HBK Wealth Management
Haire · Bohmer · Kilcoyne

WEEKLY MARKET COMMENTARY

A Candid Look into the Current State of the Markets

June 2016

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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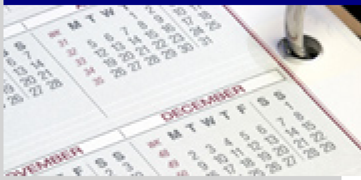


KEY TAKEAWAYS

- June is jam-packed with major market events that may go a long way toward determining the direction of the stock market.
- These events, coupled with the age of the economic cycle and election-related uncertainty, suggest that stocks may experience an uptick in volatility next month and may give us a dip to buy.
- Look for more from us on these events in future blogs and weekly publications.

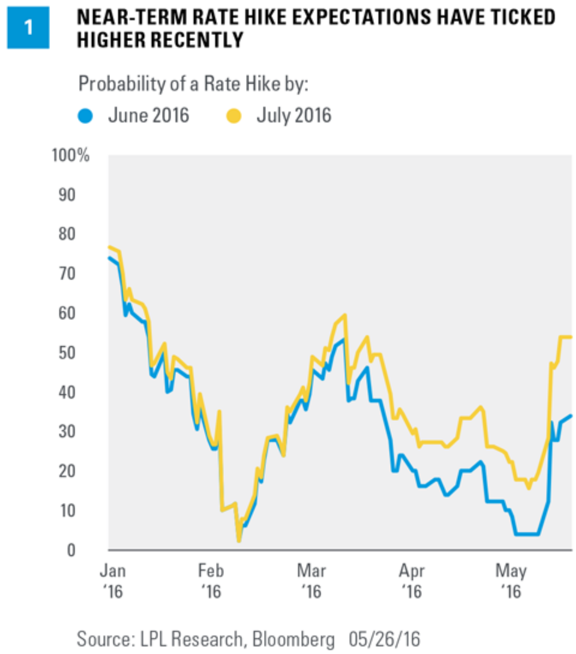
JAM-PACKED JUNE

June is jam-packed with major market events. This week we take a look at these events and potential market implications, highlighted by the "Brexit" vote and the Federal Reserve (Fed) policy meeting.

JAM-PACKED JUNE

There are a number of big market events coming up next month that may go a long way toward determining the direction of equity markets over the balance of the year:

