



SilverOak

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First Quarter 2016 Market Summary

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First Quarter 2016 Market Summary

The first quarter was a tale of two halves. At the beginning of the year, we saw investors take risk off as concerns about global growth and geopolitical tensions rose. Equity markets were down 10% - 20% through mid-February making many investors uneasy. The second half of the quarter helped calm those fears with equity markets recovering most of the negative returns. Wild swings in the markets, which led to an emotional rollercoaster for investors, came without any significant change in economic fundamentals.

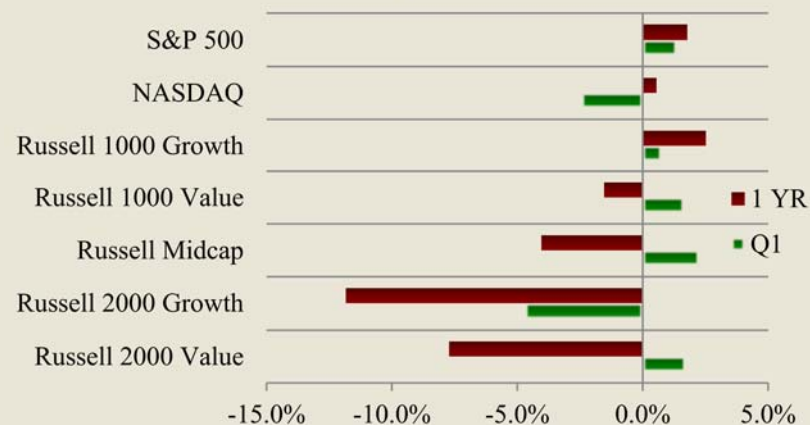
U.S. large caps, represented by the S&P 500, ended the quarter up just over 1%. U.S. small caps, represented by the Russell 2000, ended down by 1.5%. Value oriented stocks rebounded relative to growth oriented stocks across all market capitalizations after underperforming by a wide margin in 2015. The increased volatility made investors run for more defensive and higher dividend paying stocks while eschewing more volatile growth stocks. As a result, utilities, telecom and consumer staples outperformed. Health care, which has been the best performing sector the past five years, was down 5% along with Financials, which were hurt due to lower interest rates.

International developed equities were negative during the quarter as economic data in Europe and Asia continued to be subdued. A weaker U.S. dollar provided support to emerging market equities as they were up over 5% on the quarter. However, emerging markets have struggled with lower commodity prices, decreasing earnings growth and weak currencies resulting in three consecutive years with negative equity returns. As a result, emerging market valuations are now attractive relative to historical ranges.

After raising rates in December by 25bps for the first time since 2006, the Federal Reserve did not raise the Fed Funds rate in March. The Fed, citing rising global economic risks and financial turmoil, backed off their previous guidance of four rate hikes during the year and are now expecting only two hikes. Globally, interest rates fell during the quarter as economies around the world continue to struggle to create growth. U.S. Treasury yields were pushed down in part by foreign investors seeking safety and higher yields as central banks in Europe and Japan have instituted negative interest rate policies. Bond returns, in particular those within the credit sectors (i.e. investment grade corporates and high yield), were strong relative to equities. TIPS (Treasury Inflation Protected Securities) were up over 4% with inflation expectations increasing during the quarter.

Although markets have recovered from their lows and are generally in positive territory year-to-date, investors should be prepared for the potential of continued lower equity market returns and higher volatility. Valuations in many asset classes are still high relative to historical norms, which tend to correspond with lower future returns. Additionally, there is uncertainty in the markets with regard to the direction of the economy, especially in light of the Presidential campaign and the uncertainty of policy moving forward. In the past 6-9 months, there have been two periods with a drawdown of 10% or more in the equity markets. Historically, volatile periods have been grouped, which would indicate a greater chance for additional drawdowns. Through diversification, equity volatility may be dampened by fixed income exposure and other asset classes.

