Talking Points

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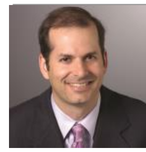

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Early 2016 Market Jitters Are a Call for Patience

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Talking Points

Global equity markets fell in early 2016, with many markets posting their worst opening week in recent history. The S&P 500 Index of U.S. large-cap stocks fell 5.9%, the Russell 2000 Index of U.S. small-cap stocks lost 7.9%, and the MSCI EAFE Index of developed-market international stocks lost 6.1%. However, we believe the health of the U.S. economy and the lack of any truly bad news in China supports improved stock prices from their recent dips. We believe now is not the time to sell out of stocks, but instead is the time for patience.

While heightened tensions between Saudi Arabia and Iran sparked concern by some and sagging oil prices worried others, China became a focal point of the renewed volatility. Twice authorities halted trading to stem major single-day losses after a poor report on manufacturing activity in China and a decline in China's currency, the yuan. This led some investors to believe that China's economy was in worse shape than many realize. China's local stock markets sold off sharply, with the MSCI China A Index down 12.6% year to date through January 8, 2016. Losses in China's were followed by losses in global markets, as well.

The Russell 2000 Index: A small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index. The Russell 2000 is by far the most common benchmark for mutual funds that identify themselves as "small-cap", while the S&P 500 index is used primarily for large capitalization stocks.

The MSCI EAFE Index: An index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada.

The S&P 500 Index: An American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.

MSCI China A Index - captures large and mid cap representation across China H shares, B shares, Red chips and P chips. With 157 constituents, the index covers about 85% of this China equity universe.

Our Take

We think the global markets have overreacted to news coming out of China. It's true that the latest manufacturing report from China was weak, but this has been a fairly persistent trend and the recent results weren't much worse than those in November of 2015.

The hefty losses in China's local stock markets are reminiscent of last summer, and in our view appear to be more about the Chinese equity markets and the government's attempts at regulation than about China's economy. China instituted new "circuit breakers" to start the year, which halt trading when stocks fall by 7%. The China Securities Regulatory Commission removed the circuit breakers when they appeared to add volatility instead of dampening volatility, as investors rushed for the exits before trading halted. The other technical concern is that trading restrictions on large investors, which were implemented to calm markets last summer, were due to expire last week. Then, late last week, Chinese regulators announced new restrictions on large investors to appease nervous domestic investors.

We also note that investors seem to pay only selective attention to Chinese stock markets. Local Chinese markets are notoriously volatile. The MSCI China A Index rose 136% in the 12-month period ending May 31, 2015, and then promptly lost 36% in the following four months. Historically, the MSCI China A Index has been two to three times more volatile than the S&P 500 as measured by standard deviation. We don't think there's much predictive value in near-term trends in China's stocks, although we recognize that this is yet another challenge for its regulators.

Aside from China, the market seemed to shrug off reasonably strong economic data from the U.S. Business activity, unemployment, and auto sales reports were all strong in December of 2015, leading us to believe the U.S. economy is reasonably healthy.

We aren't pounding the tables to overweight equities at this point in the cycle, but we see no reason to believe that market losses in early 2016 justify large-scale selling. We believe this calls for patience.