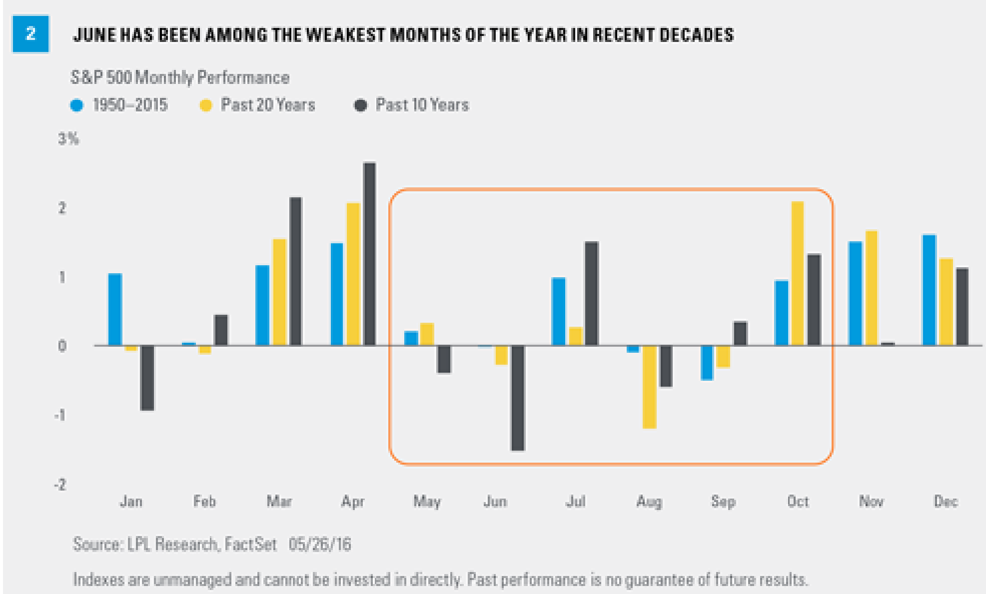
- ECB policy meeting (June 2). The European Central Bank (ECB) has embarked on a massive bond buying program (quantitative easing [QE])--similar to the Fed's programs in recent years--to help reinvigorate the region's economy and fight deflation. A major shift in policy at the June meeting is unlikely given the central bank will not start its previously announced corporate bond buying program until June (the ECB is already buying sovereign debt; the corporate bond expansion was announced in March 2016). Markets will be looking for signs from ECB Chief Mario Draghi that the ECB is inclined to expand the program even further as needed later this year. Any additional stimulus would likely weaken the euro against the U.S. dollar. We believe the ECB will eventually loosen monetary policy even further, given the challenging intermediate-term growth outlook and persistent deflationary pressures this year. The ECB may wait until after the Brexit vote on June 23 to make any changes.
- OPEC meeting (June 2). A possible deal between OPEC and non-OPEC (i.e., Russia) producers to freeze output to support crude oil prices fell apart in April 2016 when Iran failed to go along. Iran has stated its intention to boost production back to levels before Western sanctions were put in place; Saudi Arabia insists that Iran must freeze production as well, making a compromise very unlikely. We are encouraged by recent progress toward oil supply-demand rebalancing in the U.S. and the resulting rise in prices. While our base case calls for status quo overseas, and we acknowledge OPEC's diminished influence and fragmentation, it is possible that overseas producers surprise investors and come up with a creative way to support global oil markets.
- May Employment report (June 3). The U.S. government's tally of the health of the labor market is released every month, so this report does not make June different from any other month. However, given the market's intense focus on the Fed's June policy meeting later in the month, this number will take on greater importance. Consensus estimates are calling for 200,000 net new jobs created in May, up from the lackluster 160,000 created in April. Equally as important to the Fed are wages, which rose 2.5% year over year in April of 2016. Should these data points, along with the Institute for Supply Management's Manufacturing Index for May--due out on June 1--reflect further strengthening of the labor market, the odds of a June Fed rate hike may increase to 50% or more, after falling under 5% as recently as May 16, 2016.
- FOMC meeting, economic forecasts, and Chair Janet Yellen press conference (June 14-15). Although stocks have historically performed well during the first year after the initial Fed rate hike of an economic cycle, investor anxiety around the timing of rate hikes has been higher this cycle, making the June meeting particularly important for markets. We believe the market may still be underestimating the probability of an early summer rate hike and a second hike by year-end. Fed fund futures are indicating a 34% probability of one rate hike by June and 54% by July (as of May 24, 2016) [Figure 1], and are pricing in just a one-in-three chance of a second hike by December, even though Fed officials have been warning markets that--election or not--two hikes are likely in 2016. We believe the next hike is more likely to come in July than June because of the June 23 Brexit vote; two hikes this year remains our base case.



- Bank of Japan monetary policy meeting (June 15-16). The Bank of Japan (BOJ), like the ECB, has embarked on a massive bond buying program, i.e., QE, to reinvigorate its economy. The central bank surprised markets at its last policy meeting on April 28, 2016, taking no action, which drove the yen sharply higher. Expectations were that the central bank would either lower interest rates further or expand its purchases of Japanese securities (or both, including additional equities purchases) to help weaken the yen and support the country's exporters. Some have even called for the aggressive (what some would call radical) money "helicopter drop," which is just like it sounds--where the central bank prints money and distributes it directly to its citizens. Japan's economy averted recession during the first quarter of 2016 as its gross domestic product (GDP) expanded 0.4% (not annualized) and the yen has weakened versus the U.S. dollar since the April BOJ meeting, leaving some doubt as to whether the BOJ will take additional action in June. However, unless growth and inflation pick up in the coming months, we would expect the BOJ to increase the size of its QE program soon, potentially putting added upward pressure on the dollar.
- Brexit vote (June 23). The upcoming "Brexit" vote (a referendum on whether the U.K. will remain part of the European Union) has several implications, both political and economic. From a political perspective, the biggest implication would be the tacit support for other anti-EU movements across the continent, including political pushes for more autonomy in Spain (which has elections coming up on June 26), France, and Italy. Estimates on the economic impact of a Brexit, while highly partisan, suggest potential negative impact on GDP of between 1% and 3% due to a reduction in trade. Longer term, potential productivity declines and renegotiations of trade agreements may further impact growth. Perhaps the biggest wildcard is what would happen to London as a banking center and whether U.K.-based companies would choose to relocate. Recent polls show "remain" leading "exit" by as much as 50% to 38%, with 11% still undecided.

