

Sather Financial Group, Inc.

Private Wealth Management

Second Quarter Commentary 2016

Negative Rates, The Brexit, Sluggish Growth & Debt...The World We Live In

To look at the performance of the financial markets, one would have thought the Brexit was the beginning of World War 3. The day after the surprising results the stock markets fell by 3.6% followed by a 2% drop the next day.

The media ate it up. Comments from the Wall Street Journal stated, "The Dow Jones Industrial Average and the S&P 500 have erased more than three months of gains in the past two sessions and are on track for their worst month since January. The trillions of dollars lost amounted to the worst two days ever for the S&P Global Broad Market Index, a collection of stock markets world-wide, according to S&P Dow Jones Indices."



And yet, if you were the Rip Van Winkle investor who slept through the quarter, you awoke seeing the market finished pretty much where it began with no need to worry.

Although much of the second quarter was dominated by Brexit noise, the process by which we invest over long (10+ Year) time frames has not changed. Investing in the stock market remains a bumpy and volatile process, but one that has usually delivered respectable results.

Event	Reaction Dates	S&P Start Value	S&P End Value	Event Gain/Loss	12 Months Later	36 Months Later	60 Months Later	Event End thru Present
Pearl Harbor	12/6/1941 12/10/1941	9.32	8.68	-7%	8%	51%	76%	23292%
Truman Upset Victory	11/2/1948 11/10/1948	16.70	15.00	-10%	8%	52%	62%	13251%
Korean War	6/23/1950 7/13/1950	19.14	16.69	-13%	32%	45%	153%	11636%
Eisenhower Heart Attack	9/23/1955 9/26/1955	45.63	42.61	-7%	8%	17%	25%	4565%
Sputnik	10/3/1957 10/22/1957	43.14	38.98	-10%	31%	37%	41%	4941%
Cuban Missile Crisis	8/23/1962 10/23/1962	59.70	53.49	-10%	36%	72%	78%	3557%
JFK Assassination	11/21/1963 11/22/1963	71.62	69.61	-3%	24%	14%	53%	2720%
Kent State Shootings	5/4/1970 5/14/1970	79.00	75.44	-5%	35%	40%	22%	2671%
Arab Oil Embargo	10/18/1973 12/5/1973	110.01	92.16	-16%	-28%	12%	6%	2021%
Nixon Resigns	8/9/1974 8/29/1974	80.86	69.99	-13%	24%	38%	56%	2866%
U.S.S.R. in Afghanistan	12/24/1979 1/3/1980	107.66	105.22	-2%	30%	31%	56%	1768%
Hunt Silver Crisis	2/13/1980 3/27/1980	118.44	98.22	-17%	37%	55%	83%	1884%
Falkland Islands War	4/1/1982 5/7/1982	113.79	119.47	5%	39%	51%	147%	1623%
U.S. Invades Grenada	10/24/1983 11/7/1983	165.99	161.91	-2%	4%	52%	69%	1125%
U.S. Bombs Libya	4/15/1986 4/21/1986	237.73	244.74	3%	20%	27%	57%	741%
Crash of '87	10/2/1987 10/19/1987	328.07	224.84	-31%	23%	39%	85%	721%
Gulf War Ultimatum	12/24/1990 1/16/1991	329.90	316.17	-4%	32%	50%	92%	521%
Gorbachev Coup	8/16/1991 8/19/1991	385.58	376.47	-2%	11%	23%	77%	417%
ERM U.K. Currency Crisis	9/14/1992 10/16/1992	425.27	411.73	-3%	14%	42%	132%	391%
World Trade Center Bombing	2/26/1993 2/27/1993	443.38	443.38	0%	5%	46%	137%	357%
Russia Mexico Orange County	10/11/1994 12/20/1994	465.79	457.10	-2%	33%	107%	210%	343%
Oklahoma City Bombing	4/19/1995 4/20/1995	504.92	505.29	0%	28%	122%	184%	297%
Asian Stock Market Crisis	10/7/1997 10/27/1997	983.12	876.99	-11%	21%	57%	2%	123%
Russian LTCM Crisis	8/18/1998 10/8/1998	1,101.20	959.44	-13%	39%	11%	8%	103%
USS Cole Yemen Bombings	10/11/2000 10/18/2000	1,364.59	1,342.13	-2%	-20%	-23%	-12%	46%
September 11 Attacks	9/10/2001 9/21/2001	1,092.54	965.80	-12%	-12%	17%	36%	100%
Iraq War	3/19/2003 5/1/2003	874.02	916.30	5%	21%	42%	54%	119%
Madrid Terrorist Attacks	3/10/2004 3/24/2004	1,123.89	1,091.33	-3%	7%	32%	-26%	81%
London Train Bombing	7/6/2005 7/7/2005	1,194.94	1,197.87	0%	6%	5%	-11%	67%
2008 Market Crash	9/15/2008 3/9/2009	1,192.70	676.53	-43%	69%	103%	178%	169%
Price Changes Only - Does Not Include Dividends				Averages:	-8%	19%	42%	71%

