



2016 Economic Scenarios **Boom or Gloom?**



Dennis Stearns, CFP®

- Dennis Stearns is a financial planning practitioner and President of Stearns Financial Group, a **fee-only financial planning, investment management and business consulting firm** with offices in Chapel Hill and Greensboro and clients around the U.S. and overseas.
- SFG was one of the few planning firms in the nation named to the ***Financial Times* Top 300 list for 2014 and 2015.**

- The Financial Planning Association has called him “**one of the leading scenario experts and futurists in the financial planning industry.**”
- Dennis is the co-author of ***CEO Road Rules: Right Focus, Right People, Right Execution.*** The book was praised by many private and public company CEOs including ***Good to Great*** “Level 5 Leader” Daniel Jordt (Walgreen’s CEO, now retired).
- Dennis has **won numerous awards in his field** and is **frequently quoted in many regional and national publications**, including *TheStreet.com*, *AAll Journal*, *Dow Jones Newswire*, the *Wall Street Journal*, the *Journal of Financial Planning*, *Financial Planning* magazine and the *NY Times*.
- Dennis has both **undergraduate and masters degrees in finance** and is a **CERTIFIED FINANCIAL PLANNER™** practitioner.
- He is **treasurer and chairs strategic planning** for the Gateway University Research Park in Greensboro, home of the Joint School of Nano-Science and Nano-Engineering.
- Dennis is a **partner in a technology business accelerator** and is on the **advisory board for the NC Technology Association.**
- Dennis is a **chess expert and was part of one of the winningest Pan American Chess Teams in U.S. history.** He has played up to 35 people simultaneously to raise money for children’s charities. He currently coaches an inner city chess club.

Ten Predictions for 2016

- 1. U.S. stocks have a single digit % change for the second year in a row** – only the third time this has happened in the last 40 years. **S&P 500 earnings make limited headway** with many headwinds offsetting tailwinds. **Information technology, financials and telecommunications are sector leaders in the U.S.**
- 2. International blue chip stocks perform better than U.S. blue chip stocks.**
- 3. Small/Mid cap International stocks perform better than BRIC emerging markets.** Chinese economy continues to have problems but mostly kicks the can down the road, avoiding a hard landing.
- 4. Most high quality bonds have a lackluster year.** Yield curve flattens.
- 5. High yield bond spreads fall producing reasonable returns similar to stocks,** with higher risk HY bonds performing well despite periods of liquidity problems.

Ten Predictions for 2016

6. **Collapsed commodity prices, including oil, create a blanket of economic malaise worldwide** with a few high commodity consumer winners like India.
7. **U.S. economy grows around 2-2.5%**, below 5% GDP nominal rate for an entire decade – first time in history.
8. **Consumers in the U.S. (70% of the economy) remain resilient.** 40% are spending their \$1,000 average energy savings, 32% are paying down credit card debt, 20% are saving their windfall.
9. **Inflationary and deflationary forces continue to battle** – overall costs for each individual are very dependent on how they spend money. Health care inflation likely to increase.
10. **Employment trends remain good.** Possible upside hiring and wage growth surprises in 2016. Super Trend forces continue to dampen normal wage growth, plus both destroy jobs and create jobs at a very rapid pace.

2016 Scenarios

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- Should we worry about China?
- Global Economy – more modest growth with central bank support could create a “Goldilocks” environment.
- Super Trend forces are converging – disruptive innovation is growing.
- Federal Reserve interest rate hikes can be a good thing.
- Stock markets have become more volatile – what does the future hold?
- Bond uncertainty: *myth or reality?*
- What is an “Alternative” investment?
- Putting it all together – Action Plan.

