HBK Wealth Management
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WEEKLY ECONOMIC COMMENTARY

This Week's Economic Review and Outlook

March 2016

Making a positive impact on as many lives as I can.

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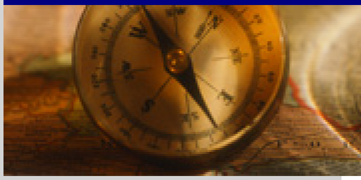
In This Issue



Weekly Economic Commentary | Week of March 21, 2016

KEY TAKEAWAYS

- The Fed's rate hike plan for 2016 was at the center of the already heightened global economic uncertainties troubling the markets.
- Although not the cause of the many imbalances, the Fed's actions can play a role in resolving some of these issues.
- The recent adjustment to the Fed's forecast for 2016 and beyond may come at the expense of higher inflation and more aggressive hikes down the road.

THE FED'S SPRING SURPRISE

As 2016 began and 2015 ended, global financial markets faced plenty of uncertainty in the wake of the first rate hike by the Federal Reserve (Fed) in nearly nine years. Although the rate hike was well anticipated and priced in by many market participants, the Fed's move forced markets to focus on imbalances in the global economy and financial markets that had been simmering for years. The fears about how (and when, if ever) those imbalances would be resolved led to an extreme bout of financial market volatility over the first few months of 2016. Those imbalances included:

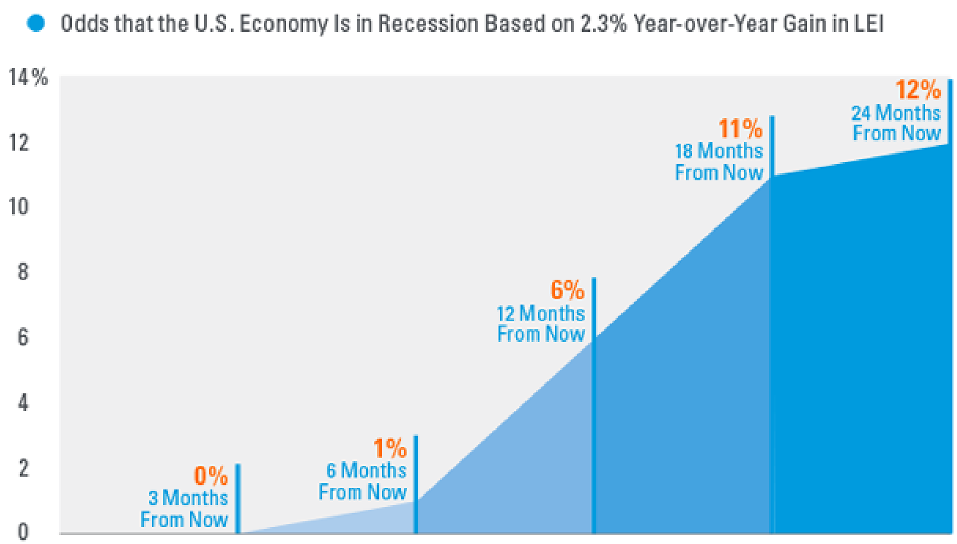
- The strong U.S. dollar
- A global oil glut and the financial stresses on countries and companies affected by the drop in oil prices
- The slowdown in the Chinese economy, and fears of a "hard landing" as it transitions from an export-led manufacturing economy to a consumer-led domestically focused economy
- Central banks outside the Fed pursuing easier monetary policy via negative interest rates and additional quantitative easing
- Rising fears of widespread global deflation and recession

UNTANGLING IMBALANCES: FED PLAN

At the center of these issues was the Fed's plan--set out in the December 2015 Summary of Economic Projections--to raise rates four times (by a total of 100 basis points) in 2016.

