WOODARD & COMPANY

Asset Management Group, Inc.

Registered Investment Advisors

Portfolio Profile

117 Kinderton Boulevard
Bermuda Run, North Carolina 27006
(336) 998-7000 (800) 214-1144 Fax (336) 998-7050
woodard@wcamg.com

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The big question likely is what will be the economic implications of this hotly contested U.S. Presidential election. We do not know the outcome or the effect of this unusual election, but we stand ready to address the risks and opportunities that arise in your portfolios.

Thru the end of the third quarter, the S&P 500 is up 7.8% for 2016 (+3.3% for the quarter). The best performing asset for the quarter was a commodity, orange juice, which rose +15.7%. We do like it for breakfast but did not see the potential investment opportunity. Markets are typically sanguine ahead of a U.S. presidential election. Small caps have done well in 2016, bond returns have been modest, and for the year so far, foreign markets have been mixed, with bright spots in the U.K. and Asia.

We were not surprised by the Fed's failure to step up to their responsibilities just before an election and raise interest rates. The failure of Quantitative Easing to stimulate the economy as noted by the St. Louis Federal Reserve in their 2015 analysis should have convinced the Fed to raise rates long before now. Politics may be preventing the Fed from raising rates in an election year. The Fed should be apolitical; it appears they are not and that is not good.

Ten years ago the national debt was $8.5 trillion on 9/30/2006; the national debt as of 9/30/2016 is $19.5 trillion — a growth of more than one trillion dollars per year.

We are currently concerned about Europe, in particular the weakness of Deutsche Bank. Some may remember in U.S. History class the teacher saying the Smoot Hawley Tariff caused the Great Depression and indeed, it was a significant contributor. But Smoot Hawley didn't pass until 1930, with subsequent implementation in 1931. The stock market fell nearly 90% in 1929, driven in part by the failure of German banks from 1927-1929 in the late stages of the Wiemar Republic (1919-1933). Hopefully, history won't repeat itself with Deutsche Bank.

We are now in the fourth quarter and since 1990 (26 years), the S&P has gained an average annual return of 5.1% during the last 90 days of the year. Equally impressive is that in 20 of the past 25 fourth quarters (80%) stocks have produced a positive total return. And December has been the best month of the year for market performance over market history. So history argues for a strong end to 2016.

In any event, we will know soon enough the results of this election year. We have been bullish this year, which has been the correct strategy, but we are looking at alternative strategies for 2017 as the first year of a presidential cycle has historically been the worst. Still, it is too early to know whether or not they will need to be implemented.

Market Review and Forecast. Any review of the stock market for the third quarter must start with the final days of the second quarter. As we are certain most of our clients remember, the Brits had just voted on June 23 to exit the European Union. This clarion call by the English citizenry presaged two rather hellish days in the market. Two. Just two. We used those two days to put whatever cash we had left into the market for our clients.

Then, confounding the prophets of doom that always surround such events, the market immediately began its upward march, ending the quarter essentially where it was before the vote occurred. And it kept climbing. Just six trading days into the third quarter, the S&P 500 set all-time record highs. And it continued setting several record highs throughout July. This was quite consequential in the historical context of the past 18 months. The S&P 500 had attempted multiple times to push through the 2120 -2130 range.

Consider the following intraday highs for S&P 500:

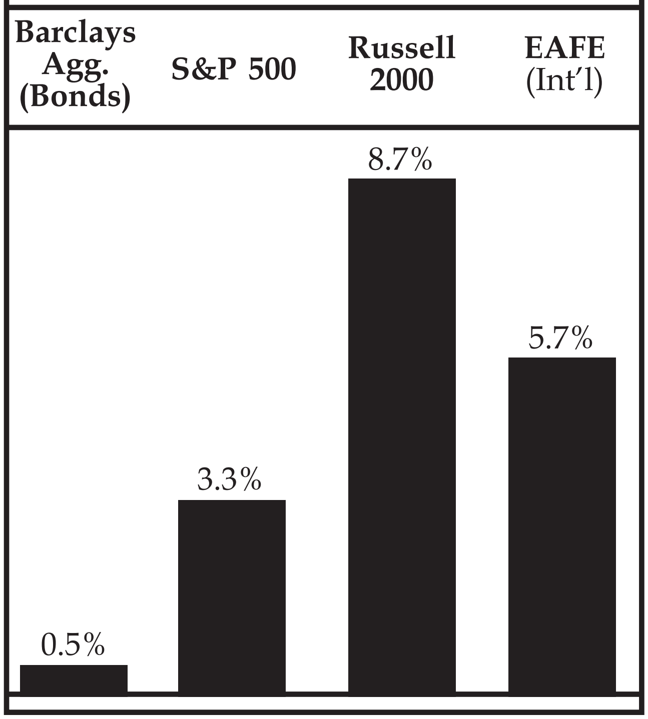
2117 on 2/24/15
2117 on 3/2/15
2113 on 3/20/15
2120 on 4/24/15
2120 on 5/4/15
2134 on 5/21/15
2128 on 6/23/15
2132 on 7/20/15
2116 on 11/3/15
2111 on 4/20/16
2120 on 6/8/16
2113 on 6/23/16

Then the decisive move higher that began in early July took the S&P all the way to 2175 on July 22. On 12 different occasions over 16 months, the market tried to go to meaningful new highs, but failed. The length of time (16 months) is important, because the longer the timeframe in which the market trades in a range, the more significant the break higher usually is.

