Investment Commentary

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The stock market is positioned for normal returns driven by business growth and dividends. This view is supported by:

1. Reasonable stock market valuations,
2. Several factors pointing to continued economic growth.

Reasonable Stock Market Valuations

The table below from JP Morgan's Guide to the Markets compares a variety of current market valuation metrics to their 25-year averages. Consistently, a picture of a stock market that is neither too rich nor too cheap is illustrated.

Should economic growth continue, future returns in the market will be more dependent on business growth and dividends and less dependent on market price adjustments due to valuation changes such as bubbles or discount bonanzas.

Further, the larger risk to stocks is placed on economic growth. As a result, we focus on the economy in the sections below.

Valuation measure	Description	Latest	25-year avg.*
P/E	Forward P/E	16.6x	15.9x
CAPE	Shiller's P/E	26.0	25.8
Div. Yield	Dividend yield	2.3%	2.0%
P/B	Price to book	2.6	2.9
P/CF	Price to cash flow	11.9	11.4
EY Spread	EY minus Baa yield	1.3%	-0.5%

*Price/Cash Flow (P/CF) is a 20-year average.
Source: JP Morgan, as of 6/30/16

Several Factors Point to Continued Growth in the Economy

Specifically:

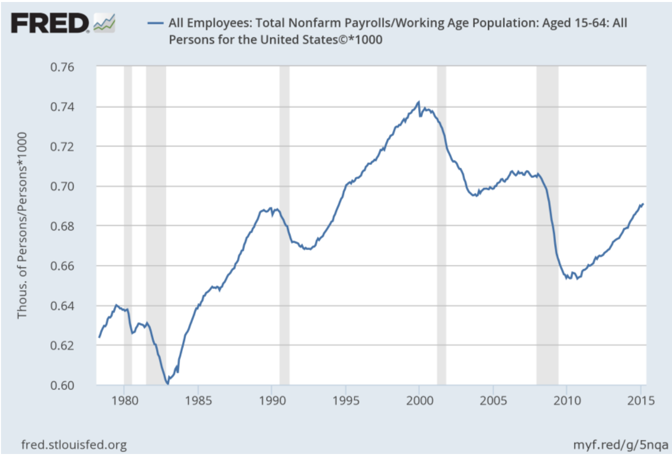
1. Healthy consumer confidence,
2. Continued gains in jobs,
3. A fiscally healthy consumer,
4. Supportive Federal Reserve policy and rates.

Consumer Confidence

Consumer confidence resides in a healthy range – at the upper end of normal. Typically, it responds quickly and dramatically in a negative fashion at the onset of a recession.

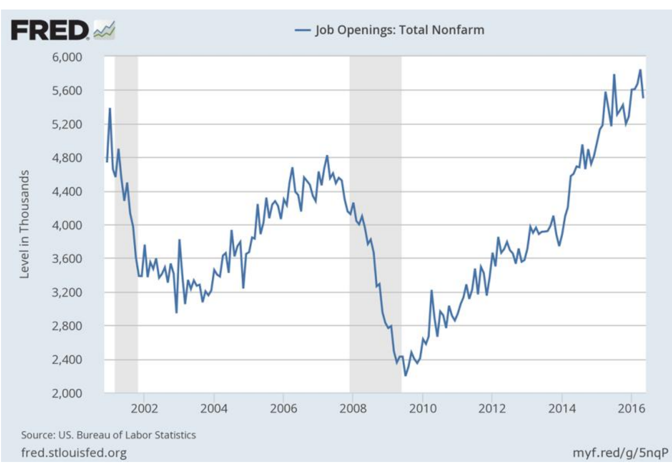
Job Gains

While one can argue about the fairness of how unemployment statistics are presented, a wide variety of data is publicly available. One way to consider job gains is to look at all employees as a percent of the population. We look below at all employees as a percent of the "working age" population of 15 to 64 years old. This measure shows us the employment situation is healthy (consistent with many other metrics in our view). This measure also tends to decline at the start of a recession but seems to be in steady uptrend.