The Fed's plan to follow up its 25 basis point (0.25%) rate hike in December 2015 with four additional hikes this year didn't cause the global imbalances noted above, as those built up over the more than eight years of zero interest rates, quantitative easing, slow global economic growth, etc. However, the prospect of the global economy and financial markets successfully working through those imbalances while the Fed was raising rates at that promised pace seemed too much for many asset classes to bear in the first six weeks of 2016. The seemingly intractable imbalances only added to the financial stresses; by mid-February 2016, the S&P 500 was down 10.5% year to date and 14.2% from its May 2015 peak, spreads on high-yield debt to Treasuries widened out considerably, and the price of oil hovered in the mid-$20s per barrel (down more than 30% from the start of 2016 and 75% from mid-2014 peaks). By that time, financial markets were pricing in near 100% odds of a recession occurring this year. Here at LPL Research, we placed the odds of a recession at 25-30% (up from 10-15% at the start of the year), with most of the increase due to the increased likelihood of a policy mistake here or abroad. The economic data itself, based on the Leading Economic Indicators (LEI), still only suggest only a 10-15% chance of a recession in the next few years [Figure 1].

1 ECONOMIC DATA STILL SUGGEST LOW ODDS OF A RECESSION IN NEXT FEW YEARS



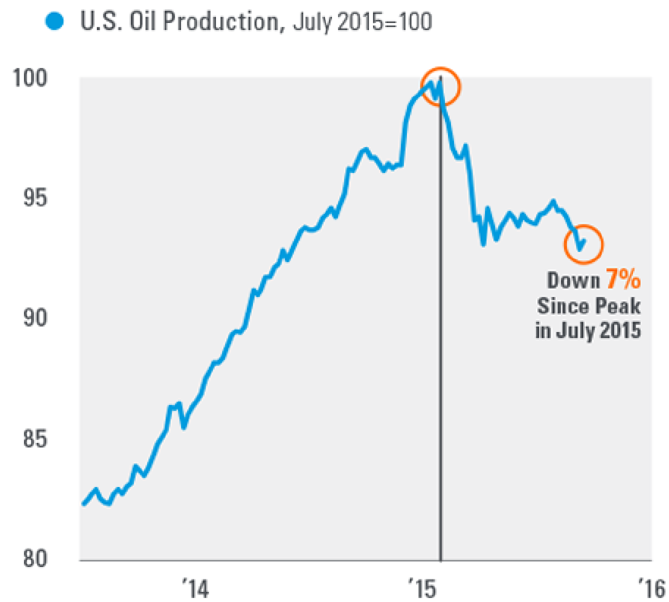
Source: LPL Research, Conference Board, Bureau of Economic Analysis 03/21/16

The Leading Economic Index is a monthly publication from the Conference Board that attempts to predict future movements in the economy based on a composite of 10 economic indicators whose changes tend to precede changes in the overall economy.

UNTANGLING IMBALANCES: GLOBAL VIEW

Prior to the Fed's meeting last week (March 15-16, 2016), a few of the aforementioned imbalances were slowly beginning to resolve, albeit ever so slowly. By mid-February 2016, at the peak of the market's concerns over the imbalances, oil production in the lower 48 United States had dropped by 7% from its mid-2015 peak [Figure 2] in response to the 75% drop in oil prices, and the Organization of the Petroleum Exporting Countries (OPEC) agreed, in principle, to a "freeze" in production. If sustained, the ongoing reduction in supply in the U.S. and the freeze in OPEC production may help to reduce the global oil glut, stabilize oil prices, and relieve (perhaps even reverse) some of the financial stresses put on corporate balances sheets, financial markets, and emerging market currencies and current account balances. OPEC has scheduled a meeting for April 2016 to assess the freeze and discuss if an actual cut in production is warranted.

