Best House on a Bad Block

If you had been in a coma at the beginning of the year only to awake on May 1st and take a look at the financial markets, you would think it was a rather tepid first 4 months of the year:

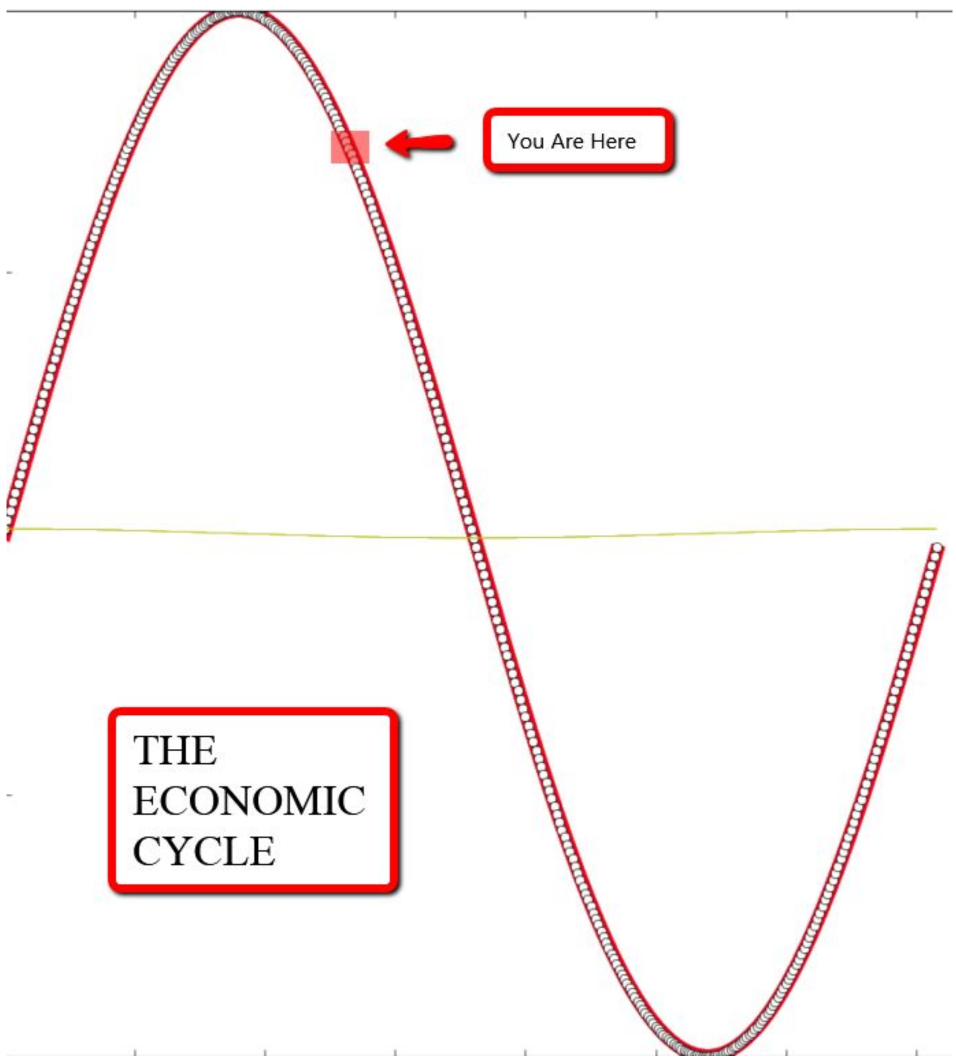
S&P 500 +1%	**Nasdaq -4%**	**Crude Oil +24%**	**10 yr Treasury +3.2%**

However, this doesn't tell the whole story as we all know. The stock market had the worst January in it's history and continued the decline into mid February reaching a low of 11.5% in the S&P 500. The Nasdaq dropped 14.9%, Crude oil tumbled along with the markets as it reached a low of $26/barrel (29.7%) in February as well. A headline citing a production freeze in crude oil halted the decline in both the oil and stock markets soon after. Since that headline oil has ran straight back to the mid $40's closing at $46/barrel at the end of April. The correlations continued with the stock market as the S&P 500 recouped all of the losses from the first 45 days of the year and currently sits at +1% year to date. The Nasdaq gained back 10% of its decline as well.

Our focus now shifts to the current environment and how that backdrop will affect the various markets across the world. While there has been a nice rebound in the U.S. stock market, unfortunately the same cannot be said for many countries internationally. The high for most markets came in the middle of 2015, so for some perspective I will pass along how these markets have performed since their highs in the last 10-12 months:

S&P 500 -4%	**Japan -23%**	**Germany -15%**
Nasdaq -10%	**China -47%**	**Italy -26%**
Russell 2000 -15%	**India -21%**	**France -14%**

While the U.S. has been the best house on the block, the neighborhood is in poor shape. So the question is, will the neighborhood (global economy) bring down the property value of all houses?



All economies run on cycles. The above picture demonstrates where we believe we are in the economic cycle. Our view remains that the U.S. is slowing and continues to slow. The data has been crystal clear. GDP came in at 0.5% for the first quarter of 2016, GDP is slowing. Corporate profits have declined for 3 consecutive quarters. Employment growth is slowing and is one of the last indicators to peak in an economic cycle, it peaked in the second quarter of 2015. Economic cycles take time to play out, this isn't something that's going to take place next week, but the data supports our views.

The cycle plays out as follows: Corporate profits drop leading to layoffs and firings, Employment declines, Household incomes decrease, which leads to a slowdown in consumption. Consumption is 70% of our GDP and thus GDP slows and depending on the magnitude of the decline we may enter a recession.

In terms of the stock market, *__every time__* in history that corporate profits have declined two consecutive quarters, the stock market has dropped at least 20% from its high. We have just had three quarters of declining profits. Unless this time is different, that would put the Dow at 14,700 at a minimum, S&P 500 at 1700!

If all of this holds true, there will still be places to protect and grow your capital. The key is knowing where you are in the economic cycle and positioning accordingly. We have done this successfully the first four months of the year and continue to be positioned for the upcoming economic slowdown.

Our edge remains in our proprietary process and modeling. The research tells us what to look for and our models tell us when statistically is the best risk/reward for entering/exiting that position. We are very pleased with the results thus far in 2016, however ⅔ of the year remain and our goal is to continue to grow and protect your hard earned capital.

If you have any questions regarding current positioning and performance, please call or email our office, 217-222-3800.

As always, please pass this a long to anyone that may have an interest.

Cory J Watson