STRATEGIC WEALTH PARTNERS INC.
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Quarterly Report-1st quarter 2016

On the Markets...

For the most part, humans are an optimistic lot. We need to be. We learned early on that life is not fair, and yet, that did not entirely discourage us. With a bit more experience, we came to understand that life is a roulette wheel with choices and trials. And yet, we go forward, with a mixture of eagerness and determination, hopeful that whatever perils lie ahead, we shall neatly sidestep the pitfall, learn a few new tricks, and benefit in the long run. Of course, this optimism may be nothing more than what psychologists label the cognitive bias of ***overconfidence***. After all, who doesn't believe that he or she is better than the "average" driver? (Can we all be better than average?)

Perhaps we optimistically expect to be properly prepared for what lies ahead because we will recognize, in advance, the warning signs of approaching danger. Ironically, we sometimes innocently issue these danger alerts ourselves, but fail to heed them. We have a list posted on our website, titled ***"55 Famous Last Words"*** which you can access here www.strategicwp.net located on the Resources tab within Market letters.

These are a few of our favorites:

"You look great-did you lose weight or something?"

"Really? -so you're a cannibal..."

"Naw, its simple: all you have to do is to connect these 2 wires."

"Go ahead: I can take criticism."

"Nice doggy....

In the worlds of commerce and finance, our suspicions might be aroused with the ominous and familiar- *"Of course... your check is in the mail."* But in the Olympics of investing danger alerts, standing proudly on the gold medal platform, are this classic phrase: ***"This time is different!"*** These are reputed to be the four most dangerous words in the investment universe, because they suggest, that despite the way this same movie played out last time, now, with high confidence- we are predicting a different result- because the old rules no longer apply.

From its peak in October 2007, the S&P500 fell 57% over 18 months in the global contagion of the sub-prime mortgage crisis. The scale and breadth of the circumstance was without precedent, and so was the response. The U.S. Federal Reserve and Central Banks throughout the world dramatically lowered interest rates and injected trillions of dollars into the financial system to restore confidence and stability. It took four years for the S&P500 to recover its October 2007 peak. Over the next two years, the S&P500 continued to strengthen, peaking anew, in May 2015. Against that backdrop, economists worried that such massive, continued, “artificial” monetary stimulus would result in runaway inflation, but it never appeared. In fact, gold, the proverbial market hedge against inflation had already fallen 35% from its previous high. A year earlier, Goldman Sachs had predicted that oil would reach $150 per barrel, but oil fell more than 70%, declining in price along with commodities at large: steel, coal, natural gas, aluminum and industrial chemicals. Inflationary concerns fell away. Now economists worried that the real threat was deflation, particularly with significant downward revisions of Chinese GDP.

Critics of the stock market’s performance charged that corporate earnings had been artificially inflated through share buy-backs because companies lacked confidence to invest meaningfully to expand their businesses in the midst of the most sluggish economic recovery in U.S. history. Yes, earnings per share had increased, particularly as the number of shares declined, but revenues stubbornly refused to grow over several quarters. The S&P500 stalled for four months as volatility increased, then fell nearly 13% giving back a year’s worth of gains by October of last year. Just as the bears were preparing their victory dance, the market reversed higher so that by Thanksgiving we were virtually unchanged on the year. But then, expectations for the traditional Santa Claus Rally were severely disappointed when the market sold off again, falling 15% by February of this year.

Meanwhile, the Fed had maneuvered itself into an untenable position. Interest rates had been held near zero for more than seven years. They would need to be raised so that the Fed could lower them again when the next financial crisis occurred. For more than a year the Fed signaled it would raise rates in a slow and incremental manner, insisting that the economy was improving. Further delay in doing so exposed them to two major risks. First, it put their credibility in doubt and worse, it increased the likelihood that a later rate increase would prove to be too little, too late- forcing them to raise rates more aggressively in the future, thus precipitating the very economic contraction it was their mandate to remedy.

Markets are wary of rate hikes: can you trust a <u>committee</u> to accurately understand, anticipate, respond and guide a complex 18 trillion dollar economy? But what markets…

find most troubling of all is uncertainty. Bulls and bears agree: *the trend is your friend.*

Even a negative trend can be identified, examined, measured and *priced.*

But the most pervasive and significant trends had all become equivocal and unreliable: Oil, gold, the Dollar, the path of interest rates, commodity prices. Even familiar problems, like the sustainability of the EU were obscured by a changed dynamic- Greece was still in (for now) but Britain was poised to leave- swapping Brexit for Grexit.

That same bizarre and anxious uncertainty is reflected in the overall society as well where the presidential campaign plays out as a grotesque brawl--like something made up in a wicked collaboration between Tom Wolfe and Steven King.

More uncertainty, anyone, and would you like fries with that?

In short, the world is so dramatically re-arranged from expectation and conventional thinking, excuse us if we feel irresistibly compelled to say- *it is different this time!*

Our view is that the market has been trapped in a trading range since April 2014 with the S&P500 moving between 1800 and 2130. That's two years, which is about as long as a consolidation period lasts within a secular bull market. Such consolidations provide a necessary interval for markets to rest, restore and recharge before moving higher.

Although global growth is tepid, U.S. markets remain the best house in a bad neighborhood. Central Banks elsewhere continue to lower rates- indeed, many have *negative* interest rates- where banks charge depositors to hold their cash. In comparison, the U.S. continues to attract investment capital.

We may be experiencing the slowest recovery in history, but it is still a recovery. The market is not cheap, but it is not overly expensive, and relative to bonds it remains attractive. Investor sentiment is weak and earnings expectations are low. These are positive contrarian indicators. The rebound in commodity prices and the recent improvement in the transportation sector are further encouraging signs that, in fact, we may be emerging from a stealthy, but shallow industrial recession. As the market has moved higher most recently, it has been led not by the “defensive” sectors, like utilities and healthcare, but by the economically sensitive sectors, like financial, technology and industrial companies. After seven years of generally rising stock prices, we still have not seen broad investor participation, or the enthusiasm that generally indicates market tops.

We continue to hold proportionately more cash in your portfolio and you continue to enjoy substantial income from high quality companies with solid balance sheets that pay rising dividends. We are defensively positioned, but participating in a market that still looks as though it wants to move higher.

As always, we invite your questions and comments, and we are deeply respectful of the trust you place in us.

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