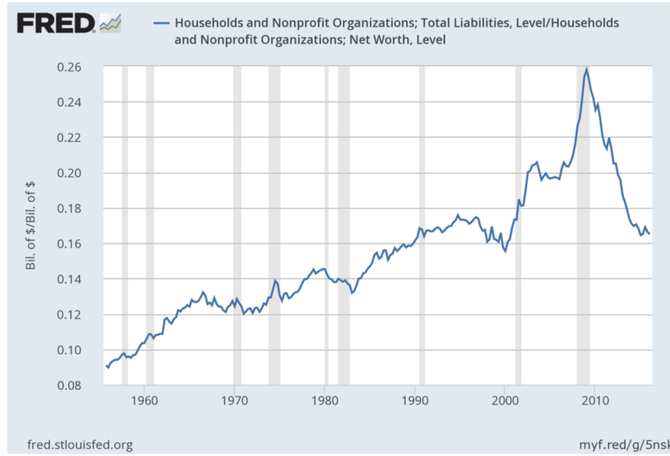
Job Openings Remain in Record Territory

Another consideration is plenty of businesses are looking to hire which generally points to rising wages and continued job gains. While this statistic has been volatile over the past several months, it hasn't broken from its appealing message of a healthy business environment.



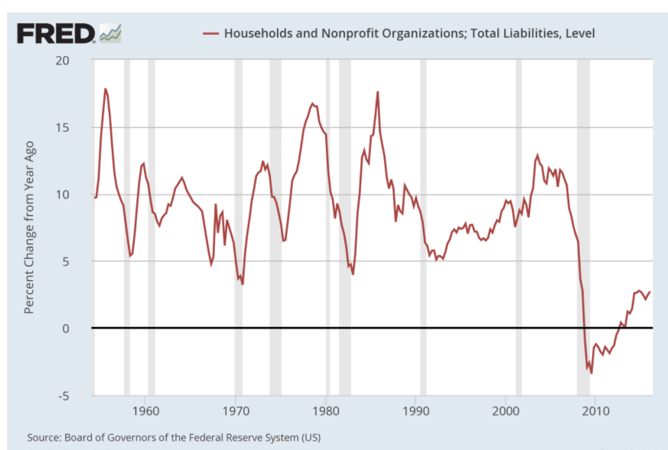
Not much Financial Strain on Consumers

Since 2008, household balance sheets have strengthened considerably as a result of growing asset values and a decline in debt and other liabilities. The chart below shows liabilities, represented as a percent of net worth, are now much lower. As a result, consumers have considerable flexibility when it comes to borrowing money (i.e. buying houses, cars, credit cards, etc.).



Early Innings in the Borrowing-and-Lending Cycle

Consumers have chosen frugality over wasteful spending – so it seems. One explanation as to why the economic recovery has been long and slow relates to consumers saving money and paying off debt. However, as consumer balance sheets have healed, they have begun spending more and, in doing so, have increased overall liabilities; demonstrated by the following chart. Typically, growth in household liabilities is much higher and often peaks prior to recessions. Predicting something other than that would violate the rule: 'never say this-time-its-different.' Consequently, we could be in the early innings of the borrowing and lending cycle which is supportive of continued economic growth.



Accommodative Federal Reserve and the Yield Curve

It is fair to suggest the Federal Reserve continues to support economic growth as they maintain low overnight lending rates. Keeping overnight lending rates low makes it easy for banks to interact with one another and for consumers and businesses to manage cash flows.

Longer term rates such as the 10-year U.S. Treasury Bond yields are also near record lows. Despite this, current Fed Funds policy rates are even lower. This means when you compare long-term rates to short-term rates, the difference is a positive number. When this number is positive, it means the "yield curve" is positive. As you will notice in the chart on the next page, negative yield curves rarely happen. However, when it happens, a recession typically follows.

The reasons a negative curve happens generally relate to an aggressive Fed Funds policy (in an attempt to reduce inflation risk, short term rates are set high) and/or low long-term rates which indicate market fears of slow economic growth. Conversely, a positive yield curve such as the one we currently have is favorable.

Conclusion

In this report, we find the market environment largely positive. We've considered several market valuation and economic concepts that are sending signals of continued economic growth and reasonable market prices. Like any normal year, we expect markets to fluctuate both up and down – with an underlying backdrop that supports opportunistic investing. However, as market conditions shift over time, our approach will adapt.

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