The next major market event of the third quarter surrounded the Fed's September meeting. For some reason, market pundits are obsessed with the next ¼ point rate hike. They love to opine about its implication and many claim it augurs the next doomsday for stocks. And as the meeting approached, market participants got nervous and sold stocks. But this turned out to be quite cathartic. "Why?" you ask.

Because the next thing market technicians look for is a successful retest of the previous market highs (roughly 2120 on the S&P 500). This happened over a 3-day period. On September 12 the intraday low was 2119 and again 2119 was the bottom two days later. A week later the Fed kept rates unchanged and the market rallied once again. The old market highs (roughly 2120) become the new market support if all is as it should be.

Even when serious rumors of Deutsche Bank's demise swirled on September 29, sellers could only push the S&P down to 2145. The S&P 500 finished the quarter at 2168, for a respectable 3.3% gain. International stocks gained 5.7% for the quarter, while small cap stocks seemed heroic, gaining 8.7% as measured by the Russell 2000. Bonds returned an anemic 0.5%.



The Major Indices
Third Quarter — 2016

So that's the "review" part. Now for the "forecast." Trying to prognosticate market movements is futile at best and impossible at worst. But the most likely scenario is one in which the market ebbs and flows within its newly established higher range, selling off on days when European banking news looks bleak and rising when earnings look strong

The ensuing presidential election should also prevent the market from rising dramatically. The collective market holds "uncertainty" in serious contempt and this election provides plenty of uncertainty. Our best guess is if Mr. Trump wins, the immediate reaction by the market would be down because his policies are a bit ambiguous. If Mrs. Clinton wins, the market reaction should be more muted since her policies are more of a known quantity.

Regardless of which candidate wins, the market should move higher into the end of the year. Because of the previously discussed "breakout," and with no recession in sight, it appears the die has been cast for a favorable run into the end of the year. Of course, should Deutsche Bank fail, there is not a technician in the universe that can prevent a hard and fast fall of stock markets around the world. But given Europe's penchant to kick the can down the road, the German bank's troubles will most likely unfold more fully in 2017.

Interest Rates. The big news for fixed income during the third quarter was the Federal Reserve Board's decision against raising interest rates in September. A rate increase had been anticipated by some professionals, hyped by the media all summer and seriously considered by the Fed, citing stronger economic performance. Fed Chairwoman Janet Yellen certainly gave the impression that the economy was in such good shape that a rate increase in September was likely.

Then on Sept. 12th, Federal Reserve Governor Lael Brainard's comments all but squashed any idea of a September rate increase. So according to the Fed, we are in a "rising rate environment" based on a healthy economy…and yet current economic conditions don't support a rate increase at this time. Which one is it?

Meanwhile, back in "Flyover America," retirees continue to be punished by the Fed-induced low interest rates continue to drain the life out of CD yields, a once robust income producer for those over 65 years of age. And now Janet Yellen is entertaining the idea of the Federal Reserve buying stocks as a part of their monetary tools in the tool box.

While the yield on the 10 Year Treasury rose to 1.6% by September 30th from 1.49% at the beginning of the third quarter, we expect it to remain range bound between 1.5% and 1.75% the remainder of the year. Solid demand for fixed income, tepid economic growth abroad and all major central banks keeping interest rates lower for longer have and continue to contribute to this low rate environment. In fact, to quote CNBC's Rick Santelli, "If you think our rates are low, you have to use a shovel to find European rates." He was specifically referring to the fact that 2-year German bonds trade at -0.7%. That's a NEGATIVE sign in front of that "yield" percentage. Simply astounding.

Fixed income investors will be pleased with their portfolio performance. The Bloomberg Barclays Aggregate Bond Index is reporting an approximate 5.7% return for 2016 through September 30. The Federal Reserve closely monitors the personal-consumption price index (an inflation indicator), which only rose 0.1% in August and is up a very sedate 1% over one year. Core prices, excluding food and energy, were up 1.7% over the same time period. The Fed targets an inflation rate of 2% excluding food and energy. So the next time you stop by the grocery store or pay your power bill, remember that Washington D.C. says those budget items for American citizens should not be considered when calculating inflation.

Commodities. Crude oil saw sub $40 per barrel pricing briefly during the quarter but rallied back to the $50 level. OPEC and Russia announced a production cut of approximately 700,000 barrels per day in November, which provided the impetus for oil's rally back to $50. However, the scheduled OPEC meeting for November, 2016 should provide a better picture for what lies ahead for prices.

Raw materials as a whole did not move much during the quarter, ending just 1.9% lower than the second quarter. Iron ore moved down 0.2% while lumber rose by 10.7%. Global economic conditions continue to be uncertain for most commodities as China's slowdown has diminished overall demand for many raw materials.

Gold finished the quarter at $1317.10 per ounce, up 24.23% for the year from its December 31 closing price of $1060.20 per ounce. Global demand for actual bullion has been active with Russia and China leading the way. However, the possibility of rising interest rates in the United States which would strengthen the U.S. dollar may make gold less attractive as we move into 2017.

If you have any other questions about your account or any concerns, please give us a call at 336-998-7000. We always enjoy talking with our clients.