MANAGED ASSET PORTFOLIOS

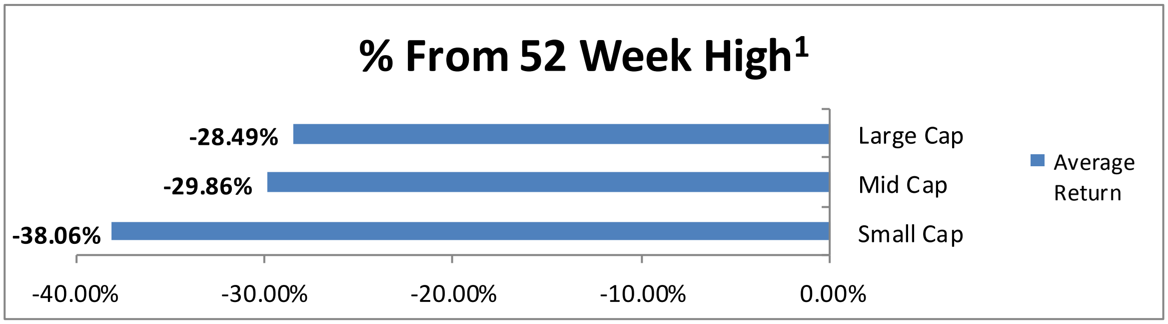
MAP VIEWS
FIRST QUARTER 2016

Global financial markets started 2016 on a sour note as stock market performance this January is shaping up to be one of the worst in history. Weaknesses in the Chinese economy and its stock market have been the primary culprits behind the recent declines. Other issues, such as continued unrest in the Middle East, the upcoming U.S. elections, future direction of interest rates, etc. are also weighing on investors' minds. It is always important for investors to think rationally and not emotionally. It appears, however, as though the masses are currently thinking emotionally, leading to the heightened volatility. Let's step back and examine the situation rationally.

There is a dichotomy between Chinese stocks and its economy. Chinese stocks were expensive and remain so, even following their recent and dramatic pullback (down over 40% from its May, 2015 high). Even with this pullback, the average Chinese stock trades at 60 times earnings. For comparison purposes, the average stock in the S&P 500 trades at about 17 times earnings and even a bit less in Europe and Japan. In other words, Chinese stocks would need to fall about 70% more from current levels to be on par with the rest of the developed world. Given the country's lack of transparency and restrictive trading, one could argue that Chinese stocks should sell at a discount to their global counterparts. On January 7th, China announced it would lift some of the restrictions they had put in place to control market movements by eliminating a mechanism that automatically stopped the trading of stocks when the markets fall too fast. These restrictions proved counterproductive, and may have actually exacerbated recent declines.

Granted, the Chinese economy is struggling, and is probably worse off than government reported statistics would indicate; however, it is not falling off a cliff. We believe the Chinese government will continue to let their currency depreciate as it attempts to boost its economy. The Chinese yuan trades within a loose band of the U.S. dollar. As our dollar has rallied against most other currencies, over the past year and a half, the yuan too has appreciated. Just as the strong dollar has hurt the competitiveness of U.S. companies and their ability to export, a stronger Chinese currency also hurts their exports. A stronger currency is more detrimental for Chinese companies than it is for their U.S. counterparts, as exports only account for approximately 22% of our GDP, while exports account for about 44% of China's GDP.

Approaching this situation rationally, we ask "what impact does a falling stock market, or even a softening economy, have on defensive companies such as Johnson & Johnson, Campbell Soup, or Novartis"? The answer is little to none, yet these stocks have retreated with the market. Many investors question whether or not this is the beginning of a bear market. In fact, the "average" U.S. stock has already experienced a bear market. While the S&P 500 is only off about 10% from its May 2015 peak, as is summarized in the chart below, the average stock is down significantly more.



[1]*Data from Bloomberg. Small Caps represented by IWM: Mid-Caps by IWR: Large Caps by IWB: All iShares ETF's and Russell data.*

As we have discussed in past communications, investors have favored growth stocks over value stocks for the past year to year and a half. The growth in the stock prices of high flyers such as the "FANGs" (Facebook, Amazon, Netflix and Google) has masked the poor performances of the majority of stocks in the broader market. Back in the early 1970's investors also embraced growth. They bid up names like Polaroid, Kodak, Xerox, Avon, etc. Such stocks were commonly referred to as the 'Nifty Fifty' and investors were willing to pay lofty valuations for companies whose earnings "were sure to grow into their share prices". The Nifty Fifty sold at 48 times earnings at their peak, before seeing their share prices chopped in half over the ensuing two years. Many of you probably remember the late 1990's, when investors bought into the Internet hoopla, paying insane prices for companies associated with the booming 'dot com bubble'. The NASDAQ Composite peaked at over 5,000 before tumbling to 1,150 in 2002, and did not see the 5,000 level again until last year. Coincidentally, today the FANGs are selling at nearly 50 times earnings. These comments have nothing to do with whether the FANGs are good companies or not. The debate is actually whether or not their valuations are justified. Remember, return is only part of the equation; risk is the other, and probably the most important factor.

In short, we believe growth stocks subject their holders to an undue amount of risk. Historically, value stocks have exhibited superior performance relative to growth stocks, while there are certainly times when the reverse is true (as we experienced in 2015). In fact, over the past 30 years in rolling ten year periods, small and mid-cap value stocks outperformed their growth counterparts 95% of the time, and 86% of the time large cap value outperformed large cap growth. We believe global economic expansion is going to be challenging and we have positioned our clients' portfolios accordingly as we remain overweight in consumer staples and underweight in economically sensitive sectors. We believe this allocation is prudent given current economic trends and will serve our clients well.

We appreciate your confidence and patronage over the years. We will continue to work diligently and ethically every day, to help achieve the best possible risk-adjusted returns for our clients.

Managed Assets Portfolios Investment Management Team:

Michael Dzialo, Peter Swan, Karen Culver, John Dalton, and Zack Fellows

For more information regarding our latest thoughts on the economy and the financial markets, please view our webinar which will be posted to our website (www.managedassetportfolios.com) on February 10th.