2 OIL PRODUCTION IN THE U.S. HAS DROPPED 7% FROM MID-2015 PEAK

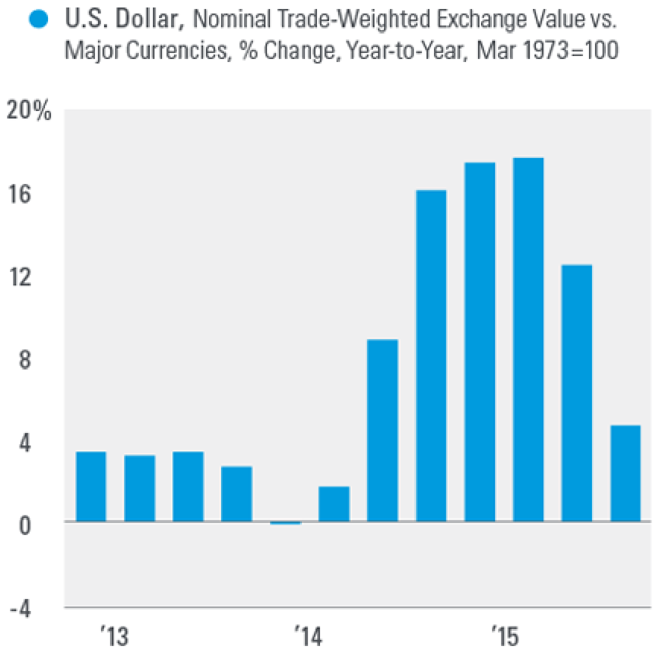


Source: LPL Research, Haver Analytics 03/21/16

Some clarity on the economic slowdown and transition in China in late February and early March 2016 also helped to untangle some of the imbalances. After making a series of policy missteps in the summer and fall of 2015 with its currency and equity markets, Chinese authorities have sounded more rational and in control in recent weeks, sending markets soothing signals that it won't abruptly devalue its currency and will continue to do whatever it takes to hit its lowered targets for economic growth in 2016. Despite the recent progress, however, Chinese policymakers have plenty of work to do, and China still has many issues to contend with (property price bubble, bad loans in its banking system, lack of transparency, etc.). But at least for now, the market seems to be satisfied that Chinese authorities are saying (and doing) the right things to avoid a "hard landing" in China.

The relentless strength of the dollar was also a key contributor to global imbalances [Figure 3]. The strong dollar was putting unwanted stress on emerging market currencies, economies, and current account balances; at the same time, it was hurting global commodity prices, driving U.S. inflation lower, and hurting U.S. exports, corporate profits, and the manufacturing sector. Here again, these effects of the strong dollar were not caused by the Fed's actions at its December 2015 meeting, but rather by the divergence between U.S. and global economies and monetary policies that was exacerbating problems many years in the making. Although not entirely of its own making, the key to resolving this issue was squarely on the Fed.

3 THE STRONG U.S. DOLLAR, WHICH HAS BEEN A KEY CONTRIBUTOR TO GLOBAL IMBALANCES, IS NOW FADING



Source: LPL Research, Federal Reserve Board, Haver Analytics 03/21/16

At last week's Federal Open Market Committee (FOMC) meeting, the Fed acted boldly. Citing "global economic and financial developments of recent months," the FOMC said last week that it now plans just two 25 basis point rate hikes this year (instead of four) and that its long-run neutral fed funds rates is now 3.25%, 25 basis points lower than Fed projections in December 2015. Those two shifts--fewer rate hikes this year and a lower end point for the fed funds rate in the years to come--went a long way toward further resolving the imbalances that wreaked havoc on global markets at the start of 2016.

COST OF RESOLUTION?

However, the Fed's decision to help resolve some of the global imbalances may come at a cost, if financial markets and, perhaps more importantly, U.S. consumers begin to see an unwanted uptick in inflation in the coming months. In our view, the data already show that the labor market has tightened enough to cause some wage inflation, although Fed Chair Yellen said she has yet to see a convincing pickup despite plenty of anecdotal evidence of wage pressures. Readings on inflation, most notably inflation excluding food and energy (also known as core inflation), are also moving higher, especially in the service sector; but here again, in her post-FOMC meeting press conference, Fed Chair Yellen downplayed that rise, noting that some of the recent rise in inflation readings are "transitory."