Source: Al Frank using Bloomberg and Ned Davis Research Events & Reaction Dates

History is filled with plenty of disconcerting events, but those who have stayed the course, sticking with their long-term investment plans, have nearly always been rewarded in the fullness of time.

Stocks vs. Bonds

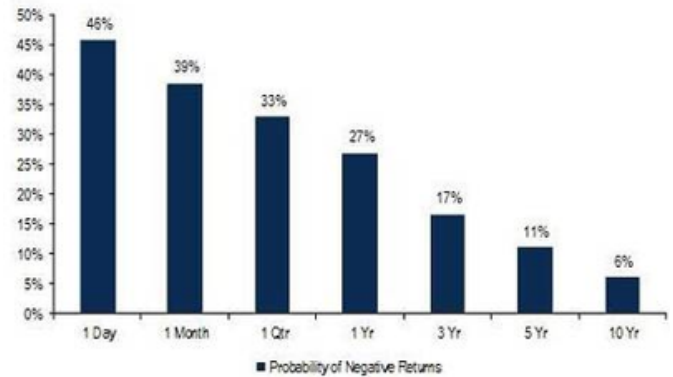
Over the long term, according to a study of rolling periods based on data provided by Morningstar, stocks have almost always outperformed bonds. Even among shorter holding periods, stocks still outperformed bonds more often than not.

Percentage, on average, that stocks outperform fixed-income investments: 1926-2015

Holding period	Long-term bonds	Intermediate-term bonds	Treasury bills
12 MONTHS	63%	66%	70%
5 YEARS	71	72	76
10 YEARS	83	81	84
20 YEARS	93	98	100
30 YEARS	99	100	100

Source: Morningstar
By The New York Times

Probability of negative S&P 500 returns over different time horizons (Based on returns from 1929-6/1/16)



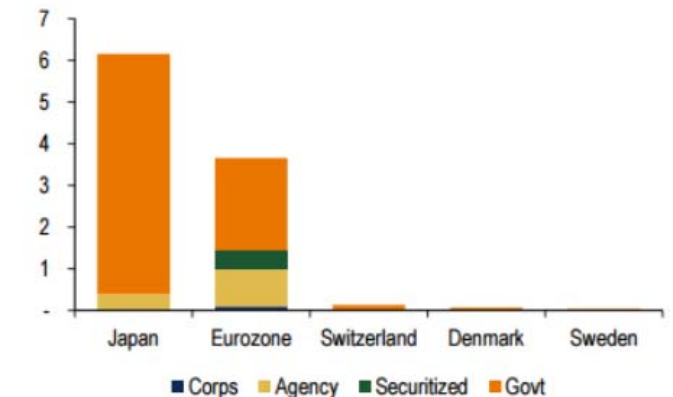
Source: S&P/Bloomberg, BofA Merrill Lynch Global Research - US Equity & US Quant Strategy

The 10 Year US Treasury yield sits near record lows at less than 1.5%.

Despite this, US interest rates remain significantly above the rest of the developed world as many of those nations have negative rates.

In fact, there are more than \$10.4 Trillion worth of government issued bonds from around the world that have **NEGATIVE** interest rates. This is about 2/3rds of bonds issued in the developed market. Essentially, this guarantees an investor will lose money.