SEASONAL WEAKNESS

As we discussed in our Weekly Market Commentary "Is Sell in May Just a Cliché?" May through November has historically been the weakest six-month period to own stocks. Investors trying to exploit this pattern would have sold stocks on May 1 and would buy them back on October 31. How about June? Over the past 10 years, June has been one of the weakest months for stocks [Figure 2]; the month has averaged -1.5% and -0.3% losses for the S&P 500 over the past 10 and 20 years and, with a marginal average decline since 1950 (-0.03%), is the worst of all 12 months. Hardly encouraging. These seasonal patterns do not always hold, but are a reason to be a bit careful as summer rolls around.



CONCLUSION
June is jam-packed with potential market-moving events that may go a long way toward determining the direction of financial markets and market volatility over the balance of the year. These events, coupled with the age of the economic cycle and election-related uncertainty, suggest that stocks may experience an uptick in volatility next month and may give us a dip to buy. But volatility works in both directions, so let's hope for some of the positive flavor. Look for more from us on these events in future blogs and weekly publications.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The 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 liquidity of the investment in a falling market.

All investing involves risk including loss of principal.

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.

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 Institute for Supply Management (ISM) Index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

This research material has been prepared by LPL Financial.

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Tracking #1-501810 (Exp. 06/17)

Weekly Economic Commentary | Week of May 30, 2016

GDP GAP

KEY TAKEAWAYS

- The gap between GDP growth in the first and second quarters has widened over the past 20 years, particularly over the last 10.
- We believe the Fed is on track for two rate hikes this year, and GDP growth of 3% in the second half of 2016 may result in a third rate hike.
- See today's Weekly Market Commentary for previews of the upcoming OPEC meeting, the May jobs report, and other potentially market-moving events ahead for June.

How fast the economy is growing at any given point in time is important to know. Citizens, policymakers, investors, central banks, and, in election years, politicians, all want to know how we're doing. These days, they want to know instantly. The problem is, getting a good read on how fast an economy is growing, in real time, is difficult at best. Trying to ascertain how the sectors of an economy (manufacturing, consumer, business spending, construction, etc.) are performing is even more difficult. Yet, despite all the issues, every day, week, month, or quarter, we obsess over the economic data and the pace and composition of growth in the U.S. (and global) economy.

While it's true that gross domestic product (GDP) is the most comprehensive look at the health of a nation's economy, it is not very timely, and it is subject to substantial revision over time. In addition to those "faults" in recent years, a gap has opened up in the quarterly pattern of GDP growth and appears to have widened substantially, making the data even more difficult to interpret, especially in the first two quarters of the year.

The U.S. Bureau of Economic Analysis (BEA) released its latest estimate of the nation's first quarter 2016 GDP last Friday, May 27, 2016. The initial take on first quarter 2016 GDP growth, at just 0.5%, was released in late April 2016. Based on the new and revised input data (construction, factory shipments, retail sales, etc.) released since late April 2016, first quarter GDP was revised up to 0.8%.

TIMELINESS VS. ACCURACY

Those responsible for collecting and disseminating economic data face the constant trade-off between timeliness of the data and the ultimate accuracy in capturing the economic phenomenon the data are trying to measure. Many nations (both developed and emerging) worldwide have robust processes in place to gather and report economic data on a timely basis. But generally speaking, the U.S. has the most reliable, comprehensive, timely, and conflict-free economic data collection and reporting system in the world. Despite our leading position on collection and distribution, the economic data digested on an hourly, daily, weekly, monthly, and quarterly basis are still subject to a great deal of uncertainty and revision.

