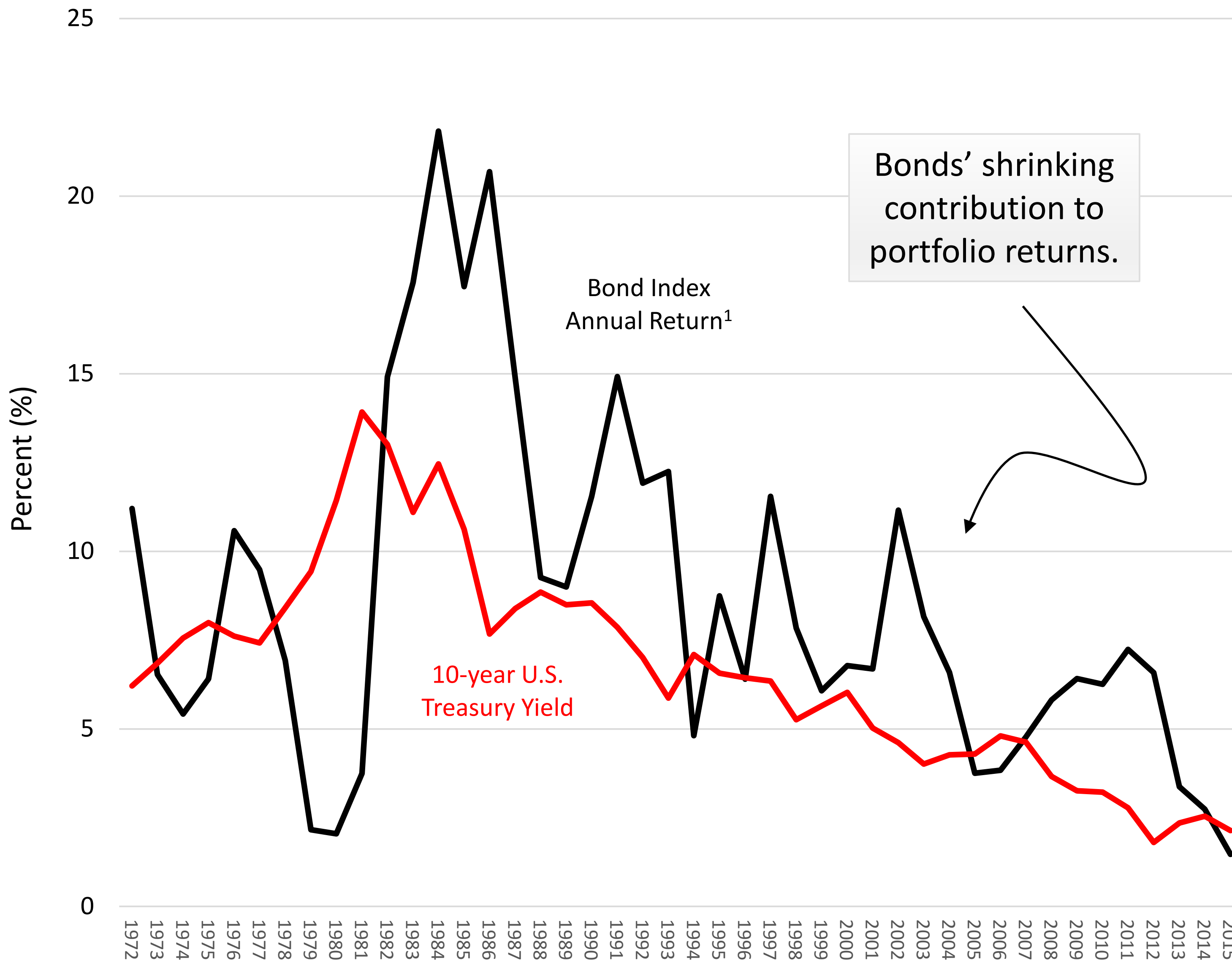


Declining bond returns



Fixed income returns can no longer boost portfolio total returns as they have over the last 40 years.

Expect very modest fixed income returns going forward.

3-year average annual return of just +1.5%

Source: Federal Reserve and ©2015 The 7Twelve ™ Portfolio powerpoint presentation, by Craig Israelsen. Used with permission.
[1] 3-year average annual return of the U.S. Aggregate Bond index represented by the Ibbotson Intermediate Term Bond Index from 1970-75 and the Barclays Capital Aggregate Bond index starting in 1976. Annual data through 2015.

ENDOWMENT WEALTH MANAGEMENT

Pensions Brace for Lower Returns

By Timothy W. Martin

Public pension funds from California to New York are cutting investment-return predictions to their lowest levels since the 1980s, a shift that portends greater hardships for employees and cash-strapped governments as Americans age.

New upheavals in global markets and a sustained period of low interest rates are forcing officials who manage retirements for nearly 20 million U.S. beneficiaries to abandon a long-held belief that stocks, bonds and other holdings would earn 8% each year, as well as expectations that those gains would fund hundreds of billions of dollars in liabilities.

More than two-thirds of state retirement systems have trimmed assumptions since 2008 as the financial crisis and an uneven U.S. recovery knocked many below their long-term goals, according to an analysis of 126 plans provided by the National Association of State Retirement Administrators. The average target of 7.68% is the lowest since at least 1989. The peak was 8.1% in 2001.

Pension funds are trimming their total return assumptions.

my back of the envelope figures:

New portfolio arithmetic?

60/40 stocks/bonds
stocks: .6 X 8% = 4.8%
bonds: .4 X 1.5% = 0.6%
5.4%

average target of 7.68%

Source: *The Wall Street Journal*, September 5-6, 2015.

Important Information

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This is not to be construed as an offer to buy or sell any financial instruments and should not be relied upon as the sole factor in an investment making decision. As with all investments there are associated inherent risks. Please obtain and review all financial material carefully before investing.

The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice.

These materials may contain statements that are not purely historical in nature but are "forward-looking statements." These include, among other things, projections, forecasts, estimates of income, yield or return or future performance targets. These forward-looking statements are based upon certain assumptions, some of which are described herein. Actual events are difficult to predict and may substantially differ from those assumed. All forward-looking statements included herein are based on information available on the date hereof and Fritz Meyer assumes no duty to update any forward-looking statement. Accordingly, there can be no assurance that estimated returns or projections can be realized, that forward-looking statements will materialize or that actual returns or results will not be materially lower than those presented.

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