



Market Commentary | Q2 2016

Quarterly Review

The Markets (as of market close June 30, 2016): In the world of equities, the second quarter of the year was anything but dull. April saw the large-cap S&P 500 and Dow make marginal gains, with the small-cap Russell 2000 and the Global Dow leading the way for the month. The Fed left interest rates at their 0.25%0.50% range, noting that economic growth had slowed since the beginning of the year. May ended up being another good month for equities as each of the indexes listed here posted positive monthly returns headed by the tech-heavy Nasdaq (3.62%) and small-cap Russell 2000 (2.12%). June started out with relatively lackluster returns for stocks as labor added only 38,000 new jobs and the Fed, once again, reiterated its reluctance to raise interest rates based on lagging inflationary trends, weakening in the jobs sector, and sluggish exports.

But the month and quarter ended with quite a bang, primarily precipitated by the UK's referendum vote to withdraw from the European Union, which sent stocks around the world into a dramatic tailspin, felled the British pound by over 10%, and drastically cut some long-term bond yields (see Japan). Nevertheless, by the last day of the quarter, stocks seem to have weathered the storm and regained much of what they had lost. Of the indexes listed here, only the Nasdaq lost value quarter-to-quarter. On the plus side, the Dow and S&P 500 posted quarterly gains of 1.38% and 1.90%, respectively.

Gold continued to increase in value, closing the month and quarter at \$1,324.90. Long-term bond yields hit the skids as investors poured money into bonds, raising bond prices and narrowing yields.

The Quarter in Review

Employment: The employment sector slowed toward the end of the second quarter with only 38,000 new jobs added in May, compared to 215,000 new jobs added at the end of the first quarter. The unemployment rate fell to 4.7% in May, and there were 7.4 million unemployed persons. Both the unemployment rate and the number of unemployed persons has shown little movement from August. The labor force participation rate decreased slightly to 62.6% in May from 63.0% at the end of March. According to the latest figures from the Bureau of Labor Statistics, the average workweek was 34.4 hours, while average hourly earnings rose to \$25.59 compared to \$25.45 at the end of March

FOMC/interest rates: The FOMC met in April and June. Following both meetings, the Committee noted that the economy appears to have slowed. The federal funds target rate has remained at the 0.25%0.50% range since it was last increased in December 2015. In support of its decision to maintain interest rates at their present level, the FOMC noted that the pace of improvement in the labor market has slowed, job gains have diminished, and inflation continues to run below the Committee's 2.0% target.

Oil: The price of crude oil (WTI) was very volatile during the quarter, falling to as low as \$37 per barrel then reaching over \$51 per barrel, finally settling at \$48.57 per barrel by the end of the quarter. The national average retail regular gasoline price increased during the second quarter of 2016, selling at \$2.329 per gallon on June 27, 2016, \$0.262 above the March 28 price of \$2.066.

GDP/budget: Based on the third estimate of the first quarter 2016 GDP, the economy is improving, at least compared to the second estimate. However, compared to the fourth quarter 2015 GDP, economic growth is slowing in 2016. According to the Bureau of Economic Analysis, the third estimate of the first quarter 2016 gross domestic product grew at an annualized rate of 1.1%, compared to the second estimate, which had the annual rate of growth at 0.8%. An increase in exports is primarily responsible for the difference in the last two estimates of the first quarter GDP. Nevertheless, first quarter growth is still lagging behind the fourth quarter's 1.4% annual growth rate. As to the government's budget, the federal deficit for May was \$53.5 billion, as total receipts came in at about \$224.6 billion and total outlays were \$277.1 billion. The deficit at the end of March was just over \$108 billion. Through the first seven months of the fiscal year, the deficit sits at \$407.1 billion, compared to \$366.8 billion over the same period last year.

