Yanni & Associates
Investment Advisors, LLC

## THIRD QUARTER – 2016 CLIENT NEWSLETTER

## REVIEW OF THE MARKETS:

| Index: | 3Q16 | 2016 |
|---|---|---|
| S&P 500 | 3.85% | 7.84% |
| S&P Mid-Cap | 4.14% | 12.40% |
| S&P Small Cap | 7.20% | 13.88% |
| Morgan Stanley's EAFE (International Stocks) | 6.43% | 1.73% |
| Barclay's US Aggregate (Bonds) | 0.46% | 5.80% |

## ECONOMY & MARKETS:

As expected, the stock and bond markets have continued their volatile trend throughout the third quarter, but ended on a positive note. Due to the upcoming Presidential election, another expected interest rate increase by the Federal Reserve, a continued declining trend in corporate earnings, various international news, and for other reasons, we expect this volatility to continue at least through year-end. **In an attempt to properly set client expectations we have been communicating that while we still do not believe a recession is on the near-term horizon, growth opportunities in both the stock and bond markets may be limited for the next several weeks.**

Second quarter GDP had its second and final revision upwards from 1.1% to 1.4%. Despite the better reading, growth for the entire first half of the year is at 1.1%, which is 1.3% year-over-year, the slowest pace in three years. Early estimates for the third quarter GDP growth are around 2.5-3%, which should help boost 2016's annual figure a bit. Unfortunately, the third quarter was supposed to bring back a return to corporate earning's growth. Heading into the third quarter earnings season, companies are now expected to report an amazing sixth consecutive quarter of earning's decline. Analysts' projections have postponed the return of earnings growth until the fourth quarter. While oil prices are up slightly year-to-date, the energy sector continues to be one of the overall main detractors. If we excluded the energy sector, corporate earnings would likely be positive for the third quarter. Despite the declining trend in earnings, low interest rates have been a main reason investors continue to favor equities over fixed-income investments. The unemployment rate for September nudged upwards from 4.9% to 5.0%, which was really caused by the rise in the labor participation rate. September's non-farm payrolls were at 156,000 below a consensus of 168,000, mainly due to a downturn in government payroll. Similar to last quarter, wage growth remained at 2.6% year-over-year, a slight positive indicator for the economy and something the Federal Reserve (Fed) monitors. The Federal Reserve (Fed) generally prefers stronger unemployment and wage growth figures and beyond likely not wanting to raise rates immediately before the upcoming election in November, will likely not raise interest rates until December. As of October12th, the S&P 500 valuation is 16.5 times projected earnings, still above the 10 year historical average of 14.3. When examining the S&P 500's P/E in relation to low interest rates and other measures, more reasonable valuations are displayed.

At its last meeting in September, the Fed forecasted one additional interest rate increase in 2016 (down from two forecasted increases in it's June meeting). Again, likely, this will occur at it's December meeting. Policymakers also lowered their 2017 expected rate hikes from three to two. It is also forecasting another three rate hikes in 2018. This "lowering forecast" has been the general theme of the

**YAIA Firm Update:** In September, **we became certified to sell Life and Long-term Care (LTC) Insurance**. Over the years, many clients have made it known that if we sold those products, it would be easier for them to purchase mainly life insurance directly from us. This will require us to change a variety of compliance documents, which should be completed in the upcoming weeks. These insurance products are not intended to be our focus, just a complement to our overall process for managing our client affairs. As a part of this exam, it did also require us to become certified to sell health insurance (mainly for LTC) and annuities (just "lumped-in" to this exam). We can now more adequately evaluate these types of outside holdings. However, we do not have intentions to sell traditional health insurance nor annuities.

**IN THE NEWS: Pittsburgh Post-Gazette 10/02/2016:** Presidential politics make investors nervous – by Len Boselovic

Click here to read the article!

Federal Reserve for all of 2016. Going back to December of 2015, the Fed raised interest rates once and forecasted four more in 2016. That initial hawkish forecast along with some additional economic factors sent the stock and bond markets into a major tailspin. After recovering several weeks later, it was apparent that the Fed's forecasts were substantially too aggressive. Interestingly, this latest Fed report also showed a lowered GDP forecast for the next several years, which is a bit counter intuitive to justify a long-run interest rate increase cycle. We would question that if the economy is going to continue to have slow growth of less than 2% for the foreseeable future, how could it withstand 2-3 interest rate hikes in a year? In our opinion, the economy cannot withstand this type of aggressive rate hikes in a calendar year! For the time being, the markets reacted positively which appears to generally support our theme that the Fed is still overestimating the number of rate hikes that could occur for the next few years. As has been the theme for many years now with low interest-rates, "Don't fight the Fed" appears to remain with us and is helping support equity valuations. The other side to the argument is that these continued low interest rates are artificially inflating other asset prices (potentially housing, stocks, and others) and the Fed is fearful of creating another asset bubble.

**SEC Money Market Reform Rule enacted October, 2016** – In July 2014, the SEC announced substantial amendments to money market funds (MMF Reform Rule). Some of these changes are being phased-in over time, with the most substantial in October, 2016. The intention is to create more stability and to protect shareholders of fluctuating Money Market Net Asset Values (prices). While the perception is that MMFs do not have fluctuating prices, extreme market circumstances and/or where exceptionally large withdrawals were made, forced some MMFs years ago to reduce their NAV below $1 per share. For example, if the NAV dropped by $0.001 and client owned 10,000 shares, he/she would only have $9,990 in the fund, not the expected "safe" $10,000. We want to outline how the new rules affect investors today:

1. Investor eligibility is changing. There is now a new distinction in regards to how investors are classified: Retail ("natural persons") and Institutional.
2. Retail, municipal, and government MMFs will be permitted to price and transact at a constant NAV. Institutional MMFs will be required to price and transact with a variable NAV.
3. Both Retail and Institutional MMFs now have tools to curb heavy redemptions in extreme/rare periods of market volatility or exceptionally tight liquidity. If these periods exist, the funds' Board of Directors will have the ability to impose "liquidity fees" and/or suspend all fund redemptions aka "redemption gates".

Our custodian-of-choice, Schwab Institutional, has already notified our existing clients. Schwab also made changes to how some of its internal money markets are categorized as well as switching clients into the appropriate classification of MMFs for the future.

**Department of Labor Rule (DOL) taking effect April 2017** – The DOL passed a new law that will change the compliance efforts for retirement plan rollovers (including IRAs). The idea is to provide an exceptional amount of transparency to clients, mainly targeting commission-based Investment Brokers (their commissions are often described as "hidden fees"). Fee-based Registered Investment Advisors (as YAIA) are also affected, but considerably less so. Disclosures going forward will need to outline the possibility for clients having higher overall expenses for using a professional Advisor. Commission-based investment brokers may also be required to quantify the actual difference between what clients will pay pre-rollover versus afterwards. Other discloses may be required too. We plan on expanding on this topic in upcoming newsletters.

**CURRENT 2016 PORTFOLIO RECOMMENDATIONS:**

- Overall – **Neutral weight stock positions for our clients' asset allocations with respect to their customized individual guidelines**
- Within equities – N**eutrally weighted position on value and growth stocks**
- Within equities – **Slightly overweight large-cap company stocks in relation to small and mid-cap peers**
- Within equities – **Slight-to-moderate underweight international stocks**
- Within fixed-income – **Overweight to high-grade corporate bonds with diversified exposure to multi-sector and individual bonds; absent high yield bonds**