Investment Commentary: 9/2016

August was a quiet month for U.S. stocks. Daily trading volumes were lower than normal and markets traded in a narrow range. The S&P 500 Index finished the month with a slight gain of 0.1%. **The market's small gain, however, disguised a big divergence in sector trends.** Financial and energy sectors outperformed while defensive and yield-oriented sectors fell sharply. Utility and telecom sectors dropped around 6% for the month as investors worried about higher interest rates, a sharp reversal from their recent trend. Even with the big correction these two sectors remain the top performers for the year.

Foreign developed market stocks were flat for the month while emerging-market stocks returned 2.5%. Investors continue to evaluate the impact of Brexit on foreign stocks, however reassurances from the European Central Bank that it will provide market liquidity if needed, seems to have supported markets. Emerging markets have benefitted from a 'risk-on' market environment and investors searching for better returns. **We became more optimistic on emerging markets a couple of months ago and started to build small positions in growth oriented accounts.** That being said, **we remain attuned with the risks** of a strengthening U.S. dollar, weakness in oil/commodities pricing, geo-political events **and their potential short-term risks to the downside**.

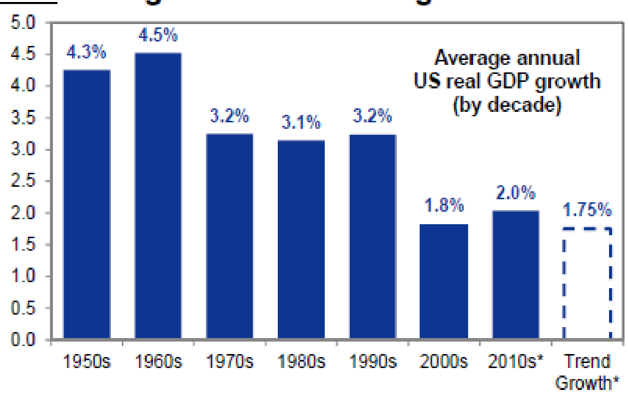
Compared to stocks the U.S. fixed-income markets were much more active during the month. The yield on the 10-year Treasury rose to 1.58%, from 1.46% at the beginning of August, reflecting firming economic performance and growing prospects for a rise in interest rates. Corporate bonds, both in the United States and the eurozone, saw high issuance, with high-yield bonds denominated in euros at a record, amid strong buying from investors searching for yield.

Another data point we are watching is the CBOE Volatility Index (VIX). The VIX, a measure of investor expectations of moves in U.S. equities, rose to 13.95 from 12.44 at the start of the month. **That's still well below its 52-week range and its historical level, but the rise could be an indicator that this relatively quiet period in equity markets may be coming to a close**. As all eyes look to the Fed, its action or inaction may be the next catalyst for larger moves or directional changes in equities before market focus shifts to the upcoming U.S. election.

It's a Slow and Low World

Despite a massive amount of monetary and fiscal stimulus provided since the Tech Bubble and Great Recession, economic growth has been incredibly sluggish. Evidenced by the chart below showing real economic growth has only averaged about 2% in the 2000's, and trend growth is expected to be about 1.75% the next few years. The reasons for slow economic growth are many, however the leading culprits are likely: 1. Excessive debt 2. Aging demographics 3. Excess global supply relative to demand 4. Low productivity. All issues that are not quickly fixed.

US ***real*** **GDP growth has averaged 2% since 2000**



*Blend of 2010 to 2015 average growth (actual) of 2.2% and 2016 to 2019 average growth (GS estimate) of 1.8%; Trend growth represents estimate by Goldman Sachs Economics.

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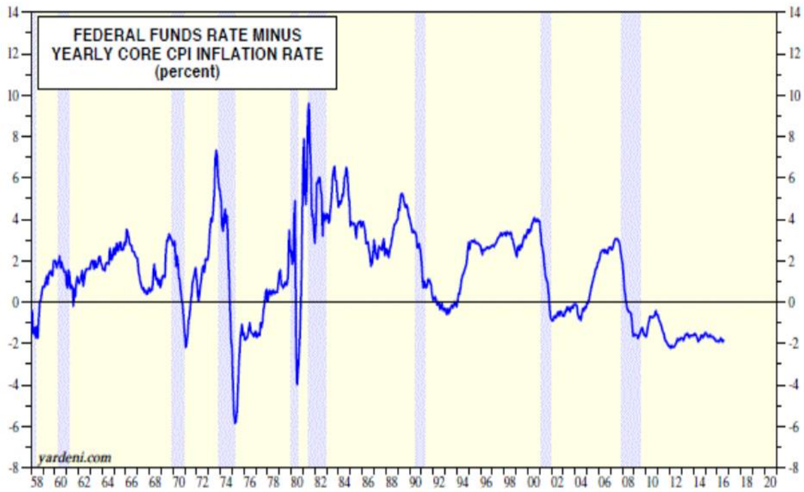
The Federal Reserve has clearly tried to do their part to stimulate economic growth (and inflation). The chart below shows that the 'Real Fed Funds' rate has been well below zero since 2008, by far the longest period of negative real rates since the late 1950's. Unfortunately, there is not much economic growth and inflation to show for their efforts.