SEASONAL ADJUSTMENT AND GDP

GDP is reported by the BEA in several different ways, but the most commonly cited way is on a "real" (inflation-adjusted) seasonally adjusted annualized basis. GDP is seasonally adjusted to smooth out the fluctuation in the economy related to weather patterns, shopping patterns, holidays, school vacations, and other factors, to allow apples-to-apples comparisons between quarters. For example, vehicle assembly plants typically shut down in July, which would depress GDP in the third quarter (July, August, and September) relative to the second quarter (April, May, and June). Similarly, jewelry sales spike around Christmas and again at Valentine's Day. Seasonally adjusting the data helps market participants to see through the swings in the seasonal data and may better reveal the true underlying health of the economy at any time of the year.

All else being equal, over long periods (40 or 50 years), annualized GDP growth across all four quarters in a year should be roughly similar, and differences in growth rates between quarters should also be minimal and stable. In recent years, however, there has been a widening gap between GDP growth in the first quarter and the second quarter that did not exist in the 45-50 years between 1950 and 1995; as a result, market participants have begun to question how well the statisticians and economists at the BEA are making these adjustments.

THE FIRST QUARTER GDP GAP

Figure 1 shows the quarter-to-quarter annualized growth rates in seasonally adjusted real GDP in each quarter for different time periods. For example, in the 46 first quarters from 1950 through 1995, real GDP growth averaged 4.3%. GDP growth averaged 3.9% in second quarters, 3.7% in third quarters, and 3.0% in fourth quarters. In general, from 1950 through the mid-1990s, there was not much difference in quarterly growth rates, which suggests that the seasonal adjustment process for GDP was relatively effective at smoothing out the quarter-to-quarter blips in the economy due to weather, purchasing patterns, shifts in holidays, the timing of school holidays, and auto plant shutdowns. During those 46 years, the first quarter was the weakest quarter of growth 13 times, or 28% of the time, which is about what you would expect.

But what about the difference between growth in the first and second quarter? This is at the center of attention this week after the tepid reading on first quarter GDP (+0.8%) versus a consensus estimate for second quarter GDP tracking at between 2.5% and 3.0%, based on the economic data in hand for April and May. From 1950 through 1995, growth in the first quarter averaged 4.3% and growth in the second quarter averaged 3.9%, a difference of just 0.4%. Indeed, in 24 of those 46 years (52% of the time) growth in the first quarter was faster than in the second quarter, but that has changed over the past 20-and especially the past 10-years.

Since 1995, first quarter GDP growth has averaged 1.3%, and, on average, is the quarter with the slowest growth; it has been worst performing quarter of the year in 11 years, more than half the time. Again, if seasonal adjustment was working, this should not be the case over a 20-year period; quarterly variations should be more randomly distributed throughout the year. Over that same time, GDP growth in second quarters has averaged 3.3%, a full 2 percentage points higher than growth in first quarters. In 14 of the past 20 years (70% of the time), GDP growth in the second quarter has been faster than in the first.

Over the past 10 years, this GDP gap has widened even more. Reported GDP growth in the first quarter between 2007 and 2016 has been -0.3%. Although this figure is clearly skewed lower by the 5.4% drop in real GDP in the first quarter of 2009, it is well below the average gain in second quarters over this period (2.4%); also, the 2.7% gap between growth in the first and second quarter is nearly seven times as wide as it was between 1950 and 1995. GDP growth in the first quarter has been the slowest quarter of growth in 6 of the past 10 years, again, not what you would expect if the seasonal adjustment process was working.

Academics and government statisticians have written many papers on why this is happening, but we'd do them a disservice by trying to recap them here. A year ago, in May 2015, the BEA acknowledged this gap, calling it "residual seasonality" and said it would attempt to adjust for it in the future; although more than a year later, the "gap" between first quarter and second quarter GDP still exists.

WHAT DOES THE SEASONAL GDP GAP MEAN FOR THE FED?