Thus, although the Fed's actions at its March 15-16, 2016 FOMC meeting may have relieved some of the global imbalances and provided some additional time for the oil market glut to clear, for global growth to stabilize, for China to rebalance its economy, and for some of the financial stresses to ebb, it may have done so at the cost of higher inflation (and more aggressive rate hikes) later this year or in 2017.

IMPORTANT DISCLOSURES

All performance referenced is historical and is no guarantee of future results.

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for your clients. Any economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

All indexes are unmanaged and cannot be invested into directly.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

DEFINITIONS

Quantitative easing (QE) refers to the Federal Reserve's (Fed) current and/or past programs whereby the Fed purchases a set amount of Treasury and/or mortgage-backed securities each month from banks. This inserts more money in the economy (known as easing), which is intended to encourage economic growth.

Yield spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. High-yield spread is the yield differential between the average yield of high-yield bonds and the average yield of comparable maturity Treasury bonds.

INDEX DESCRIPTIONS

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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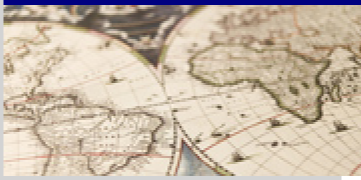


Weekly Market Commentary | Week of March 21, 2016

KEY TAKEAWAYS

- Last year was difficult for European corporate earnings and stock market performance, with this year not appearing much better.
- Many "wildcards" may cause European equities to outperform low expectations, but at current valuations we do not believe investors are being properly compensated for the risks associated with the asset class.

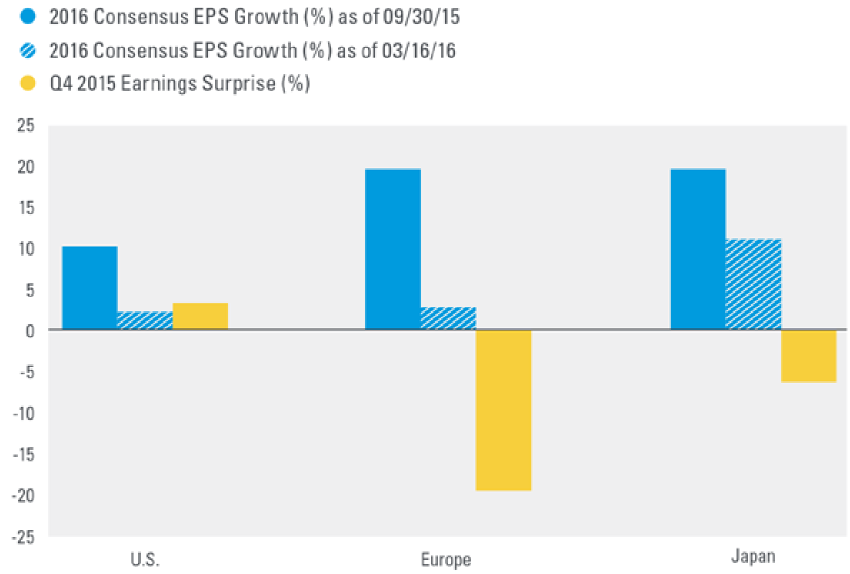
EUROPE - NOT ENOUGH GROWTH

Forecasts for European corporate earnings have become increasingly pessimistic. Analysts have reduced calendar year 2016 expectations to just under 3% earnings per share (EPS) growth, currently from nearly 20% as of the end of September 2015. Even though European stock prices have declined, the collapse in growth expectations suggests that these markets are still fairly valued; few, if any, bargains have been created. Recent aggressive monetary policy by the European Central Bank (ECB) may have boosted stock prices, but the implications for corporate earnings are much less certain. At just over 15 on a forward basis, the price-to-earnings ratio (PE) is well above the average since 2004 of 12.8 and does not present a great opportunity given the uncertainty around 2016 earnings expectations. Existing growth forecasts may be at risk due to political events, most notably the referendum on Britain's continued membership in the European Union (EU). Central bank activity has created volatility in the currency markets, volatility for which U.S. dollar-based investors are not likely to be compensated. These factors lead us to be cautious on Europe at this time.