Inflation/consumer spending: Inflation continues to run below the Fed's target rate of 2.0%. In April, personal income (pretax earnings) and disposable personal income (income less taxes) each rose 0.5%, while personal spending, as measured by personal consumption expenditures, increased 1.1%. However, May saw a slowdown in growth in each of these important indicators. Personal income and disposable personal income increased only 0.2%, respectively. Personal consumption expenditures grew by a scaled-back 0.4%. Core personal consumption expenditures (personal spending excluding volatile food and energy costs) rose 0.2% in May, the same as April, but 1.6% over May 2015. The Producer Price Index, which measures the prices companies receive for goods and services, increased 0.4% in May following a 0.2% gain in April and a 0.1% decline in March. For the 12 months ended May 2016, final demand prices for all categories of goods and services inched down 0.1%. However, over the same period, prices (less food, energy, and trade services) rose 0.8%. The Consumer Price Index increased 0.2% for May. Over the last 12 months, the CPI has risen 1.0%. Retail and food services sales gained 0.5% in May over April and 2.5% above May 2015. Total sales from the March through May period were up 2.4%.

Housing: While the housing market may have shown signs of slowing in the first quarter, it has picked up through May of the second quarter. Sales of existing homes grew from an annual rate of 5.33 million in March to 5.53 million in May, according to the National Association of Realtors®. May's sales of existing homes grew 1.8% over April and are now up 4.5% from May 2015 (5.29 million). The median sales price for existing homes was \$239,700 up from \$222,700 in March an increase of 7.6%. The latest figures from the Census Bureau show that the 551,000 annual rate of sales of new single-family homes in May was 6.0% below the revised April rate of 586,000, but still 8.7% above the May 2015 estimate of 507,000. Compared to the end of the first quarter, new home sales are up 5.5%. The median sales price of new houses sold in May was \$290,400, while the average sales price was \$358,900.

Manufacturing: Manufacturing and industrial production have been relatively weak economic sectors. The Federal Reserve's monthly index of industrial production (which includes factories, mines, and utilities) fell 0.4% in May following a 0.6% increase in April. A steep drop in motor vehicle production and parts was a major factor in the May decline. Capacity utilization for manufacturing decreased 0.4 percentage point in May to 74.8%, a rate that is 3.7 percentage points below its long run average. Factory production has been hindered by weak exports and low demand for energy equipment. The latest report from the Census Bureau shows new orders for all durable goods (expected to last at least three years) fell 2.2% in May from the prior month. Excluding the volatile transportation segment, new orders fell a disappointing 0.3%. Orders for capital goods dropped 0.7%, while

shipments fell 0.5%. Despite the relatively poor numbers, new orders in May are 0.1% ahead of March's total, and year-to-date, new orders are up 1.7%.

Imports and exports: The advance report on international trade in goods revealed a trade gap of \$60.6 billion for May-up from April's \$57.5 billion trade balance. Exports fell 0.2% while imports jumped 1.6%, accounting for the increased trade deficit. The prices for U.S. imports (goods purchased here but produced abroad) increased 1.4% in May following a 0.3% gain in April. The prices for exports rose 1.1%. Year-on-year, import prices are down 5.0% and export prices have fallen 4.5%.

International markets: The United Kingdom's referendum vote at the end of June to exit the European Union sent equities markets around the globe reeling as the second quarter came to an end. If, in fact, the UK Parliament follows the apparent voter mandate to "Brexit" from the EU, the process of negotiating a withdrawal will likely play out over an extended period of time. No one is certain of the consequences of this major economic event. Elsewhere, the International Monetary Fund urged China to address its rising corporate debt, which the IMF estimates to be 145% of that country's GDP. In Japan, the Nikkei was hit hard by the Brexit vote, falling almost 8.0% the day after the referendum results were announced.

Consumer sentiment: Consumer confidence seems to have picked up during the second quarter. The Conference Board Consumer Confidence Index® for June rose to 98.0 following May's index reading of 92.4. The Surveys of Consumers of the University of Michigan also showed increasing consumer confidence in current economic conditions, while the Index of Consumer Sentiment fell slightly in June to 93.5 from 94.7 in May.