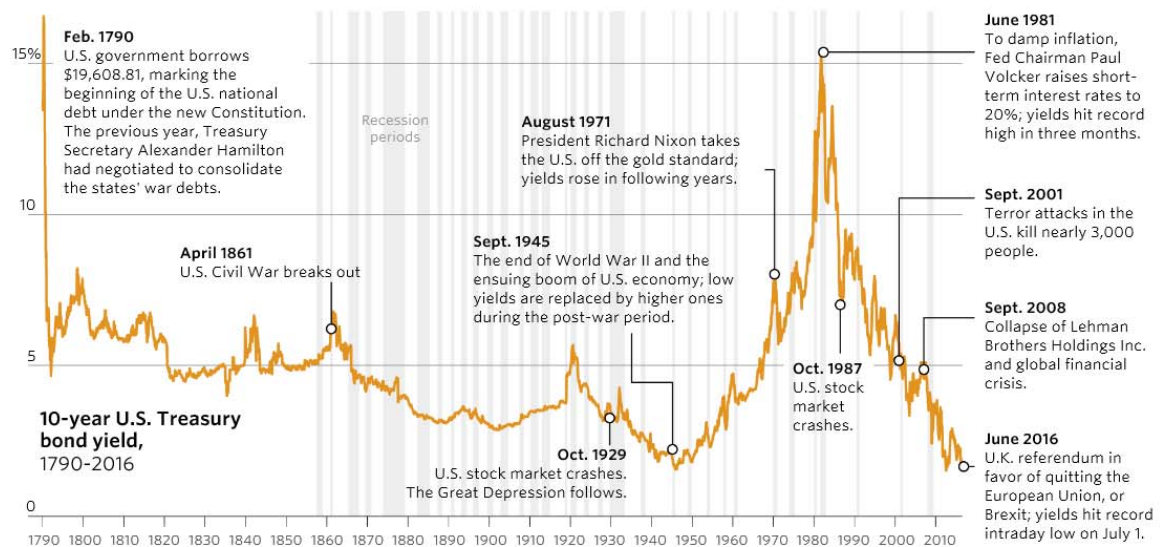
Chart 13: Negative yielding global fixed-income debt by country. Japan (\$6.2tr) has 70% more negative debt than the Eurozone (\$3.7tr)



Source: Bloomberg, \$ trillion. GFIM index.

Life, Liberty and the Pursuit of Yield

Yields on the benchmark 10-year U.S. Treasury bond briefly touched their lowest on record Friday before moving higher. A history of the bond yield since the country's earliest days:

