Q1 2016 Commentary

"R - Word" *Fears Subside as First Quarter Concludes*

The first quarter of 2016 is now history, and if by chance you were on a desert island somewhere during these past three months, the market activity may at first appear to have been somewhat benign or even a bit boring, as stocks, high yield credit spreads and oil prices all concluded about where they started.

Yes, when looking at a start to finish on the first quarter it almost looks uneventful. Yet as we know, for all of us who lived it day-to-day, it was anything but that.

Markets saw sharp declines during January and the first half of February as the "R" word—Recession—began to enter the national dialogue as an increasing risk for investors. In fact, as of mid-February stocks were down double digits from year-end 2015 levels, credit spreads had widened close to 200 basis points, and oil prices had declined 30%. It was a rough winter to say the least.

Since that time however, various economic data have emerged in our opinion contradicting the notion that recessionary risk in 2016 had in fact increased. These included:

- Two upward revisions to the 2015 fourth quarter gross domestic product (GDP) which, once feared to have potentially been negative, now looks to have been solidly positive at close to 1.5%.
- The February employment report which materially exceeded expectations with new jobs added to the economy of over 240,000, well above the sub 200,000 level anticipated.
- Personal Income reports in January and February which also exceeded expectations and now represent 11 consecutive months of positive growth.

Of course there was also the Federal Reserve and the market's initial impression back in January that the Federal Open Markets Committee (FOMC) may have been embarking upon a tightening cycle just as the economy was weakening, or what some were referring to as the "reverse Goldilocks scenario." This fear was mitigated following what was perceived to be incrementally dovish statements by the FOMC following its January and March meetings. Despite the market's short-term sense of relief regarding expected Fed action for the rest of this year, we continue to believe that future rate increases, or as the Fed like to call these "Rate Normalization," is needed for longer term economic growth and stability.

We were not in the camp earlier this year that the probability of a U.S. recession had increased considerably, and we continue to believe that GDP growth will likely be in the 2% to 2.5% range for the calendar year. As the strong dollar and low oil prices of 2015 begin to anniversary themselves, we believe a meaningful improvement in corporate earnings could well be in the cards during the second half of the year. We also feel sustained lower oil prices will ultimately serve as a catalyst for consumer spending and therefore prove additive to the broader economy. All of this remains consistent with our 2016 outlook of mid to high single digit gains for stocks and high yield bond returns of coupon rates or better.

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