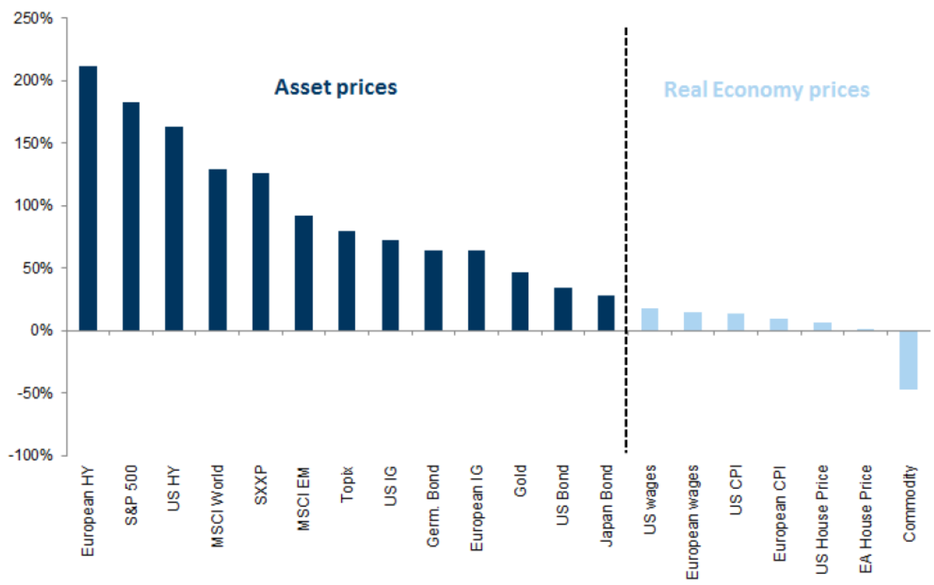


Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Federal Reserve Board and Bureau of Labor Statistics.

Unless, of course, you take a broader look at inflation than the traditional consumer price index. The truth is inflation (higher prices) can show up in many places that are not included in the traditional consumer price indices. The chart below shows how prices in the real economy have stayed low, since the Great Recession, while asset prices have risen substantially (asset inflation). Primarily because low interest rates have contributed to signficant valuation expansion in almost all financial assets. As an example, the P/E on the S&P 500 has increased by 75% since 2011.

Exhibit 7: Wide dispersion between asset price inflation and 'real economy' inflation

Total return performance in local currency since January 2009



Source: Haver, Datastream, Goldman Sachs Global Investment Research

Investment Commentary: 9/2016

The challenge to investors is the current environment of *slow* economic growth *and* extremely *low* interest rates is not sustainable indefinitely. The 'Slow and Low' environment has given an extrodinary boost to financial assets and we don't know exactly when it will end, but we can say with a high level of confidence that it will. It would be wise for investors to start thinking about the implications of a change in interest rates and economic growth, we hope the chart below is helpful!

	GOLDILOCKS Rates stay low Growth accelerates	**REFLATION** Rates increase Growth accelerates	**SLOW & LOW** Rates stay low Growth stays low	**STAGFLATION** Rates rise Growth stays low
Market	• Most positive for risk • Equities outperform bonds • Higher equity valuations	• Positive equities • Equities outperform bonds • Equity valuations stable	• Equities drift higher • Equity valuations stable • Bonds offer low but steady returns	• Equities and bonds correct • Equity valuations fall
Segments	• High beta outperforms • Cyclicals and pure growth outperform	• Cyclicals outperform "bond proxies" • Banks rally • Staples/Defensives underperform	• Stable growers & yields outperform • Defensive stocks outperform cyclicals • Banks underperform	• Commodities outperform • Inflation hedges needed
Areas	• EM outperforms	• US underperforms Europe & Japan	• US outperforms • EM does well	• DM outperforms EM • US outperforms

Source: AWM, Goldman Sachs, Leuthold

AWM Investments (9/16)