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AAFMAA Wealth Management & Trust LLC

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The Market Outlook – *Q1 2016*

The U.S. stock market, as measured by the S&P 500 index, got off to a rough start in 2016. The first week of the year went on record as the worst first calendar week in history. The market continued to falter over the following two months and by mid-February had lost over 10% year-to-date. However, a strong March rebound pushed the market to a small gain for the first quarter.

Investors seemed especially worried and quick to pull the sell trigger. Who could blame them? In the past 15 years, investors endured a tech bubble, a financial crisis spurred by the greatest decline in housing since the great depression, unemployment over 10% and two major market declines in the 50% range. Current worries du jour include energy — first too high and now too low, the dollar — too weak or too strong, sub-par economic growth, weak corporate earnings, cyber security, terrorism, and as always, the Federal Reserve Bank — to ease or not to ease, that is the question! No wonder investors are so jumpy! Many regret having anything to do with equities, high yield bonds, commodities or any asset class that has a hint of risk attached to it.

We live in an uncertain world and stocks by definition are risk assets, subject to price volatility that can be extreme at times. No one likes to lose money and market corrections are scary. Even mini pull-backs in market values can cause distress for all but the seasoned investors. But remember, history demonstrates that over time equities can create great wealth. The current bull market, which began in October 2011, has rallied 82% through the end of March 2016. If you reinvested your dividends back in to the market during that time, your return would be slightly greater than 100%, or 16.7% annually. During this period, numerous corrections ranged from 6% to over 10%. If you panicked and sold out during one of these corrections, you're likely regretting it now.

Oil Prices

We receive many inquiries from clients about where we think oil prices are going. We wish we knew. No one can give you a definitive answer as to when oil will bottom and at what price. There are just too many variables that impact both sides of the equation. We do know that low oil prices tend to cure low oil prices. Meaning price impacts demand and vice versa; low oil prices eventually lead to reduced production. We already see the dramatic decline in the number of rigs in production.

While supply and demand are unpredictable, we can analyze the market impact of past major oil price declines. The Hartford Funds performed an interesting study entitled "Stock Market Returns After Significant Oil Price Declines." The study reviewed 30 years of data ending in 2015. During this time period, the study found five oil price declines of 50% or more. What they found was the oil price transmission mechanism took time to work its way through the economy and had two phases. The first phase had a strong negative effect on energy-related regions of the country and energy-related credit, including high yield and bank loans. The second phase took much longer — around a year or two — and had a much more positive effect, due to the stimulating economic impact of lower energy costs on the millions of people in the U.S. and billions around the world. The recent price decline in oil is equivalent to an estimated $200 billion annual tax cut for U.S. consumers alone. After rebalancing their household budgets, raising saving and repairing balance sheets, consumers begin to spend this new found windfall — "permanent income hypothesis."

Reduced oil prices also dramatically effected the stock market. After the price of oil bottomed out, the S&P 500 index gained an average of 27% over the following year, ranging from 16% to 38%. Of course, there is no way to know for sure what the index will do after oil bottoms out this time, but with history as a guide, it could be significant.

So how do you navigate the volatility of this market and achieve investment success?

1. Use an investment strategy that matches your goals and risk tolerance. Determine the correct strategic asset allocation that matches both your time horizon and your ability to tolerate price fluctuations. Most people's goals span years or even decades, and the longer that period of time, the more aggressively you can allocate your portfolio. However, if you panic every time the market wanes, you should not choose an aggressive allocation. To be a successful long-term investor, you must match both your time horizon and your risk tolerance.

2. Diversify your portfolio. No one knows what areas of the market (large, mid, small) or what style (value, core, growth) or what sector (health care, technology, utilities, etc.) will out-perform or under-perform each year. At AWM&T we over-weight certain areas based on historical valuation parameters, but we never make big investment bets.

3. Don't forget the world. There are around 7 billion people in the world, 95% of whom are non-Americans. The share of economic activity generated outside the U.S. is large and growing and your portfolio should include exposure to this area.

4. Manage your portfolio. A select it and forget it approach will not produce long-term investment success. While market timing does not work, periodic rebalancing does.

AAFMAA Wealth Management & Trust can help. As a fully regulated and chartered trust company, we hold the highest level of a fiduciary duty and care for our clients Talk with your account administrator, relationship manager and investment officer to make sure your investment risk is calibrated correctly for your situation, because proper risk assessment will better enable you to stay the course through all types of markets.

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