TW Advisors **Newsletter –July 2016**

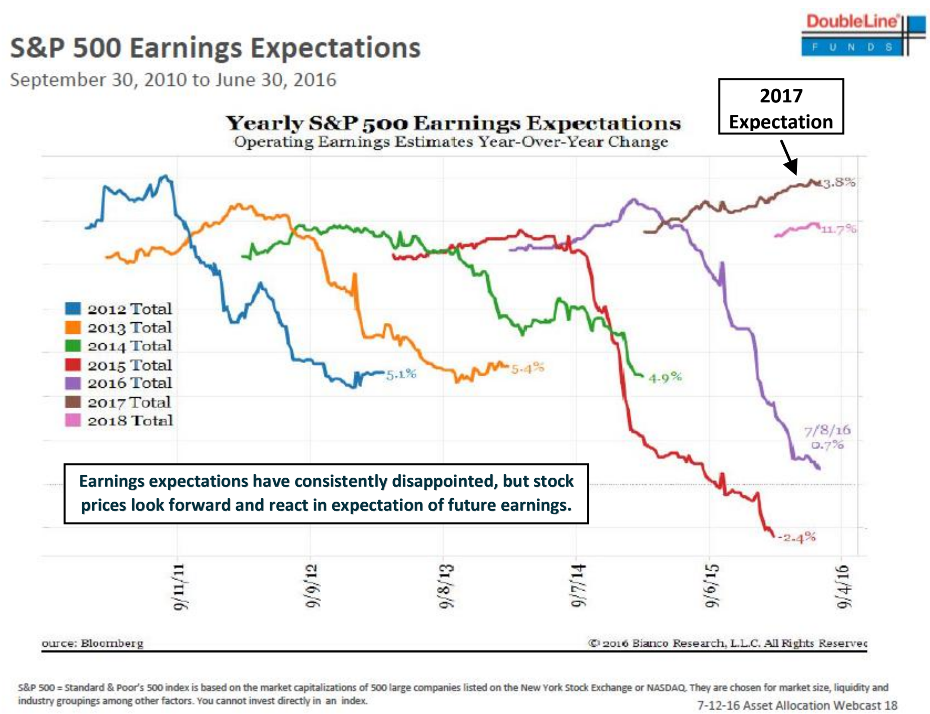
<u>MARKET BREAKS THROUGH (ALMOST) TWO YEAR RANGE… FINALLY</u>

About two years ago we started raising cash in our portfolios because stock valuations looked stretched. Knowing that long-term returns are very dependent on initial valuation levels it seemed appropriate to reduce risk. At that time we wrote:

"Early in the year there was plenty of cautiousness, but sentiment conditions changed pretty dramatically as the stock market reached new highs. Margin debt is near all-time highs. A recent Investors Intelligence poll of U.S. investment advisors showed just 13% stock market bears, the fewest since 1987. A big red flag is now waving as a few prominent Wall Street strategists who were cautious all turned positive." (Oct. 2014)

Sure enough from that point until just recently the S&P 500 had been stuck in a trading range from about 2130 on the high side to 1850 on the downside. Incredibly U.S. stocks were the haven during this period. Blue chip international indices performed much worse falling about -15% over the past two years.

The good news recently is that the U.S. market has finally surpassed the previous highs. Despite a tangible sense of gloom from investors due to global concerns like Brexit, the attempted coup in Turkey, terrorist attacks and increasing calls for protectionism (or maybe because of it), the markets have been resilient and seem to be signaling a potential improvement in corporate earnings. Moreover, for the first time in a while all major central banks are in easing mode or have suspended tightening plans and many governments are initiating or pondering fiscal stimuli. These are potentially powerful forces for the economy and stock market.



For the past several years, earnings expectations for companies have consistently eroded from early predictions to final announcement. As the chart (right) depicts, the disappointment from first predictions have been great, especially in the past two years. While it is still too early to know the accurateness of earnings predictions for the next two years, growth targets are more achievable now that earnings have fallen over the past 18 months.

An end to stagnation in the market prices of the average stock and improving earnings may combine to move stocks forward from here. **Unlike previous attempts to advance, the breadth of recent performance has been much broader to include mid-cap, small-cap and international stocks**. **2015's advance was driven by a few highly valued names making up the often discussed" FANG" grouping (Facebook, Amazon, Netflix and Google) while the average stock was down for the year. Encouragingly, so far in 2016 Value stocks in the S&P 500 are beating Growth stocks by over 3%.**

While the S&P 500 was range bound there was a divergence of performance internally with sectors such energy, commodity, industrial and financials suffering their own "bear markets" cycles, and we believe are now priced to provide above average returns over the long-term. Starting in late 2015 we began making smaller investments in deep value companies we feel have a good risk/reward profile. The general characteristics have been big price declines, strong balance sheets, attractive dividends and positive earnings. While not all have worked out so far as a group they have done well, and we believe will continue to do so.

Please contact us if you have any questions. Best wishes.

James G Tillar, CFA *Steve Wenstrup*