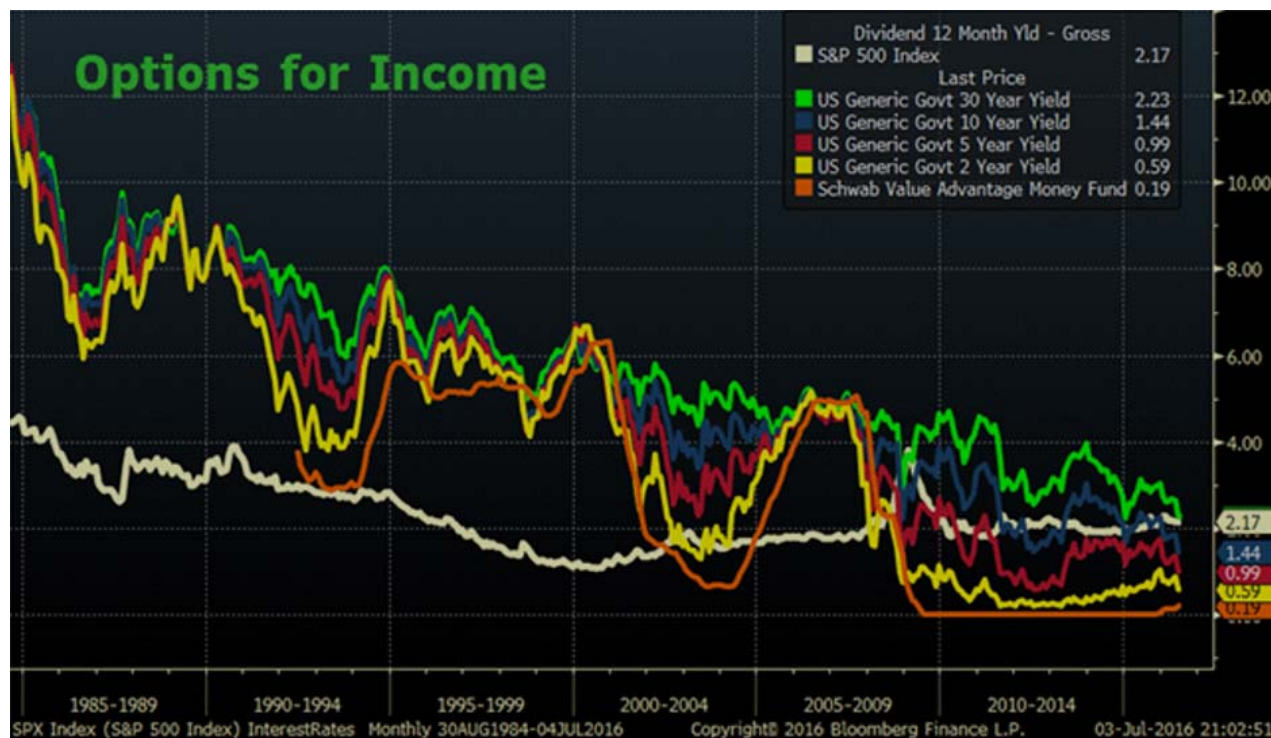


Recessions prior to 1854 lack official dates.
Source: Global Financial Data

With interest rates so low, investors continue to face quite the dilemma—take the guaranteed yield of a Ten Year US Treasury (1.46%)—or get 50% more income by investing in stocks (S&P 500 Dividend Yield: 2.17%)?

It is worth pointing out that if you buy a Ten Year Treasury, your rate is fixed for the term of that bond. In contrast, good quality stocks have a good habit of increasing their dividend over long periods of time.

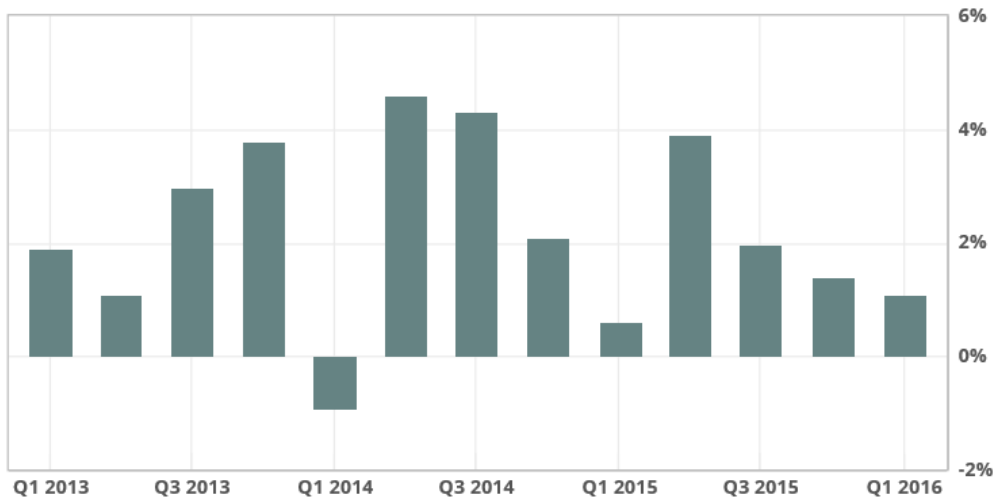
Although this is not a guarantee, it appears to be a better way of increasing cash flow and offering a legitimate attempt at maintaining purchasing power—if you have the appropriate time frame and tolerance for volatility.



Adding further frustration to fixed income investors, GDP continues to be weak. As such, we see little indication that the Federal Reserve will increase rates any time soon.

Still pretty weak

Real GDP



Source: Commerce Department via FRED

Growth in the economy and employment traditionally go hand-in-hand. Unfortunately, this is not the case today. Hiring is at its weakest pace since 2010—however, there are 5.8 million job openings currently.

Although the “official” unemployment number is below 5%, this number excludes reality. Once you factor in the number of people who are marginally employed, have quit looking or whose unemployment benefits have expired, the true figure of unemployment is much closer to 10%.

As we have discussed previously, the Labor Participation Rate is more meaningful. This figure measures the number of people in our country, age 16 and older, who are working. Currently, this figure is at 62.6%--the lowest level in more than 35 years.

U.S. Hiring Slows to Weakest Pace Since 2010

The rate of job creation is falling fast

The most disturbing part of Friday's jobs report is not that the headline number was as low as it was, but that revisions to previous month's estimates were revised downward to the point that there is now a clear trend of slowing job growth in the American economy.

