TIMMONS
WEALTH MANAGEMENT

Market Commentary – Third Quarter 2015

October 5, 2015 – A relatively quiet start to the third quarter gave way to growing levels of fear and anxiety by the beginning of August. Higher valuations left markets more susceptible to a selloff as investors sold US and international holdings in the face of a variety of market challenges including ongoing confusion about Federal Reserve policy, a steady stream of negative news headlines out of China and the continued collapse in commodity prices. For the quarter, the S&P 500 Index declined -6.44% after falling nearly -10% from its peak in late July. Mid and small size US companies fared worst, declining -8% and -11.9% respectively. Outside the US, international developed markets fell -10.2% with the emerging markets experiencing sharp declines of -17.9% in the third quarter. Short and intermediate term high quality bonds were the loan bright spot in the quarter, returning +0.31% and +1.23% respectively. High yield bonds, an area of strong outperformance for the first half of 2015, declined -4.9% in the quarter as investors feared rising default rates across commodity-exposed companies. *In summary, the third quarter was a challenging environment for global investors. Though it is never pleasant to see the values of portfolios decline, it is important to recognize that this is a normal occurrence in market cycles and can provide unique buying opportunities for patient investors.*

Putting the third quarter into perspective, there were a number of interrelated themes driving market pessimism. Slowing growth in the Chinese economy raised concerns about the strength and resilience of the global economy. Over the past decade, the Chinese government has boosted both domestic and global growth through massive amounts of industrial spending providing a tailwind to commodity-exporting emerging market nations and many industrial and commodity companies. Rising commodity prices and strong demand for exports led many commodity producers and emerging market countries to aggressively expand production and take on debt assuming the good times would last forever. As the Chinese economy slowed and began its transition away from an infrastructure and manufacturing based economy, global demand for commodities waned leaving a long list of heavily indebted companies and countries in its wake. Today, many multinational companies doing business in China and other emerging markets are forced to contend with depreciating currencies (hurting overseas profits) and weak demand for products and services. Emerging market economies that had borrowed heavily in good times, often financing projects and budgets with debt issued in US dollars and Euros, are now forced to contend with falling revenues from slumping commodity sales, weaker currencies making it more expensive to service debt in foreign currencies and widening budget deficits at a time where stimulus is required to boost economic growth. In the face of these worries, more than $1 Trillion of foreign investment has left the emerging markets over the past 13 months.

In the midst of these global worries, the Federal Reserve has continued to send mixed messages about the timing of the first interest rate hike, with greater emphasis now being placed on foreign market developments. Expanding beyond previous targets tied to the labor market and inflation levels, Federal Reserve Chair Janet Yellen highlighted "heightened uncertainties abroad" in the September FOMC press conference as a factor in the decision to delay interest rate actions. The stronger dollar and weaker demand for US exports has hurt US manufacturers in recent months while increasing the US economy's reliance on the consumer to drive GDP growth. Investors have taken a pessimistic view of US market valuations in recent months as profitability and earnings projections for the third quarter and the year have declined driven by weakness across the energy sector, slowing global growth and the negative impact of a low interest rate environment on banking profitability. Though the risks behind many of these market worries have not been fully resolved, I do take heart in knowing that they are now widely known and ideally priced into asset values given the recent market correction.

So what have these market developments meant for the composition and performance of client portfolios? The core mutual fund and ETF holdings across client portfolios remain relatively unchanged, with the expectation that some of my favorite value-oriented strategies which have lagged the broader market this year will begin to outperform when the market begins to prioritize company fundamentals and valuations over high growth companies with excessive valuations and flashy stories. The past quarter has provided some unique opportunities to add individual stock positions in high quality companies at discounted prices while reducing risk levels where appropriate. Timely individual stock picks in the beaten-down airline, utility, telecom and business development company sectors boosted performance given their attractive yields and low valuations. With many high quality companies now trading down more than 20% from recent highs, my shopping list of potential investments has grown as I methodically work through assessing the risk/return potential for new additions to client portfolios.

During the quarter, I sold our small remaining stakes in emerging markets and international small company investments to free up cash for new investment ideas. As markets moved deeper into correction territory, I added a new position in an undervalued global retailer while increasing client holdings in a high quality diversified international stock fund. Healthcare, a top performer over the past five years, experienced a sharp decline in the quarter due to heavy liquidations across hedge funds and some panic selling in the face of industry pricing concerns (particularly related to high profile orphan drug increases) which were magnified by comments made by presidential hopeful Hillary Clinton. I continue to maintain a small targeted position in healthcare in the range of 2%-5% for clients given the longer term potential for the sector, with many leading pharmaceutical and biotech companies now trading at attractive price levels.

In light of the recent market correction, it is time to refocus on the facts. The US economy has remained relatively resilient despite troubles abroad. Labor markets continue to recover with unemployment falling and rising wages. Improving consumer spending and consumer confidence has been apparent across key metrics including auto sales, retail sales, growing consumer credit and falling savings rates. US inflation remains subdued driven by lower energy prices and lower import prices, meaning more money in the consumer's pocket. The US housing market continues to exhibit healthy growth across existing home sales and new construction. Though future economic growth will be impacted by a continued slump in the energy sector and weaker manufacturing levels driven by falling export demand, I remain relatively upbeat about the outlook for the US economy over the next 12 months.

