JB MERIDIAN ADVISORS

Financial & Economic Review

For the past several quarters we've prognosticated about the Federal Reserve raising short-term interest rates as the bull market matures, only to be disillusioned by the "nothing to see here" attitude of the Federal Reserve. Our opinion and that of many reputable analysts is one of utmost caution in regards to investing in longer-duration fixed income investments. The inability of the average investor to find yield has led many to stretch for longer maturity issues, driving valuations to all-time highs. Couple the previous fact with the surge in total governmental debt, as evidence surfaces that inflation is rearing its head, and the prospect for large losses in longer duration treasuries increases significantly. Another consequence to lower rates is the search for growth at the corporate level, fueling an increase in M&A activity across many sectors. The broader stock markets are the other beneficiary of the lower interest rate environment, as investors opt for dividend paying equities that present greater comparable yields. This condition has led to stock valuations being stretched. The current forward 12-mo P/E ratio on the S&P500 is about 16.6. Far above the 5-year and 10-year averages of 14.8 and 14.3. The reversion to the average market multiple can and would come as a result of surging earnings or falling stock prices. We feel that odds of the latter are increasing and investors should take heed.

With stock valuations well above historic norms, we continue to urge caution while investing new capital and expect a heightened level of volatility for the remaining months of 2016. The S&P 500, Dow Jones Industrial Average and NASDAQ Composite Index returned 3.3%, 2.1% and 9.7% for the third quarter respectively. Technology, Financials and Energy Limited Partnerships were the best performing equity sectors in Q3, rising 13.1%, 7.2% and 6.5%. The worst performing sectors were Utilities, Equity Precious Metals and Real Estate losing -4.1%, -1.5% and -0.9% respectively. On the fixed income side, the U.S. Aggregate Bond index returned 0.5%, while the 10-year Treasury bond yield increased to 1.6%, an 8% increase from Q2[1]. The most overvalued sectors to end the quarter were Basic Materials and Energy trading at approximately 1.28 and 1.22 times Morningstar's coverage universe. Financial Services and Healthcare, although not very discounted, were the most undervalued at 0.94. At the current late stage in the market cycle, diversification in a disciplined strategy remains paramount. The potential risk of inflation is creeping into discussion and all eyes are on the unconventional monetary policies of policy makers worldwide.

We appreciate your business and continued faith and support in our Firm, as we are diligently search for potential values in the many asset classes and sectors of the market. We look forward to continuing to assist our clients and friends in navigating the financial markets in the years ahead. Growing your investments and earning your trust and referrals remains our top priority.

Jack A. Kennedy
Chief Investment Officer

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[1] Results referenced from Morningstar.com

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