INDEPENDENT WEALTH MANAGEMENT

Market & Economic Review

A Quarterly Publication | Historical Perspectives | 3rd Quarter 2016

3Q16 Benchmark Returns

	3Q	YTD
Equities		
S&P 500 Total Return Index	3.9%	7.8%
Russell Index 1000 w/Dividend	4.0%	7.9%
Russell Index 2000 w/Dividend	9.0%	11.5%
Russell Index 3000 w/Dividend	4.4%	8.2%
MSCI Developed EAFE (USD)	5.8%	-0.8%
MSCI Emerging Markets (USD)	8.3%	13.8%
Alternatives		
Credit Suisse Hedge Fund Index	1.6%	0.0%
DJ Wilshire Global REIT Index	-1.1%	7.0%
Credit Suisse Hedge Mgd Fut Index	-1.5%	0.5%
S&P GSSI Natural Resources Index	4.2%	24.6%
Barclays High Yield Bond Index	5.6%	15.1%
Fixed Income		
90 Day Treasury Bill	0.1%	0.2%
Barclays Muni Bond Index	-0.3%	4.0%
Barclays Aggregate Bond Index	0.5%	5.8%
Barclays Global Bond Index	0.6%	14.8%

INDEPENDENT WEALTH MANAGEMENT

Jay Berger, CFP®
jay.berger@iwmusa.com

Steve Fisher, CFP®
steve.fisher@iwmusa.com

Scott Hackney, CFP®
scott.hackney@iwmusa.com

236 1/2 East Front Street
Traverse City, Michigan 49684
231 929 1086 *tel*
888 929 1086 *toll free*
231 346 5959 *fax*
www.iwmusa.com *web*

Third Quarter / Key Takeaways

Despite numerous uncertainties, including a U.S. presidential campaign that continues to unfold as the most unconventional in recent memory, the S&P 500 Index rose by nearly 4% in the third quarter. Stock market volatility remained at extremely low levels through July and August.

September seemed to usher in a change in tone. During the month, stock investors registered high anxiety, with markets rising and falling sharply in response to any oil-related headlines and any suggestion of interest rate hikes by central banks.

European stocks outperformed the S&P 500 after the Brexit low and for the third quarter. They still trail U.S. stocks for the year (both in dollar-hedged and unhedged currency terms).

Emerging-market stock returns have been particularly striking, building upon their sharp rebound and outperformance versus other markets that began in late January. Emerging-market stocks are now up 17% for the year.

Yields on U.S. 10-year Treasury bonds rose to as high as 1.75% during the quarter on worries over central bank policies, but the Federal Reserve's decision not to raise interest rates in September soothed markets. Yields ended the quarter at 1.56%, still up from 1.44% on July 1. A December rate rise is potentially still on the table, and financial markets remain keenly attuned to this possibility. The core bond index gained just 0.4% for the quarter.

Third Quarter 2016 Investment Commentary:

Near Term Strategy: Keep the Long Term In Sight

U.S. Stocks: The S&P 500's gain occurred in the context of a market that saw sharp intraday drops followed by swift reversals, as well as strong rotation into and out of sectors perceived to be "safe," such as utilities, telecoms, and consumer staples. Financials remained pressured by low interest rates, a challenging regulatory environment, and poor investor sentiment—negative headlines surrounding Deutsche Bank and Wells Fargo have not helped.

Developed International Stocks: European stocks outperformed the S&P 500 after the Brexit low and for the third quarter. They still trail U.S. stocks for the year (both in dollar-hedged and unhedged currency terms).

There are any number of known and unknown catalysts that could result in an earnings recovery. One may be the European Central Bank's continued efforts to keep borrowing costs down to stimulate lending and investment spending. The ECB recently started buying investment-grade corporate bonds as part of its quantitative easing program. That may spur investment and lead to better economic growth. Or, it may spur financial engineering, with companies using the proceeds from issuing debt to buy back stock and boost earnings per share. Either outcome could bode well for future profits and stock prices.

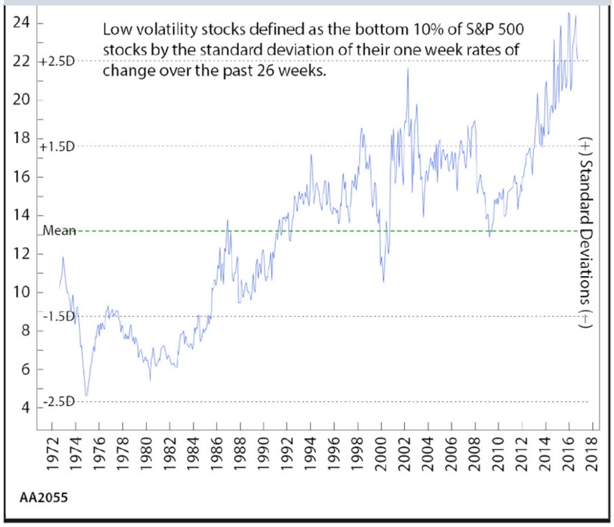
Brexit, along with the rise of many right-wing political parties, may serve as a wake-up call that authorities need to generate better growth in the economic bloc soon. As a result, they may become more open to loosening the fiscal purse strings to assist the ECB's reflation efforts.