Why do markets care about this quirk? The market and Federal Reserve (Fed) policymakers are well aware of the first quarter GDP gap and will likely look at average GDP growth in the first and second quarter to get a better gauge of the economy. The GDP data for the second quarter of 2016 are not due out until July 29, so Fed policymakers won't have that data in hand when they meet on June 14-15 or July 26-27. If second quarter GDP accelerates to 3%, GDP growth in the second quarter would be faster than the first for the seventh time in the past 11 years.

In addition, should it land at around 2% for the first half of the year (first and second quarters), real GDP would be growing faster than potential GDP, taking up slack and slowly pushing up wages/inflation. (See our Weekly Economic Commentary, "Building Blocks.") Potential GDP is the "maximum" growth rate for an economy, based on labor force growth and productivity, and due to stagnant productivity and slow growth in the labor force, potential GDP is running at just under 2.0%. Even with the economy growing at around 2.0%, the Fed is already on pace to do two interest rate hikes this year. If growth accelerates into the 2.5-3.0% range in the second half of 2016, the Fed could be considering a third rate hike later this year.

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Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

This research material has been prepared by LPL Financial.

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RES 5507 0516 | Tracking #1- 502175 (Exp. 05/17)

Taking stock of your assets and liabilities may require a bit of research at first, but the process will get easier each time you do it.

A Net Worth Statement Helps Keep Retirees on Track

A number of planning tools can help retirees monitor their cash flow and make appropriate adjustments in response to changes in income and expenses. Not the least of these is a net worth statement.

By calculating your net worth, you are essentially taking a snapshot of your current financial status. That snapshot can then provide you with the information you need to make important financial decisions.

What is net worth? It is more than just your income -- it's your overall wealth. To determine your net worth, just add up your assets and subtract your liabilities. Your assets are everything you own, including the money in your bank accounts, retirement plans, and investments accounts as well as real estate and even possessions such as your car(s) or a boat. Your liabilities are what you owe. This may include the balance on your home mortgage, credit card debt, car payments, and even unpaid taxes.

Taking stock of your assets and liabilities may require a bit of research at first, but the process will get easier each time you do it. It's a good idea to review the calculation each year to make sure you stay on the right track.

Whether your net worth is higher or lower than you expected really should not be of concern. The main purpose of identifying your net worth is to give you a reference point for assessing your overall financial health.

The following worksheet will help you break down your assets and liabilities so you can reach your bottom line.

YOUR ASSETS	
Cash/bank accounts, CDs, etc.[1]	$
Vested share of retirement accounts (employer plans, pensions, profit-sharing plans, etc.)	$
Market value of investments (stocks, bonds, mutual funds, IRAs, annuities, etc.)[2]	$
Market value of real estate (home, other property)	$
Market value of vehicles (car, boat)	$
Cash value of insurance policies	$
Other (valuables, furnishings, etc.)	$
TOTAL ASSETS	$
YOUR LIABILITIES	
Balance due on home or real estate mortgage(s)	$
Balance due on loans (car, student, real estate)	$
Balance due on rental properties	$
Balance due on credit cards	$
Fixed monthly payments	$
Unpaid taxes	$
Other	$
TOTAL LIABILITIES	$
YOUR NET WORTH (Subtract liabilities from	$

assets)

[1]CDs are FDIC insured and offer a fixed rate of return if held to maturity.

[2]Investing in stocks involves risks, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Investing in mutual funds involves risk, including loss of principal. Mutual funds are offered and sold by prospectus only. You should carefully consider the investment objectives, risks, expenses and charges of the investment company before you invest. For more complete information about any mutual fund, including risks, charges and expenses, please contact your financial professional to obtain a prospectus. The prospectus contains this and other information. Read it carefully before you invest.

An annuity is a long-term, tax-deferred investment vehicle designed for investment purposes and contains both an investment and an insurance component. They are sold only by prospectus. Guarantees are based on the claims-paying ability of the issuer and do not apply to an annuity's separate account or its underlying investments. The investment returns and principal value of the available subportfolios will fluctuate so that the value of an investor's unit, when redeemed, may be worth more or less than their original value. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal.

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