ISM data corroborates payroll weakness

The payroll data coming from the Census Bureau is not only warning sign we're seeing. Data from the Institute for Supply Management **released Friday** showed the growth in the services sector slowing in May, with the employment component falling into contractionary territory.

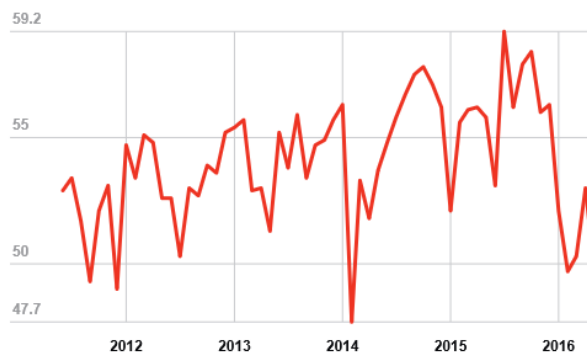
Monthly Job Growth

year-over-year change in total nonfarm payrolls



Source: Bureau of Labor Statistics

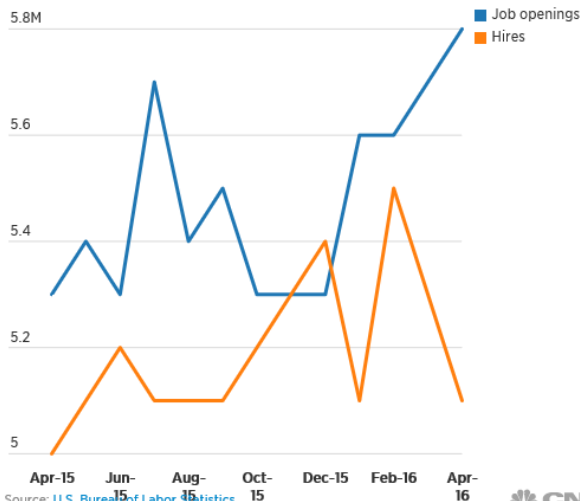
ISM Non-manufacturing: Employment Index



A reading below 50 represents contraction

Source: Institute for Supply Management

Job Openings and Labor Turnover

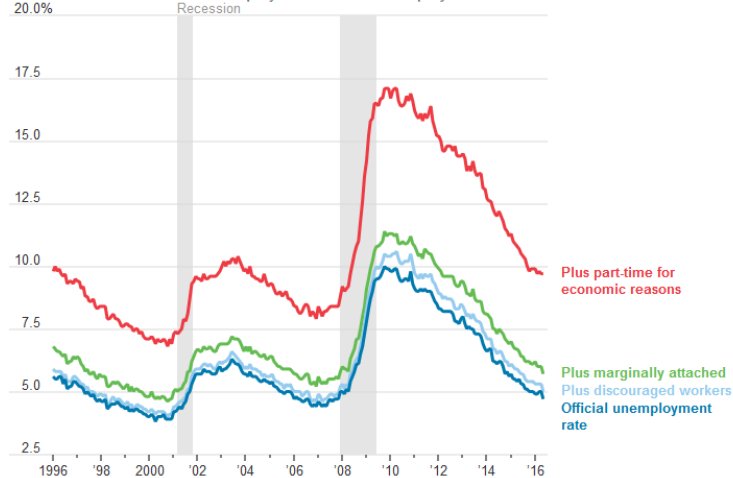


Source: U.S. Bureau of Labor Statistics

CNBC

Broader Measures

Alternate measures of the unemployment and underemployment rate



Note: Seasonally adjusted
Source: Labor Department

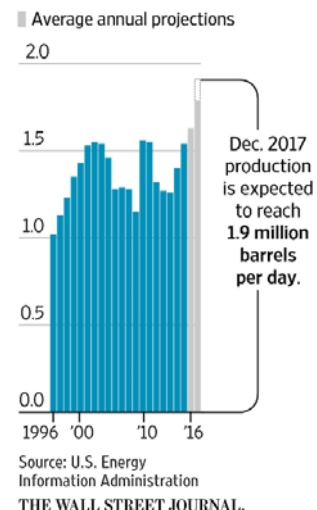
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A bright spot for us in Texas has been the rebound in the price of oil. At approximately \$50 per barrel, life in the oil patch has a heartbeat again. Although we see some activity, it remains cautious and metered.