MORE THAN THE USUAL OPTIMISM

Investment analysts are typically overly optimistic when beginning to forecast earnings and earnings growth for a given time period. Analysts subsequently revise those forecasts downward. Forecasts for Europe in 2016 have dropped dramatically, from expectations of nearly 20% growth to now less than 3%. Though forecasts for other regions were revised down, the apparent reversal of opinion on Europe was much greater [Figure 1]. Financial analysts were very optimistic on both Japanese and European corporate earnings growth as recently as September 2015. Expectations for U.S. earnings growth were not as robust, so although they fell to about the same level, the drop is less dramatic. Despite continued loose monetary policy from their respective central banks, earnings forecasts fell, but much more for Europe than Japan or the U.S.

1 SOFT GROWTH—BUT SHARP SURPRISE



Source: LPL Research, FactSet, Thomson Reuters 03/16/16

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

An earnings surprise occurs when a company's reported quarterly or annual profits are above or below analysts' expectations.

What happened? First, the fourth quarter was dreadful for European companies. The majority of companies (52.3%) *missed* the already lowered earnings expectations, while 58.2% of their U.S. peers *outperformed* expectations. Furthermore, the magnitude of the earnings miss in Europe was extreme at -19.5%, again contrasting to the positive 3.5% outperformance of U.S. companies relative to their fourth quarter expectations. After seeing the poor performance of so many European companies relative to expectations, analysts had to substantially reconsider future forecasts.

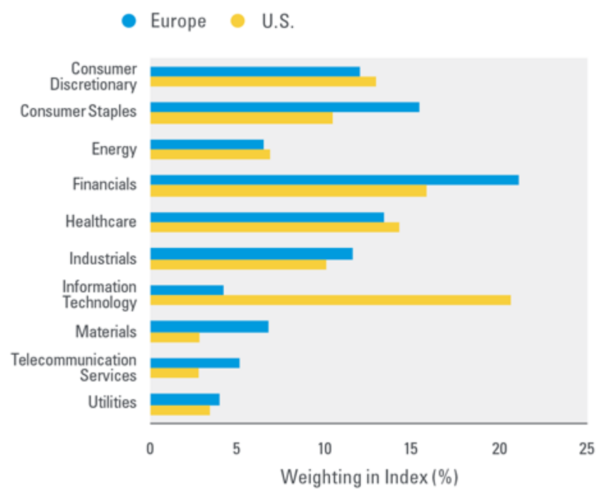
The macro backdrop for the region also gives the market little reason to believe that Europe can break out of its nearly five-year earnings recession. European earnings peaked in November 2011 and have fallen 16% since then. Gross domestic product (GDP) for the EU grew at 1.9% in 2015, and forecasts for 2016 are for 1.8%. These forecasts are at risk given the potential damage that could be caused should Britain decide to leave the EU. This is not the supportive backdrop European companies need for accelerated earnings growth.

IS THE STORY IN THE SECTORS?

Given the dramatic decline in energy prices, it is not surprising that the subsequent earnings and price decline of energy stocks influences and perhaps distorts broader market metrics. In fact, 85% of the market capitalization of European energy stocks consists of the three major multinational integrated energy companies--those that extract, refine, and sell finished products such as gasoline and diesel. In the United States, less than half of the market capitalization consists of the top three companies, with many more pure exploration and production companies or service providers in the energy industry. Therefore, earnings forecasts for European energy stocks are highly reliant on a small number of very similar companies. Given the composition of the sector, we expect U.S. energy stocks to be more sensitive to underlying commodity prices.

