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Well, That Was Fun!

After all the wailing and gnashing of teeth in January, the S&P 500 and Dow Jones made a small gain in the quarter. 1.5% for Dow! Yes, it was a little "difficult" to maintain a moderately bullish stance when the Dow was below 15,700. One tends to question the validity of their convictions, but it all worked out well. China did not cause a U.S. Recession, oil did not go to $10, and aliens did not take over NYC (but I'm not sure about Washington DC!!).

Now that Wall Street and Main Street doesn't perceive the glass to be half-empty, it doesn't really believe it's half-full either. Corporate earnings are doing "okay", slightly above expectations, but guidance (as a whole) is still a little sluggish. By the way, this sluggish outlook is the main reason why the Federal Reserve has pulled back somewhat from their interest rate expectations. We probably will see the economy get a little stronger in the second half, unemployment improve some more, and maybe a little inflation (gasp!). This will allow the Fed to have one (or two) more interest rate hikes this year.

For the stock market, it will all be about valuation. Last year was about being in Large Cap stocks and staying away from value and small cap. Of course, we didn't know that (who did!), but it's strange how that door swings back and forth. For those of you who are curious, the Large Cap Growth index was up 8.18% last year (not a typo!) but the Small Cap Value index was down 7.47%. Quite a disparity. Foreign markets were also a large disparity – Large Country International marks were down slightly (around 1%) but emerging markets got slammed…down 15 to 20%.

I would like to point out that one of our most widely held global funds, the American Funds New Perspective, made Morningstar Fund of the Year in its category (International). Additionally, two other funds we use widely also received awards too. The PIMCO Short-Term (Morningstar U.S. Fixed Income Fund Manager of the Year) and Vanguard Wellesley Income (Morningstar U.S. Allocation Fund Manager or the Year).

Looking forward, we are still slightly bullish. We see more upside than downside. Here is the "problem", when the market was down 10%, we were telling our clients the market is 15% undervalued. So, now it has come back 10%, so now we are only 5% undervalued. Roughly speaking, we are where we should be. Some areas look somewhat "cheap" – small caps, transportation, high-yield bonds and of course, energy and emerging markets (but still have some more time to go before being attractive).

Since we are already in the second quarter, we are now getting a better handle on 2016 corporate earnings. They still look "fair". Somewhere in the 5 – 10% range. Our asset allocation is leaning toward large-cap (especially dividend paying), but still doing some small and mid-cap. In bonds, we are still overweighting high-yield and short-term bonds with some convertible exposure. Additionally, we are slightly under weighting foreign stocks, but over weighting income real estate (still in a sweet spot).

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We had three negative surprises last year (China, U.S. Dollar, and Energy). Most likely we will see a surprise this year too, seems like we always do. Terrorism, natural disasters, etc. are all wild cards. But China seems to be stabilizing, same for U.S. dollar and oil. A balanced, moderate allocation seems appropriate. Bonds are paying practically nothing. Likewise, CDs and money markets. Real Estate is attractive, but not much else. Put your head down and keep the faith!

If you would like to discuss the market and/or your account(s), please call me at 713.428.2050, x2 or via email to josborn@houcap.com.

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