INVESTMENT COMMENT
1st Quarter Review and Strategy Update

April 7, 2016

The 1st Quarter of 2016 was quite interesting. A glance at full quarter performance masks the gyrations that transpired during these first few months. Global capital markets began the year with negative sentiment arising from weakness in China's stock market and global oil prices. Headlines like "Oil Skids to 12-Year Low" and "Why China's Market Fell So Much" joined with comments from renowned investment managers (e.g. George Soros, "…reminds me of the crisis we had in 2008") to fan market fears.

By February 11, broad measures of Risk had declined more than 10% (S&P 500 Index -10.3%, MSCI AC World Index -11.3%) before rallying to end the quarter with positive returns. Low Risk segment returns performed well during the quarter, led by longer-term bonds (US Treasury 20-30yr Notes +8.7%), as interest-rates fell.

For market participants, this quarter had something to interest everyone: stock market volatility, significant interest-rate movements, declining US Dollar (-4.1%), and debt concerns related to oil company borrowings, in addition to political uncertainty as the US presidential election draws near.

What did we do during 1st Quarter?
Our investment actions are process-driven as we adhere to each client's Investment Policy Statement. By early- to mid- February, we purchased Risk segments, where appropriate, to rebalance each portfolio back to its targeted Risk exposure. In some cases, for taxable investors, the market swoon also provided an opportunity to rearrange portfolio holdings to "harvest" tax-losses to offset future gains.

Selected Asset Classes As of March 31, 2016	**1st Quarter**	**12 Month**	**5-Year Annual**
PORTFOLIO **RISK** SEGMENTS			
US Large Cap	+1.0%	-0.3%	+11.0%
US Large Cap Value	+1.7%	+1.1%	+10.6%
US Small Cap	+1.1%	-7.5%	+8.8%
US Small Cap Value	+3.5%	-4.7%	+9.7%
International Large Cap	**-1.9%**	-7.4%	+2.4%
International Large Cap Value	**-3.6%**	-13.1%	+0.5%
International Small Cap	**-0.3%**	+2.7%	+5.7%
International Small Cap Value	+1.5%	+2.0%	+5.8%
Emerging Markets	**+5.9%**	-12.9%	-4.2%
Emerging Markets Small Cap	**+3.2%**	-10.5%	-3.3%
Emerging Markets Value	**+8.9%**	-11.4%	-6.4%
US Real Estate Investment Trusts	**+6.3%**	+4.0%	+11.8%
International Real Estate	**+4.9%**	-2.1%	+5.1%
SELECTED PORTFOLIO **LOW-RISK** SEGMENTS			
US Treasury 1-3yr Notes	+0.9%	+0.8%	+0.8%
US Treasury 7-10yr Notes	+4.8%	+3.7%	+5.6%
US Treasury 20-30yr Notes	**+8.7%**	+2.5%	+10.4%
US Treasury Inflation-Protected	+4.6%	+1.4%	+2.9%
Inv Grade Short Duration	+1.7%	+1.8%	+2.3%
Inv Grade Intermediate Duration	+3.5%	+2.8%	+5.0%
Inv Grade Long Duration	+6.8%	+1.3%	+8.7%
International Bonds (Non-Dollar)	+5.1%	+3.1%	-3.4%
EQUITY INDICES			
MSCI All-Country World Index	**+0.4%**	-3.8%	+5.9%
S&P 500 Index	**+1.4%**	+1.8%	+11.6%
BALANCED PORTFOLIOS			
Vanguard 60/40 Fund	+1.9%	+0.6%	+8.1%
DFA 60/40 Fund	+2.1%	-1.5%	+5.1%
DFA 25/75 Fund	+1.9%	+0.2%	+3.3%
OTHER NOTABLE MARKET DATA			
Crude Oil Futures	-4.1%	-33.1%	-17.7%
Gold ETF	+16.0%	+3.5%	-3.4%
US Dollar (Trade-Weighted)	**-4.1%**	-3.8%	+4.5%
High Yield Bond ETF	+2.1%	-7.2%	+3.2%

Source: Bloomberg Professional

Note: Returns include reinvested dividends

CAPITAL MARKETS HIGHLIGHTS

Risk Segments

Emerging Markets and Real Estate segments were the best performers. Emerging Markets Value (+8.9%) led all Risk segments. US REITs (+6.3%) and International Real Estate (+4.9%) were also leading segments.

International Risk returns benefitted from a weaker US Dollar, but still lagged US Risk returns and were the weakest performing Risk segments (International Large Cap Value -3.6%, International Large Cap -1.9%). It is interesting to note that many market forecasters had expected a *strengthening* US Dollar against other currencies. In fact, one of Goldman Sachs "Top Trade" ideas for 2016 was for Dollar appreciation versus Euro and Yen[1]. *Currency movements, like stock market returns, are not predictable.*

Low Risk Segments

Despite the much-awaited first increase in short-term interest rates by the Federal Reserve in December, US bond market interest rates *declined* during the 1st Quarter. US 10yr Treasury note yields ended at a price to yield 1.77%. US Rates, although low, are higher than most other developed countries. *Note that purchase of a Japanese or Swiss 10-year government bond locks-in a yield-to-maturity that is negative – US rates seem attractive, by comparison.*

Table 2: Global Bonds

10 Year Government Bonds	**Yield**
United States	+1.77%
Canada	+1.22%
United Kingdom	+1.41%
Japan	-0.04%
Germany	+0.15%
France	+0.48%
Switzerland	-0.38%
Italy	+1.22%

Investors with risk-balanced portfolios ended the 1st Quarter with positive, but unremarkable returns. The impact of 2016's first quarter was more psychological/emotional and may raise some questions in investor's minds:

Was George Soros correct in making a comparison to 2008?

He was referring to potential global economic and financial strains from China's "hard landing". However, the global financial system is far stronger than pre-2008 and global capital markets have been functioning normally to-date. A review of our written Investment Comments from August 2007[2] serve as a reminder of how very different the financial world was then. *Bottom-line: No. Since the 2008 Financial Crisis is fresh in most investor's minds, comparisons are inevitable each new crisis, but such comments are more likely to conjure up emotional decision-making that detracts from a well-constructed investment strategy.*

Is the U.S. heading for a recession?

Economist forecasts[3] do not anticipate a US recession in the next few years. Recently, however, several market pundits have predicted an imminent US and/or global recession. While economic data does not support such negative forecasts, stock market weakness during the first six weeks of 2016 was touted as evidence of an impending recession. One famous economist's observation almost 50 years ago that the stock market has "…predicted nine out of the last five recessions"[4] may be applicable now. Another, more recent observation from Merrill Lynch's chief economist is that "It's always something"[5]. We couldn't agree more: there are always risks for investors. The best way to build portfolios to profit from risk-taking is to adhere to a discipline that accepts measured risk exposures and manages Risk / Low Risk balance accordingly.

[1] "Goldman Sachs Abandons Five of Six 'Top Trade' Calls for 2016", February 9, 2016, Bloomberg

[2] See "Repricing Risk Due to Sub-Prime Mortgages and Leverage Loans", August 6, 2007 and "A Crisis of Confidence in Money Markets", August 21, 2007 under LIBRARY tab at marylandcap.com

[3] April 7 survey of 90 economists, +2.0%, +2.3%, +2.2% mean GDP growth, Bloomberg ECSC function

[4] Samuelson, Paul (September 19, 1966), "Science and Stocks", Newsweek, p. 92

[5] "Merrill Lynch chief economist nails the truth about risk in a perfect 3-word sentence", finance.yahoo.com, April 7, 2016