Broad Market Index Returns First Quarter 2016



HIGHLIGHTS

MACROECONOMICS

- The Bureau of Economic Analysis released the advanced estimate of first quarter 2016 real GDP, an annual rate increase of 0.5% from the preceding quarter. While unimpressive, GDP continues to show slow growth in the economy.
- The University of Michigan Consumer Sentiment Index final reading for March was 91.0, which was a decrease from February and the previous quarter. Consumer sentiment remains high despite leveling off during the past year.
- The ISM Manufacturing Index rebounded during the quarter from 48.0 in December to 51.8 in March. The ISM Index has trended down since the end of 2014 as manufacturing has struggled. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- In March, the Conference Board Leading Economic Index increased 0.2% month-over-month to 123.4. The Index has increased gradually over the past year showing steady, but slow growth in the economy.
- The price of WTI Crude Oil was \$36.14 at the end of March, which is 2.6% lower than \$37.12 at the end of December. The price of Brent Crude Oil increased 0.4% in the quarter to \$36.75. The price of oil has been volatile as the supply and demand dynamics are being affected by a weaker than expected global economy and a market share battle among U.S. shale companies and OPEC members.
- In March, headline CPI increased 0.9% year-over-year, up from an increase of 0.7% in December. Core CPI, which does not include food and energy, had a 2.2% increase. Inflation levels have remained low over the past year and have been less than historical averages and the Fed's 2% inflation target.

HOUSING

- Preliminary existing home sales decreased in March with an annualized rate of 5.33 million units from 5.45 million units in December. However, the March annualized rate is 1.5% higher than the 5.25 million units in March 2015. The strength in home sales that we saw throughout 2015 has continued in the beginning of the year.
- Median existing home sale prices decreased during the quarter. However, the preliminary prices for March were 5.7% higher than the levels of one year ago and have been trending up since the beginning of 2012.

- New home sales decreased during the quarter with a seasonally adjusted annual rate of 511k homes sold in March versus 537k in December. However, on a year-over-year basis new home sales increased. Home sales have rebounded from the lows of May 2010, when 280k new homes were sold.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose 5.4% year-over-year in February.

EMPLOYMENT

- The labor market improved during the quarter on a year-over-year basis as nonfarm payrolls averaged 209,000 jobs added per month, which was 10% more than the first quarter in 2015. However, this was lower than the 282,000 jobs added per month in the fourth quarter 2015.
- The unemployment rate was flat at 5.0% during the quarter.
- Initial Jobless Claims have been decreasing since 2009 and dipped to lows last seen in 1999.

DOMESTIC CORPORATIONS

- Corporate operating earnings were lower than expected in the fourth quarter but are expected to rebound in the first quarter 2016. As we go through 2016, lower oil prices and weaker foreign currencies should have less of an impact on year-over-year earnings growth than past quarters.
- Operating margins have retreated from highs but remain well above historical averages.
- Forward and trailing P/E multiples are near or above historical averages.
- The U.S. dollar depreciated vs. major currencies after rising the past year. Multinationals have seen their earnings pressured due to their international exposures.
- The price of oil has been volatile to start the year, declining 30% to the mid-\$20s a barrel before rallying 50% in the second half of the quarter. The price of oil ended the quarter relatively unchanged from the beginning of the year.