Looking beyond energy, European materials, telecoms, and utilities sectors also saw earnings declines during the quarter. These three sectors comprise 15.8% of the MSCI Europe Index, compared to 9% of the S&P 500 Index. Collectively, these sectors tend to be lower growth. Figure 2 shows the relative sector weights for the U.S. and Europe. In particular, Europe provides investors with a greater exposure to materials stocks, including major mining companies where most of their production comes from Australia and Africa. These companies are highly sensitive to the Chinese slowdown. In fact, the companies in Europe that performed best relative to expectations in the fourth quarter of 2015 were those where most of their business was conducted within Europe. The companies that performed worst relative to expectations had the most exposure to emerging markets.

2 MARKET COMPOSITION VARIES BY REGION



Source: LPL Research, FactSet 03/16/16

The U.S. and Europe are represented by the S&P 500 Index and MSCI Europe Index, respectively.

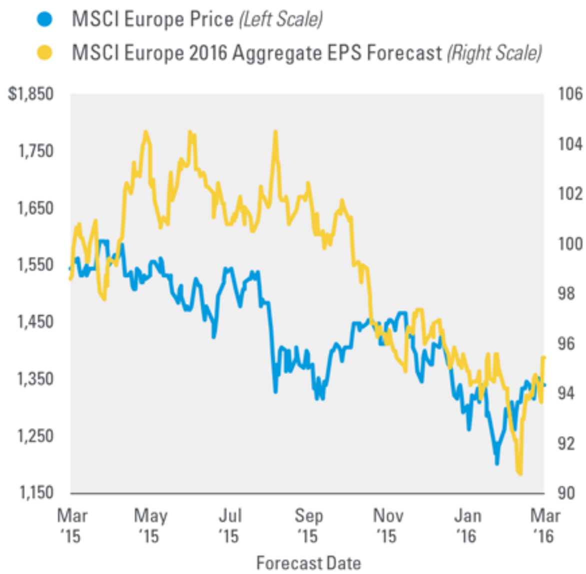
Indexes are unmanaged and cannot be invested into directly.

EUROPEAN FINANCIALS AND NEGATIVE INTEREST RATES

Another significant difference between the U.S. and Europe is that Europe has a much larger financial sector. Both current and expected earnings of financial stocks in Europe have been impaired by the negative interest rate environment in Europe. The ECB was so concerned about the impact of negative rates impacting banks that it announced a new Targeted Longer-Term Refinancing Operations provision (officially called the TLTRO II, suggesting that the ECB has run out of clever acronyms). This program will lend banks money interest free, and if that bank increases its lending over the next two years, the ECB will reward it with additional money. This program represents the ECB's attempt to stimulate the economy, while improving the "business of banking," and therefore, encouraging more lending. Regardless of any success over the life of the program, the nature of the program is not expected to have any impact on earnings until 2018.

Despite negative returns for the MSCI Europe Index last year and a 5% decline this year, these markets are still not cheap. Prices for European equities declined fairly steadily last year and the first six weeks of 2016, as earnings forecasts were revised downward, consistent with the weakening earnings and economic backdrop. Stocks and growth forecasts have rebounded with energy prices more recently. But have they fallen enough to make Europe attractive, considering this background? Data suggest that they have not [Figure 3]. Forward valuations for the market suggest a PE of around 15x expected 2016 earnings. This is consistent (if not at a premium) with the longer-term average for the market.

3 REDUCED EARNINGS FORECASTS LOWERS MARKET



Source: LPL Research, FactSet 03/16/16

EPS = earnings per share.

Indexes are unmanaged and cannot be invested into directly.
Past performance is no guarantee of future results.

CURRENCY MATTERS

Currency matters for European investments, but can have both positive and negative effects. The euro declined last year against all of Europe's major trading partners, including the U.S., Japan, and China. This provided some boost to export-oriented companies, though clearly not enough to have a major impact on overall earnings. However, the declining euro also impairs returns for U.S.-based investors. Our expectation is for the dollar to be more stable this year.

