MANAGED ASSET PORTFOLIOS

MAP VIEWS

Third Quarter 2016

Wild Ending to a Wild First Half

Stocks finished the second quarter with a modest gain, despite a late quarter global sell-off, which was triggered by the 'Brexit' vote. Through the first half of 2016, the S&P 500 gained 2.7% (excluding dividends), with the Nasdaq Composite down 3.3% and the Dow Industrials off a hair. Globally, stocks have not fared as well, with Japan's Nikkei down 18% and the Stoxx Europe down 9.6%. Gold gained nearly 25% and oil rebounded 84% from its February lows, albeit still well below year ago levels.

Perhaps the biggest surprise during the first half of the year was the decline in interest rates. Recall, that as 2016 began, investors were bracing themselves for approximately four interest rate increases during the year. In December, the Fed raised rates by 25 basis points, marking the first time it had raised rates in nearly a decade. This action rattled investors, sending stock markets around the world to one of their worst yearly openings on record. Calming words from the Fed (fewer rate hikes than anticipated) soothed investors, sending interest rates lower and bond and stock prices higher. By the end of June, the benchmark U.S. 10-year Treasury note finished at 1.492%, just above its record low of 1.404% set in July of 2012. For comparison purposes, the yield stood at 1.78% at the end of March and 2.27% at the end of December. In as much as the Fed would like to raise rates, we believe they will sit on the sidelines for the balance of this year and probably for the majority of 2017. In fact, last month James Bullard, President of the St. Louis Federal Reserve Bank, commented that the Fed may not have to raise rates for the next two years. His comments were particularly noteworthy, as he has historically been in the hawkish camp (in favor of higher rates).

In short, we believe that the U.S. economy is not strong enough to tolerate higher rates. We add the caveat that the Fed may consider one hike, if economic data shows some improvement. The recent weakness in the euro and pound post-Brexit vote, however, lessens the possibility of higher rates, as that would send the dollar higher, hurting U.S. exports. Eventually, we believe Central Banks will get their way and higher inflation and interest rates will materialize, but not now. During this time, we believe it is prudent to keep maturities short, as the timing of higher rates is a wildcard. The risk/reward proposition is not favorable for extending maturities.

Nice Way to Start the Second Half

In the days following the end of the second quarter, stocks shook off worries about the Brexit vote, with the S&P 500 and Dow Industrials both posting record highs. Global stocks have rallied sharply as well; however, they remain well below where they began the year. The recent rally has led many investors to question current valuation levels. Presently, the S&P 500 is selling at 20 times trailing twelve-month earnings per share. While this number is above 5, 10, and 15 year averages, of 15.8 times, 15.9 times, and 17.6 times, respectively, we view judging the market's valuation on price-to-earnings levels alone as analogous to a doctor gauging a patient's health by only taking a temperature.

With interest rates at historically low levels and inflation still benign, we view current stock levels as fairly valued…not overvalued. We do caution, however, there are certain areas of the market that appear frothy. We continue to search for value in sectors that are not reliant upon a strong economy to do well, such as consumer staples. Although value is harder to find in these sectors, we are finding some ideas, particularly in Europe, where we are currently overweight.

As we look towards the second half of 2016, it appears as though uncertainty, and hence, volatility is not going away. We believe the final shape of Brexit will take years to gain clarity; November's elections in the U.S. will likely cause a greater level of uneasiness; and corporate earnings are likely to be hard pressed to show meaningful gains against a backdrop of economic malaise. Additionally, mounting banking problems in Europe merit watching. In particular, we have growing concerns about Deutsche Bank. We are watching this name closely, as the stock price has been moving down for nearly three years, and a substantial amount of money is being wagered on their credit default swaps (i.e. bankruptcy). In fact, the International Monetary Fund (IMF) recently said that Deutsche Bank may be the "biggest contributor to systemic risk among the big banks." We believe a heightened level of volatility should favor value stocks versus their growth counterparts. As investors may recall, during most of 2014 and 2015 growth stocks outperformed value. As we have mentioned in previous commentaries, historically growth stocks perform best when volatility is low, while value stocks tend to outperform during times of volatility; hence, the outperformance of value over growth during the first half of the year.

We sincerely appreciate the opportunity to serve as your investment adviser. This is a responsibility that we do not take lightly. We work diligently every day in search of finding investments that provide the best possible risk adjusted returns to meet our clients' objectives. Enjoy the rest of your summer!

Managed Asset Portfolios' Investment Team,

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