Bright Spot

U.S. Gulf of Mexico crude oil production, in millions of barrels per day



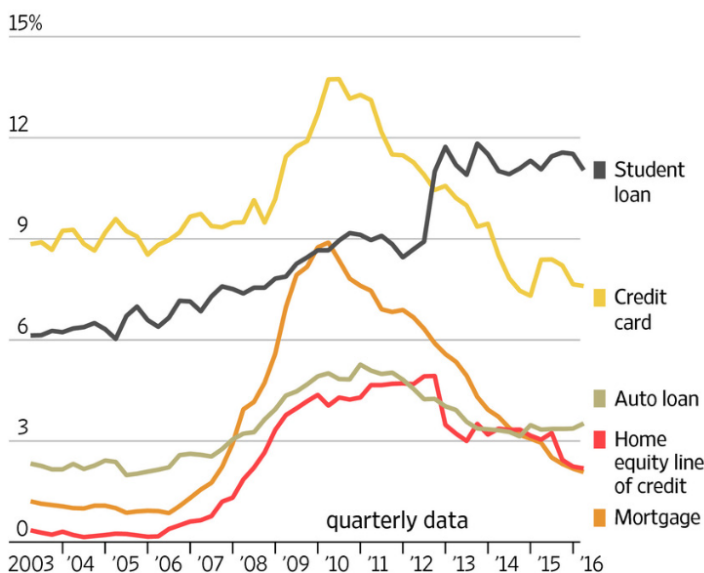
For decades we have been told that the path to a better life is through education. It is hard to argue with the statistics.

According to the Bureau of Labor Statistics and the NY Federal Reserve, a person with a Bachelor's degree will make 50% more than someone with a high school diploma and have about half the unemployment rate. While this is generally understood, what is less well known is the cost to obtain this education and the hangover associated with this education.

Debt, But No Degree

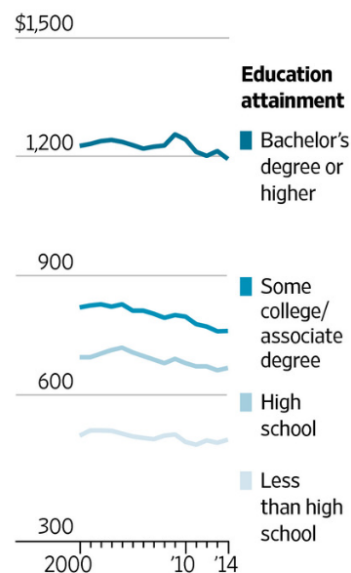
Student debt defaults have soared in recent years, particularly among students who borrowed but then dropped out. Dropouts earn only marginally more than high-school graduates, and far less than college grads.

Share of loans, by type, that are delinquent 90 days or more



Source: Federal Reserve Bank of New York (delinquencies); Labor Dept. (earnings)

Median weekly earnings



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At the same time that more and more consumers are falling behind on their student loan debts, they are borrowing more and more for car purchases and on credit cards.

This is putting the average consumer further behind in terms of saving for their retirement or the future in general.

Additionally, allocating capital to depreciating assets like a car, or a credit card, has to erode long-term purchasing power.

At the end of the day, you can't spend more than you make and you have to continuously save for a rainy day. Sometimes that rainy day is an obvious deluge. However, most times the rain water slowly accumulates over time until it is overwhelming.



RECORD AUTO LOANS

- Amount Borrowed: \$30,032
- Monthly Payment: \$503
- Loan Length: 68 months

SOURCE: EXPERIAN

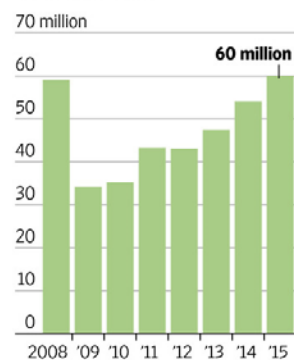
Charged Up

Consumers are keeping more debt on their plastic, in part because issuers are aggressively marketing again.

Credit-card outstanding balances, quarterly data*



Number of new general-purpose credit cards issued



*Seasonally adjusted

Sources: Federal Reserve (outstanding balances); Equifax

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Lastly, today we celebrate our nation's independence.

In doing so, we were given the opportunity to get up and go to work, to freely worship and to speak our minds.

Have a safe and happy 4th of July!



Sincerely,

Dave

Dave Sather, President
CERTIFIED FINANCIAL PLANNER™

Warren

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CERTIFIED FINANCIAL PLANNER™