The significant wildcard of the "Brexit" remains. Should Britain leave the EU, we would expect significant currency weakness versus the U.S. dollar and other currencies, almost certainly in the British pound, but also likely in the euro as well. In our view, given current equity market valuations, investors are not being rewarded for taking on the politically induced currency uncertainty.

CONCLUSION

European companies and equity markets' performance has been a disappointment. The major underperformance of companies relative to expectations has made analysts pessimistic for this year as well, forecasting just 2.9% earnings growth for all of 2016. At this point, nothing in the political or economic environment is suggesting a significant reversal in this position; if anything, the political issues in Europe are adding uncertainty to the market. Given current valuations, we do not believe investors are being rewarded for this uncertainty. For the foreseeable future, we will remain cautious on the European market.

All investing involves risk including loss of principal.

International investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

Because of its narrow focus, investing in a single sector, such as energy or manufacturing, will be subject to greater volatility than investing more broadly across many sectors and companies.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation; a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with a lower PE ratio.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Currency risk arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The MSCI Europe Index is a free float-adjusted, market capitalization-weighted index that is designed to measure the equity market performance of the developed markets in Europe.

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Tracking #1-479999 (Exp. 03/17)

Understanding Health Savings Accounts
Health savings accounts (HSAs) are tax-preferred savings accounts set up in conjunction with high-deductible health insurance policies that are used to fund qualified medical expenses. Enrollees or their employers make tax-free contributions to an HSA, then use the funds typically to purchase medical care until they reach their deductibles. But HSAs are not for everyone and it helps to fully understand how they work before considering them as a viable option to help fund your health care costs.

HSA Specifics

You are eligible for an HSA if you meet these four qualifying criteria:

- You are enrolled in a qualified high-deductible health plan (HDHP).
- You are not covered by another disqualifying health plan (whether insurance or an uninsured health plan).
- You are not enrolled in Medicare.
- You are not a dependent of another person for tax purposes.

HSAs are generally available through insurance companies that offer HDHPs. Many employer-sponsored health plans also offer HSA options. Although most major insurance companies and large employers now offer an HSA option under their health plan, it's important to remember that most health insurance policies are not considered HSA-qualified HDHPs. In fact, the IRS has set limits as to what qualifies as an HDHP. For 2016, a plan can only be considered an HDHP if its deductible is at least $1,300 ($2,600 family). So make sure to check with your insurance company or employer to see if an HSA plan option might apply.

The maximum contribution to an HSA for 2016 is $3,350 if you have single coverage, or $6,750 if you have family coverage. If you are over age 55, then you can contribute an additional $1,000 in 2016 regardless of whether you have single or family coverage. Such contributions are made on a before-tax basis, meaning they reduce your taxable income. Note that unlike IRAs and certain other tax-deferred investment vehicles, no income limits apply to HSAs.

HSAs offer investment options that differ from plan to plan, depending upon the provider. What's more, HSA account balances carry over from year to year, unlike their predecessors, medical savings accounts (MSAs), which contained a "use it or lose it" feature that severely limited their usefulness for most people. Earnings on HSAs are not subject to income taxes.

Any ordinary medical, dental or health care expense that would qualify as a tax-deductible item under IRS rules can be covered by a HSA. A doctor's bill, dental procedures and most prescriptions are examples of covered items. See IRS Publication 502

for a definitive guide of what costs are covered. If funds are withdrawn for any other purpose than qualifying health care expenses before age 65, you will be required to pay taxes on amounts withdrawn plus a 20% additional federal tax. Once you reach age 65, you can use HSA money to pay for non-medical expenses, but you will still owe taxes on the withdrawal.

In summary, HSAs can offer significant benefits for some situations, but may not fit your specific needs.