Europe's struggles with Greece have subsided for now with PM Tsipras returning to power and working to meet the new demands for the latest bailout package. GDP growth across the Eurozone grew a stronger than anticipated (albeit anemic) +0.4% in the 2Q15, though unemployment levels still remain high and inflation remains well below target levels. A weaker Euro has been a boost to major European exporters over the past year, though weaker global demand will hurt some of the biggest industrial exporters including Germany which is also dealing with the fallout surrounding Volkswagen's emissions scandal. The European economy remains fragile and susceptible to shocks, and further monetary policy actions from the European Central Bank are likely needed to boost growth and inflation levels. Across Europe today, stocks continue to be a more appealing option vs. bonds given the low level of interest rates and the positive impact stimulus actions should have on stock valuations. Beyond Europe, Japan's struggles continue to be evident with the economy contracting -1.2% in the 2Q15 driven by falling auto and equipment exports and weaker consumer spending levels. Despite supportive actions by the Bank of Japan, inflation levels have turned negative again and it is likely that the Japanese government and central bank will be required to implement additional fiscal and monetary stimulus measures to once again boost growth. The long term outcome and effectiveness of these measures remains largely unknown.

I believe the most likely scenario for China remains a prolonged period of slower growth. Recent Chinese stock market declines have highlighted risks facing investors in the Chinese capital markets (something largely ignored and never discussed in many of my discussions with Wall Street strategists and money managers). The deceleration in Chinese growth will impact the rest of the world by varying degrees. Germany and Japan are among the most exposed of the developed nations to a slower Chinese economy, along with many of China's major trade partners across the emerging markets. I see a difficult road ahead for many emerging market economies driven by subdued commodity demand, eventual higher interest rates in the US, high debt levels and the lack of action related to economic reforms when times were better. This is not to say all emerging markets will face the same challenges, but at this time I prefer to obtain emerging market exposure via multinational companies based in developed countries with geographically diversified revenue streams.

The environment for bond investors remains challenging with unclear Federal Reserve policy continuing to make portfolio positioning difficult. With a healthy US economy, I have favored credit risk with higher comparative yields given default levels have remained subdued and the limited protection the highest quality bonds offer investors in a rising interest rate environment. The past quarter's performance across lower credit quality bonds has highlighted the growing risk of defaults driven by the collapse across the energy and materials sectors, and I have taken steps to reduce risk within client bond portfolios. I do continue to expect interest rates will rise but likely at a much slower pace than originally anticipated given the current global environment.

Some final thoughts as we enter the fourth quarter. The recent market decline has been unnerving for many investors, and that's natural. We are six years into the current economic cycle which began after the Great Recession, and this is longer than what we might typically expect. However, data today does not suggest that a recession is near which would be the typical precursor to a bear market. Client portfolios remain broadly diversified and in-line with longer term asset allocation targets. As I have noted in the past, the key to long term investment success is sticking with our investment strategy and ignoring the short term gyrations in the market. Whereas institutional money managers are often forced to emphasize near term quarterly results, as individual investors we have the benefit of time and patience to buy attractively priced assets and wait for the market to realize their worth. It is this mentality and process which is employed by the actively managed mutual fund strategies within client portfolios, and the same approach I take when selecting individual stocks and investments for client portfolios.

Please do not hesitate to call my office to discuss anything contained within the client letter or to schedule a time to meet and review your portfolio. I hope you and your family have a wonderful fall season!

Sincerely,

Liam Timmons, President
Timmons Wealth Management

TIMMONS
WEALTH MANAGEMENT

Market Commentary – Third Quarter 2015

Third Quarter 2015 Market Data:

Asset Class	Category	Performance Comparison Peer Group & Benchmark	3Q2015	YTD
US Stocks	US Large Cap Stocks	S&P 500 Index	-6.44%	-5.29%
US Stocks	US Mid Cap Stocks	Russell Mid Cap Index	-8.01%	-5.84%
US Stocks	US Small Cap Stocks	Russell 2000 Index	-11.92%	-7.73%
International Stocks	International Developed Large & Mid Cap Stocks	MSCI EAFE Index	-10.23%	-5.28%
International Stocks	Diversified Emerging Markets	MSCI EM Index	-17.90%	-15.47%
Bonds	Short Term Treasury Market	Barclays US 1-3 Yr Treasury Bond Index	0.31%	1.00%
Bonds	US Investment Grade Bond Market	Barclays US Aggregate Bond Index	1.23%	1.13%
Bonds	High Yield Bonds	BofAML US High Yield Master Index	-4.90%	-2.53%
Real Estate	Real Estate Investment Trusts (REITs)	MSCI US REIT Index	1.75%	-5.05%
Alternative Investments	Market Neutral/Merger Arbitrage	Barclays US Treasury Bill 1-3 Month Index	0.01%	0.01%
Cash	Money Market	Barclays US Treasury Bill 1-3 Month Index	0.01%	0.01%

Disclosure Historical performance results for investment indices and or benchmarks have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. You cannot directly invest in an index.

Index return information is sourced from Morningstar Office.