Market Performance

Index Performance for Period Ending 6/30/2016

US Equity Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
US Small Growth	Russell 2000 TR Growth	3.24%	-1.59%	-10.75%	7.74%	8.51%	7.14%
US Small Value	Russell 2000 TR Value	4.31%	6.08%	-2.58%	6.36%	8.15%	5.15%
US Small Blend	Russell 2000 TR	3.79%	2.22%	-6.73%	7.09%	8.35%	6.20%
US Mid Growth	Russell Mid Cap TR Growth	1.56%	2.15%	-2.14%	10.52%	9.98%	8.12%
US Mid Value	Russell Mid Cap TR Value	4.77%	8.87%	3.25%	11.00%	11.70%	7.79%
US Mid Blend	Russell Mid Cap TR	3.18%	5.50%	0.56%	10.80%	10.90%	8.07%
US Large Growth	Russell 1000 TR Growth	0.61%	1.36%	3.02%	13.07%	12.35%	8.78%
US Large Value	Russell 1000 TR Value	4.58%	6.30%	2.86%	9.87%	11.35%	6.13%
US Large Blend	Russell 1000 TR	2.54%	3.74%	2.93%	11.48%	11.88%	7.51%
S&P 500	S&P 500 TR USD	2.46%	3.84%	3.99%	11.66%	12.10%	7.42%

US Fixed Income Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
US Multisector Bond	Barclays US Agg Bond TR USD	2.21%	5.31%	6.00%	4.06%	3.76%	5.13%
Intermediate	Barclays US Govt/Credit Interm TR U	1.59%	4.07%	4.33%	2.95%	2.90%	4.48%
Short Term Bond	Barclays US Govt/Credit 1-3 Yr TR U	0.67%	1.65%	1.59%	1.22%	1.10%	2.80%

International Markets	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
Emerging Markets	MSCI EM PR USD	-0.32%	5.03%	-14.21%	-3.92%	-6.16%	1.10%
Foreign Large Blend	MSCI EAFE PR USD	-2.64%	-6.28%	-12.70%	-0.62%	-1.19%	-1.24%
World Bond	Barclays Global Aggregate TR USD	2.89%	8.96%	8.87%	2.80%	1.77%	4.40%

Allocation Portfolios	Index	Quarter	YTD	One Year	3 Year	5 Year	10 Year
Balanced	DJ Moderate TR USD	2.19%	4.67%	1.73%	6.18%	5.91%	5.63%
Target Date 2046-2050	S&P Target 2050 TR USD	1.94%	3.14%	-0.18%	7.54%	7.43%	5.54%
Target Date 2036-2040	S&P Target 2040 TR USD	2.01%	3.36%	0.32%	7.25%	7.15%	5.52%
Target Date 2026-2030	S&P Target 2030 TR USD	2.02%	3.57%	0.98%	6.80%	6.71%	5.46%
Target Date 2016-2020	S&P Target 2020 TR USD	1.98%	3.79%	1.77%	6.19%	6.09%	5.33%
Target Date Income	S&P Target Today TR USD	1.86%	4.09%	3.07%	4.55%	4.56%	4.52%

Key Takeaways

- ▶ **June's Brexit:** (U.K. votes to leave the European Union) creates market turmoil, but U.S. stock market finishes the quarter in positive territory. Foreign stock markets finish in negative territory, but not as poorly as expected. U.S. and foreign bond markets post positive returns. Gold and commodities rebound with returns of 6.8% and 12.8%, respectively.
- ▶ **FOMC** recognizes slowing pace in labor market improvements and below target inflation rate. Leaves Fed Funds Rate at 0.25%-050% range.
- ▶ **U.S. manufacturing growth** remains slow due to drop in vehicle and parts production, weak exports and low demand for energy equipment.
- ▶ **U.S. housing market** shows positive signs. Existing home sales up 4.5% from May, 2015 with their median sales price (\$239,700) up 7.6% since March, 2016.

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