Contribution and Out-of-Pocket Limits for Health Savings Accounts and High-Deductible Health Plans[1]

	For 2016	For 2015	Change
HSA contribution limit (employer + employee)	Individual: $3,350 Family: $6,750	Individual: $3,350 Family: $6,650	Individual: no change Family: +$100
HSA catch-up contributions (age 55 or older)*	$1,000	$1,000	No change**
	Individual: $1,300	Individual: $1,300	Individual: no change

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HDHP minimum deductibles	Family: $2,600	Family: $2,600	Family: no change
HDHP maximum out-of-pocket amounts (deductibles, co-payments and other amounts, but not premiums)	Individual: $6,550 Family: $13,100	Individual: $6,450 Family: $12,900	Individual: +$100 Family: +$200

* Catch-up contributions can be made any time during the year in which the HSA participant turns 55.

** Unlike other limits, the HSA catch-up contribution amount is not indexed; any increase would require statutory change.

[1]Source: Obamacarefacts.com, "Health Savings Account (HSA)."

The Internet Crime Complaint Center reported complaints resulting in over $800 million in losses in 2014.

Surf Safely: Protect Yourself From Online Scams

Online criminals continuously change their operating methods. That's why it is crucial that Internet users keep up on the latest scams and the steps to take to protect their personal and financial information when online.

Here is an overview of two of the most widespread techniques being used to commit online fraud, as well as some practical tips to protect your personal security.

Phishing: This is one of the most popular methods of online fraud. Phishing, or "spoofing," is a scheme whereby users are sent fake emails that claim to be from a legitimate source. The email directs the user to a counterfeit website where they are asked to update personal information, such as passwords and user names or credit card, Social Security, and bank account numbers. By hijacking brand names of banks, online retailers, and credit card companies, phishers often convince recipients to respond.

Crimeware: This is a class of computer programs designed exclusively to facilitate online identity theft. Cyber thieves use a variety of techniques to steal confidential data through crimeware, including:

- Secretly planting keystroke loggers onto a user's computer to collect sensitive data -- such as login and password information for online bank accounts -- and reporting the data back to the thief.
- Redirecting a user's browser to a counterfeit website controlled by the thief even when the user types the website's proper address in the address bar.
- Stealing passwords cached on a user's system.

This type of scam received national attention several years ago when it was revealed that business executives at major U.S. firms were the targets. The "bait" used to lure the recipient was an official-looking subpoena from the U.S. District Court in San Diego. When recipients clicked on the document to view it, software designed to collect keystroke data was secretly installed on their computers. It was estimated that thousands of people fell victim to this scam.

Play It Safe

The Federal Bureau of Investigation estimates that online scams were responsible for over $800 million in losses in 2014.[1] With the number and sophistication of online scams increasing, there are some basic recommendations you can follow to help avoid becoming a victim.

- **Don't recognize it? Don't open it.** Do not open any email, email attachment, or website link from suspicious or unknown senders.
- **Don't give out your info.** Be wary of any e-mail that asks for personal information such as passwords or account numbers. Similarly, avoid any email that promises a prize or gift in exchange for completing a survey or answering questions online.
- **Blast those pop-ups.** These small windows typically appear on or behind the window that you are currently viewing. While many are harmless advertisements, some may contain viruses or software that can monitor your Web activity.
- **Be sure sensitive data is encrypted.** Always ensure that you are using a secure website -- one that employs state-of-the-art encryption technology -- when submitting credit card data or other sensitive personal information.
- **Check your accounts.** Regularly log in to your online accounts and check your bank, credit, and debit card statements to ensure all transactions are legitimate.
- **Keep your system up-to-date.** If your computer's operating system is more than five years old it may not offer the same degree of protection as newer models. Most system manufacturers issue updates and security patches on their websites or automatically through your Internet provider. Similarly, be sure to use the latest Web browser and anti-virus software.

Finally, if you think you've fallen victim to a scam, report it. The FBI has a Cyber Operations unit devoted to fighting cyber crime. Their Internet Crime Complaint Center is at www.ic3.gov.

[1]*Federal Bureau of Investigation, Internet Crime Complaint Center, 2014 (most recent available).*

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