The exact timing is highly uncertain. It's possible nothing much happens with fiscal stimulus until major elections are completed over the next year, meaning the ECB continues to do what it can and Europe muddles along.

Emerging-Market Stocks: Returns have been particularly striking, building upon their sharp rebound and outperformance that began in late January. They are now up 17% for the year (versus almost 8% for the S&P 500) and up 32% from their January low (versus 17% for the S&P 500).

The political and economic risks, including the very rapid growth of debt in China in particular, are well known.

Low-Volatility Stock Valuations Near Record High



Source: S&P Capital IQ Compustat, as of 8/31/16.

Perception Versus Reality: Managing Risk

While we spend time analyzing each of our individual positions and holdings, in portfolio management, the whole is much more than simply the sum of its parts. By definition, a well-diversified portfolio (i.e., one with investments that do not all move together in the same direction) will contain some laggards during any given measurement period, particularly over shorter-term periods. But it's at least as important to focus on the overall portfolio, how the pieces fit together and perform relative to each other, and whether that performance is consistent with the original rationale for owning them.

Successfully managing portfolios also requires the discipline to resist trading based on emotion, rather than on long-term return drivers such as valuations, yield, and earnings growth. Even in an advanced economy such as the United States, the stock market has fallen by at least 10% every 16 months on average since 1950. Bear markets (20% or greater declines) in the United States have happened about every seven years on average. In most cases you can't predict what the exact cause of the volatility will be or exactly when it will hit. Even if you could successfully call it, you'd need to also successfully time your re-entry so as not to miss out on the subsequent gains—and do so consistently and repeatedly over an investment lifetime. That is not realistic.

To take just one example of why making investment decisions based on short-term market forecasts (guesses) is a losing game, we turn to the U.S. presidential election. We are being asked about the election even more than usual this year. While the specific circumstances of any given election are always unique, our approach remains the same. To the extent a particular result is widely expected, current asset prices will reflect the market consensus. There is too much uncertainty and too many variables that impact investment outcomes for us to likely see any value in positioning our portfolio for a particular result. Instead, we stick to our longer-term approach, in which we will respond by taking advantage of opportunities that present themselves in times of uncertainty.

Along with the U.S. presidential election, central banks' policies, particularly the Fed's, remain a key near-term wildcard for financial markets. At its September 21 meeting, the Fed remained on hold but signaled it is on course to raise rates later this year, likely in December. It also lowered its longer-term forecast of rate hikes yet again. It now forecasts just two in 2017, down from the three forecasted at the June meeting and the four forecasted at the March meeting. Financial markets responded positively.

Investors are effectively being forced out of low-risk, extremely low-yielding, core bonds into riskier assets that offer higher current yields (still quite low compared to historical levels). Many investors appear to be "reaching for yield" as well as *perceived* safety in traditionally "defensive" yield-oriented sectors of the stock market, such as utilities, telecoms, consumer staples, and REITs. Valuations have soared. But these trades can unwind quickly and momentum can work in reverse. It certainly seems "defensive" plays are vulnerable to any hint of interest rate increases and are potentially higher-risk right now than the broad stock market, not to mention bonds.

Trying to anticipate the markets' reaction to each Fed governor utterance or Fed policy statement is a short-term guessing game that we simply won't play with our investment portfolios.

Putting It All Together

Clients need to be psychologically and financially prepared for periods of market stress and able to ride them out on the path to achieving long-term investment and financial goals. Investors who can't stomach a given level of volatility or downside risk should reallocate into a portfolio with a lower targeted risk level. The time to do so is *before* a period of volatility, not during or right after it when they would be selling their riskier assets at lower prices and buying more defensive assets at higher prices.

While July and August were unusually calm months for the markets, volatility picked up in early September. We're prepared for more of it heading into (and potentially coming out of) the November election, as well as on increased likelihood of a Fed rate hike in December.

As always, we thank you for your continued trust and confidence as we work together to achieve your financial goals.

Independent Wealth Management IWM

Disclosure: 1. This presentation may include forward-looking statements. All statements other than statements of historical fact are forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," and "expect"). Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements. **2.** Historical performance is not indicative of any specific investment or future results. Views regarding the economy, securities markets or other specialized areas, like all predictors of future events, cannot be guaranteed to be accurate and may result in economic loss to the investor. **3.** Investment in securities involves the risk of loss of interest and/or initial investment capital. **4.** Nothing in this letter is intended to be or should be construed as individualized investment advice. All content is of a general nature. Individual investors should consult their investment adviser, accountant, and/or attorney for specifically tailored advice. **5.** The opinions expressed herein are solely the opinions of the respective authors. Certain material in this work is proprietary to and copyrighted by Litman/Gregory Analytics and is used by permission. Reproduction or distribution of this material is prohibited and all rights are reserved. Independent Wealth Management, LLC is a Michigan Registered Investment Advisor.