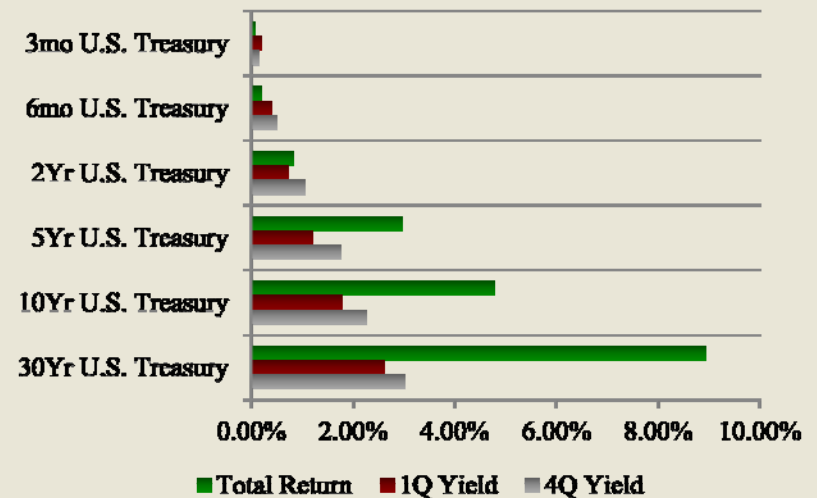
FED POLICY

- In March, the Federal Open Market Committee (FOMC) announced they would leave the federal funds rate at 0.25% - 0.50%. The Fed raised rates last December for the first time since 2006. In their statement, the Fed noted the economy is expanding moderately, the labor market is strengthening and the housing sector has improved.
- The Fed has backed off their previous forecast of four rate hikes during 2016 and now expect only two hikes. Many investors continue to feel the economic data justifies one or possibly two rate hikes in the back half of the year.

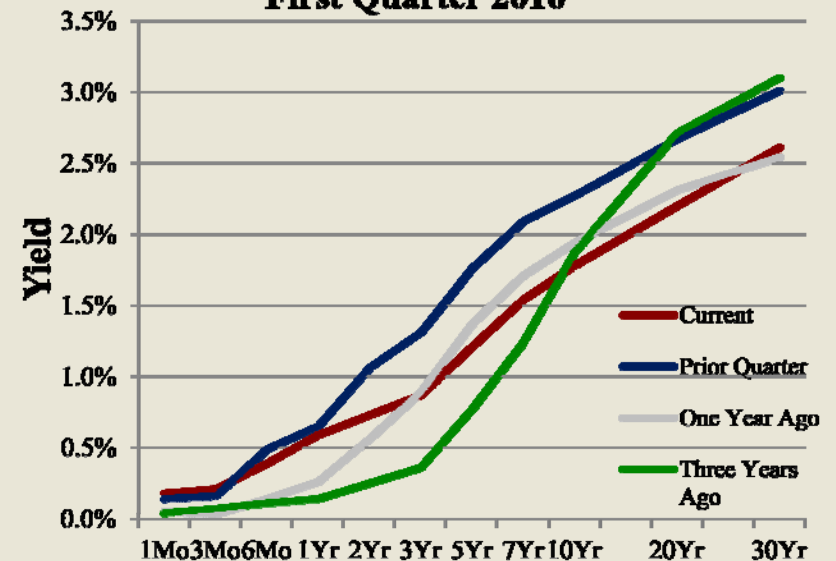
FIXED INCOME

- Most yields, except very short-term Treasury securities, decreased quarter-over-quarter causing the yield curve to flatten.
- On a historical basis, the yield curve is still relatively steep due to the Fed holding down short term rates. A steep curve indicates market participants are not concerned about a recession over the next year. However, with the Fed beginning to raise the fed funds rate, the short end of the yield curve will likely increase more than the long end of the curve, causing further flattening. Short term interest rates are controlled or heavily influenced by central banks where as long term interest rates are controlled by market forces and economic growth.
- U.S. yields remain attractive for the global investor as some central banks have gone to a negative interest rate policy such as the Bank of Japan and the European Central Bank. Therefore, despite low absolute yields in the U.S. they are relatively attractive.

Treasury Yields & Returns First Quarter 2016



U.S. Treasuries Yield Curve First Quarter 2016



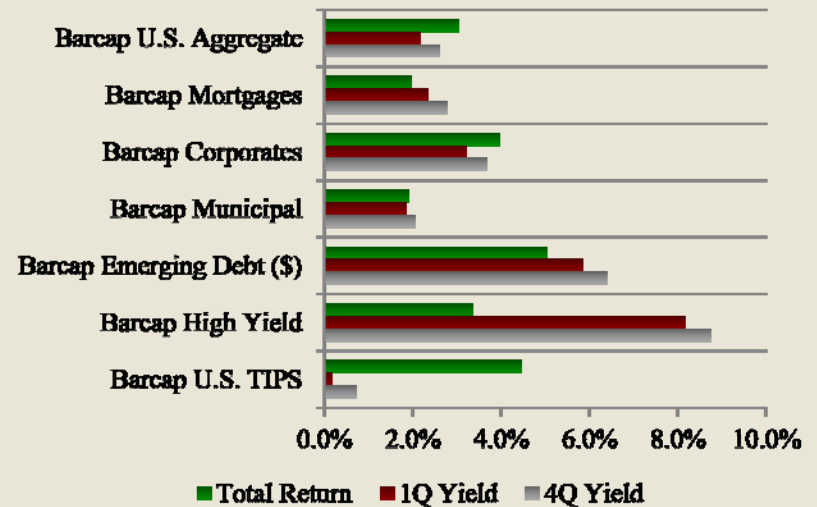
FIXED INCOME (continued)

