QUARTERLY COMMENTARY
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The historic volatility evident since mid-2014 was even more extreme in this year's first quarter. The dramatic market decline in last year's third quarter was followed by an equally dramatic fourth quarter rally. An almost identical decline and rally were compressed into the first three months of 2016. Following the worst start to a year in U.S. stock market history, Fed Chair Janet Yellen gave stock prices at least a temporary boost when she surprised markets by not hiking interest rates at the Fed's January meeting. Her dovish tone gave investors hope that the Fed would still be supportive in the months ahead. The brief late-January rally quickly faded, however, and prices retreated to a new low, breaking a potentially important support area on February 11. Conspiracy theorists were given ammunition when rumors surfaced within ten minutes of the breakdown that the OPEC countries were preparing to meet to discuss cutting back oil production. Oil prices immediately rallied, and stock prices followed. Prices rallied into the end of the quarter, recovering all of the January – February decline, closing with a slight gain.

Late in the quarter, further dovish comments by Fed Chair Yellen as well as additional stimulative central bank actions in Europe and Asia were designed to boost economies and support stock and bond prices. They succeeded on the bond side, but stocks have shown far less enthusiasm in recent weeks in the US and throughout most of the world. Despite extremely aggressive stimulus, Japan is a prime example of central bank ineffectiveness, with the Nikkei down about 11% year-to-date as this is written. Despite an aggressive negative interest rate policy by the European Central Bank, European stock indexes declined an average7.7% in the first quarter. Many opponents of central bankers' experimental monetary policies are now arguing that such stimulative strategies have reached the limits of their effectiveness and may now, in fact, have become counterproductive.

Former Fed Chairman Alan Greenspan made a remarkable confession last week, saying: "Monetary policy is largely economic forecasting. And our ability to forecast is significantly limited." Bill King, who writes *The King Report*, had a classic response: "Nowwww he tells us that the Fed is Mr. Magoo when forecasting!" I have written two articles in the past several weeks pointing out the absolute absurdity of granting the Fed, comprised entirely of academics and regulators, the power to effectively orchestrate the US economy. (See http://www.missiontrust.com/blog/2016/03/reduce-the-feds-mandate/ and http://www.missiontrust.com/blog/2016/03/wheres-the-outrage/.) Also over the past several weeks the Organisation for Economic Co-operation and Development, the International Monetary Fund and the World Trade Organization all continued their now longstanding pattern of dropping earlier estimates of world GDP growth. Their average estimate is now about 3% for 2016, essentially a recessionary level in much of the world. In this country, the Atlanta Fed's most recent estimate of first quarter US GDP growth is barely above zero, having been sharply reduced in recent weeks. Reflecting slowing global growth, global corporate profits have been declining since 2011(according to Bloomberg) and are today well below their 2007 peak levels. In the US, "as reported" profits for the S&P 500 are at 2012's level, although stock prices have risen substantially over that same timespan, thanks to central bank support.

Wall Street remains silent about an imminent recession either domestically or globally. It is noteworthy, however, that over the past 45 years, Wall Street has forecast none of the past seven US recessions. Wall Street isn't likely to predict recessions, because it's just not good for business. One very telling statistic, however, that argues strongly for a global slowdown is the pronounced decline in global exports. Exports are slowing because global demand has dried up. Over the past quarter of a century, export growth has declined year-over-year only during recessions.

The unprecedented global central bank actions have so distorted normalcy that world interest rates in this cycle have descended to lows seen only once before, in the late-1500s. Short-term rates in Europe and Japan have been pushed into negative territory. In this country, they are barely positive. Thirteen European countries' fixed income securities have negative yields to maturities out beyond a year, with Germany and the Netherlands negative out to eight years and Switzerland out to 15. Owners of more than $7 trillion worth of securities have decided that paying those governments to hold their money is more attractive than all other alternatives-- a remarkable distortion of everything we know about investments. Some market commentators refer to today's fixed income securities as "return-free risk." In the US, with the 10-Year Treasury Note at 1.8% as I write, it would take a very small increase in yield to produce a negative total return for a year or more. While yields could always go lower, the risk/reward equation at these yields is extremely unattractive.

The credit quality of non-government loans is increasingly being called into question. According to The Wall Street Journal, energy company loans in danger of default are expected to top 50% this year at several major banks. And J.D. Power estimates that the delinquency rate on subprime auto loans will hit 17.5% this year, approaching the 19.6% peak reached just before the financial crisis in 2007. Bonds are hardly an attractive safe haven in the current environment.

Because of central bank actions, today's debt excesses around the world are the most severe in history. In this country, equity valuations are at their historical highs but for the dot.com bubble at the turn of the century, from which point stock prices were more than 50% lower nine years later. Over the decades, there has been a very clear negative relationship between valuations at the time stocks are purchased and subsequent returns. With valuations currently stretched near all-time highs, stocks will be swimming against the historic tides in the years ahead.

Aldous Huxley famously observed: "Facts do not cease to exist because they are ignored." The facts are that debt and equity valuations remain at dangerous extremes, having been ignored for years. Instead, trust has been placed in government's willingness and ability to keep stock prices elevated. So far, over this market cycle, that trust has been well placed. Investors are still faced, however, with the dilemma of whether to bet on a continuing divergence between equity prices and underlying fundamentals or to expect market prices to revert toward historic fundamental norms. For all but relatively short-term traders, we strongly suggest the latter alternative. It is important to recognize that virtually no investors get to keep what they have at market highs, but rather what still remains at market lows. And given how overextended this market is after seven years of powerful government support, we fully expect there will be opportunities to become more aggressive in equities in the quarters and years ahead at lower prices—possibly substantially lower.

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