- Returns across fixed income sectors were strong, particularly in credit sectors such as corporates and high yield. Returns benefitted from lower interest rates and narrowing credit spreads. The Barclays U.S. Aggregate was up just over three percent during the quarter. Municipals lagged but still had positive returns. Fixed income continues to perform well compared to equities as economic growth remains limited.
- Fixed income returns, going forward, are expected to be lower than historical averages as interest rates are starting at a very low level. Historically, future ten year fixed income annualized returns have been about equal to the 10 year Treasury yield at the start of the period. However, spreads in credit sectors are at or above historical averages which could benefit credit returns if the economy continues to grow.

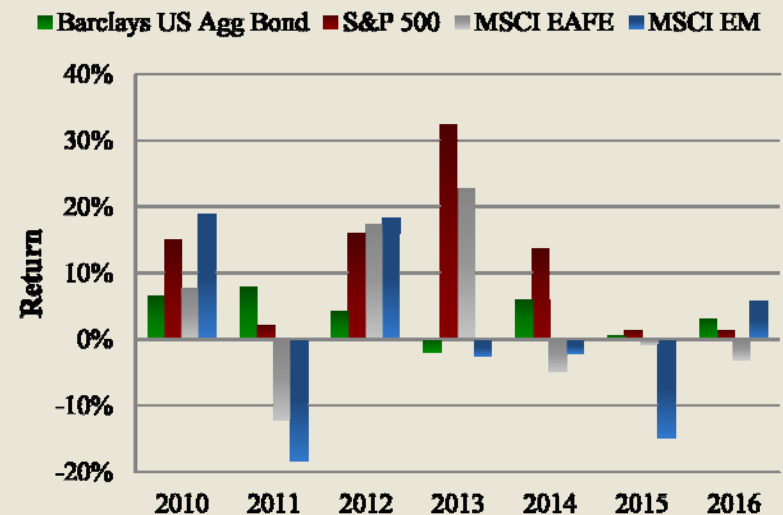
EQUITIES

- As forecasted, volatility continued into the first quarter of the year. Equity markets were down 10-20% through mid-February but rebounded to close the quarter near breakeven.
- We saw a market leadership change during the quarter with value outperforming growth and economically sensitive areas, such as materials and industrials, posting solid returns. Generally, across asset classes, higher yielding assets had stronger returns with investors continuing to search for yield.
- U.S. large caps have dominated returns relative to other asset classes for the past three consecutive years, which is uncommon. We saw this trend change in the first quarter as a diversified portfolio provided solid returns with assets such as emerging market equities, REITs, and fixed income performing well.
- After a strong bull market in equities since 2009, returns are expected to be lower as earnings growth remains sluggish and valuations are slightly higher than average. Volatility should continue as 2016 unfolds.

Fixed Income Yields & Returns First Quarter 2016



Equity & Fixed Income Market Annual Returns



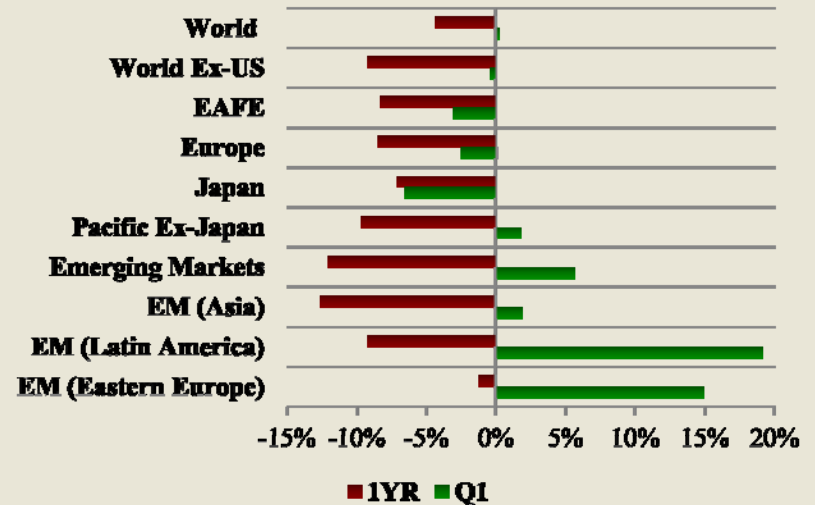
INTERNATIONAL EQUITIES (continued)

- Developed international stocks performed worse than U.S. domestic equities. The MSCI EAFE index of international markets stocks decreased 3.0% during the quarter. On a year-over-year basis, the EAFE is down 8.3%.
- During the quarter, emerging market stocks rebounded as they performed better than developed markets; however, they are still down significantly on a one year basis. The MSCI Emerging Markets Index increased 5.7% in the quarter and has a negative 12.0% return over the past year. Returns have been greatly impacted over the past year by emerging market currency devaluations and lower economic growth expectations. However, stabilization in commodity prices and currencies should benefit emerging markets going forward.
- Valuations are lower in developed international and emerging market equities than in the U.S.; however, many regions are trying to recover from economic slowdowns or are going through structural changes.

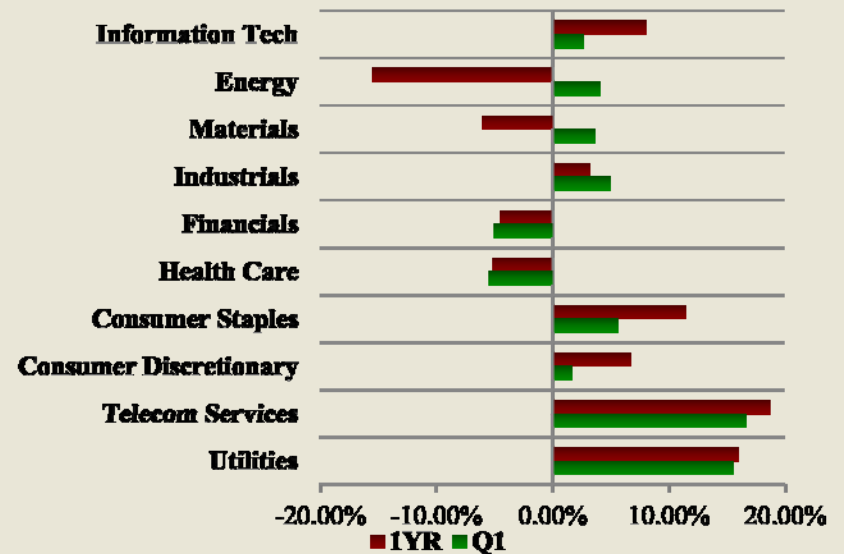
DOMESTIC EQUITIES (continued)

- The Russell 1000 Index of large capitalization stocks posted a total return of 1.2% during the quarter. On a year-over-year basis, the Russell 1000 Index has increased 0.5%.
- Small capitalization stocks, as represented by the Russell 2000 Index, posted a negative total return of 1.5% during the quarter. On a year-over-year basis, the index has declined 9.76%.
- Higher-yielding stocks performed well during the quarter as investors sought income. Utilities and telecom had double-digit returns and were the best performing sectors. Health care and financials were the worst performing sectors, posting negative returns. Value across market caps outperformed growth.

Non-U.S. Equity Market Returns First Quarter 2016



U.S. Equity Market Returns by Major Sector (Securities in S&P 500, First Quarter 2016)



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