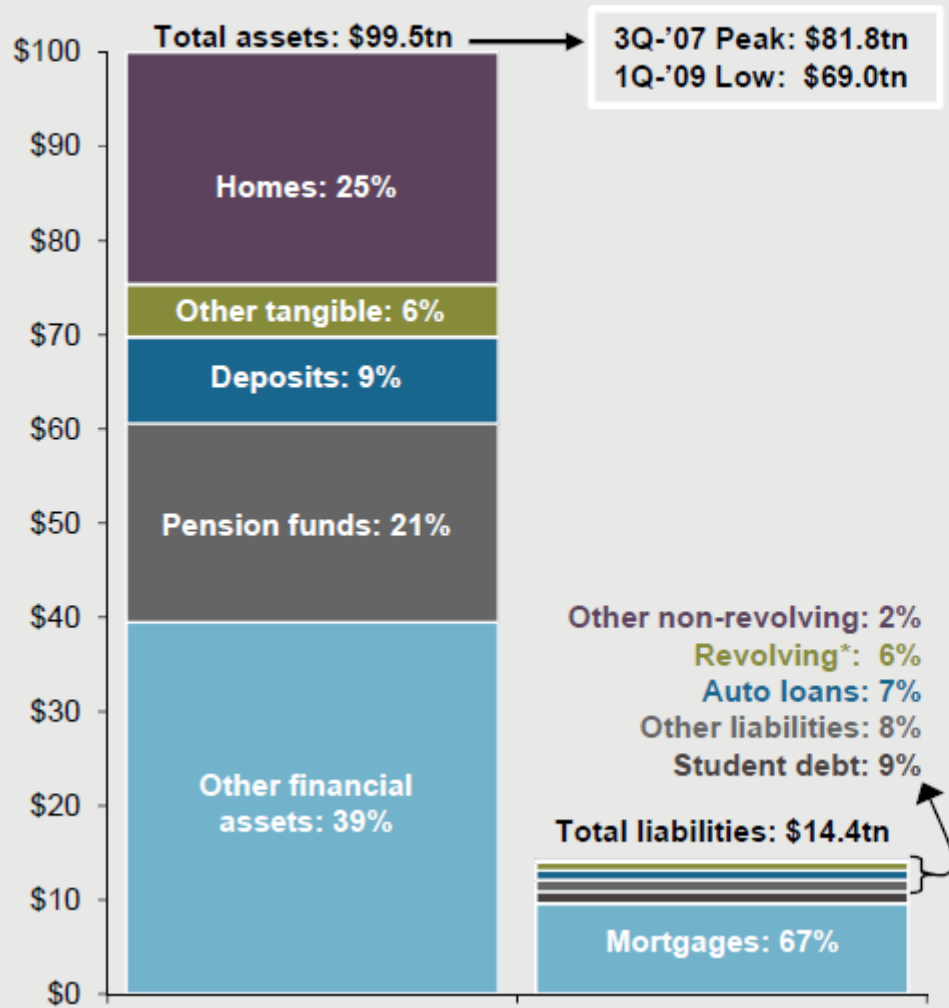
Key Issues for 2016

- **Low risk of official recession in U.S.** – 2.5% growth likely.
- **Rolling sector recessions around the world** caused by Super Trend forces.
- **Labor market better but many dislocations caused by second industrial revolution.**
- **Strong U.S. dollar** a problem for U.S. manufacturing, good for consumers.
- **Geo-political wildcard risks** remain elevated.
- **Investing:** time for “Goldilocks” strategy.
- **Distractions:** Asia, Middle East, Fed Watch and Big Short movie.

Consumer Finances

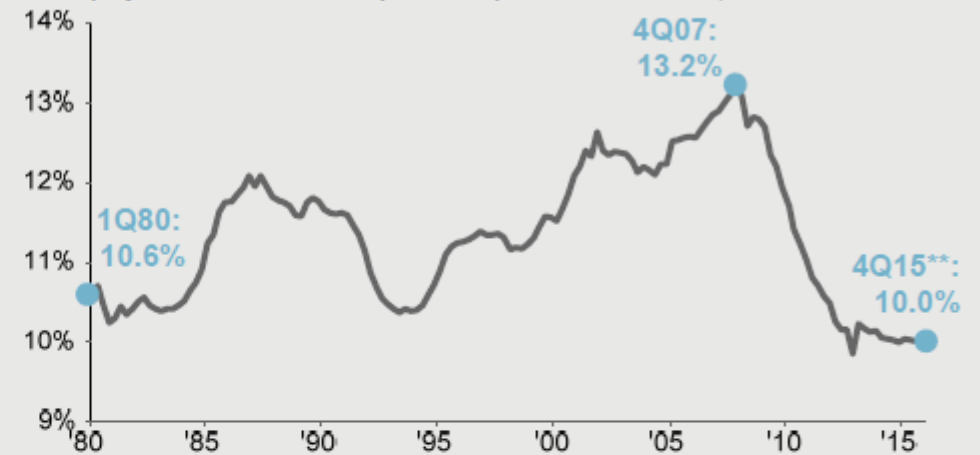
Consumer balance sheet

3Q15, trillions of dollars outstanding, not seasonally adjusted



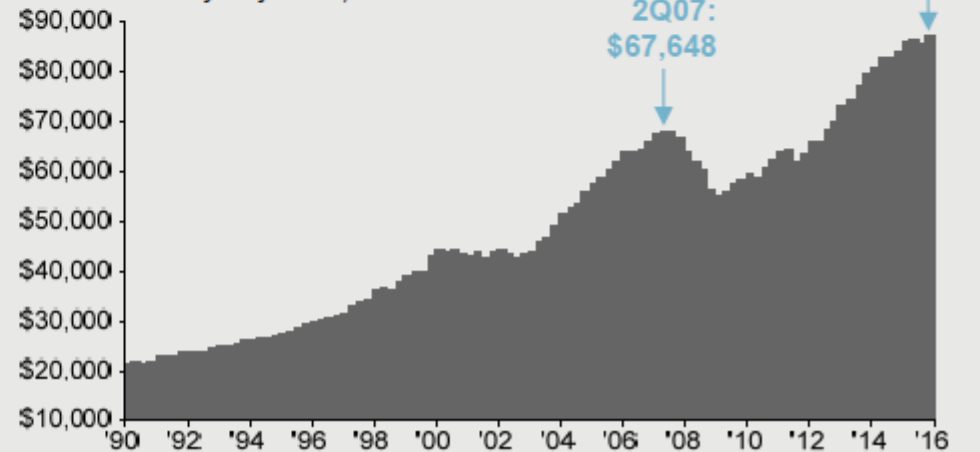
Household debt service ratio

Debt payments as % of disposable personal income, SA



Household net worth

Not seasonally adjusted, USD billions



Source: FactSet, FRB, J.P. Morgan Asset Management; (Top and bottom right) BEA.

Data include households and nonprofit organizations. SA – seasonally adjusted.

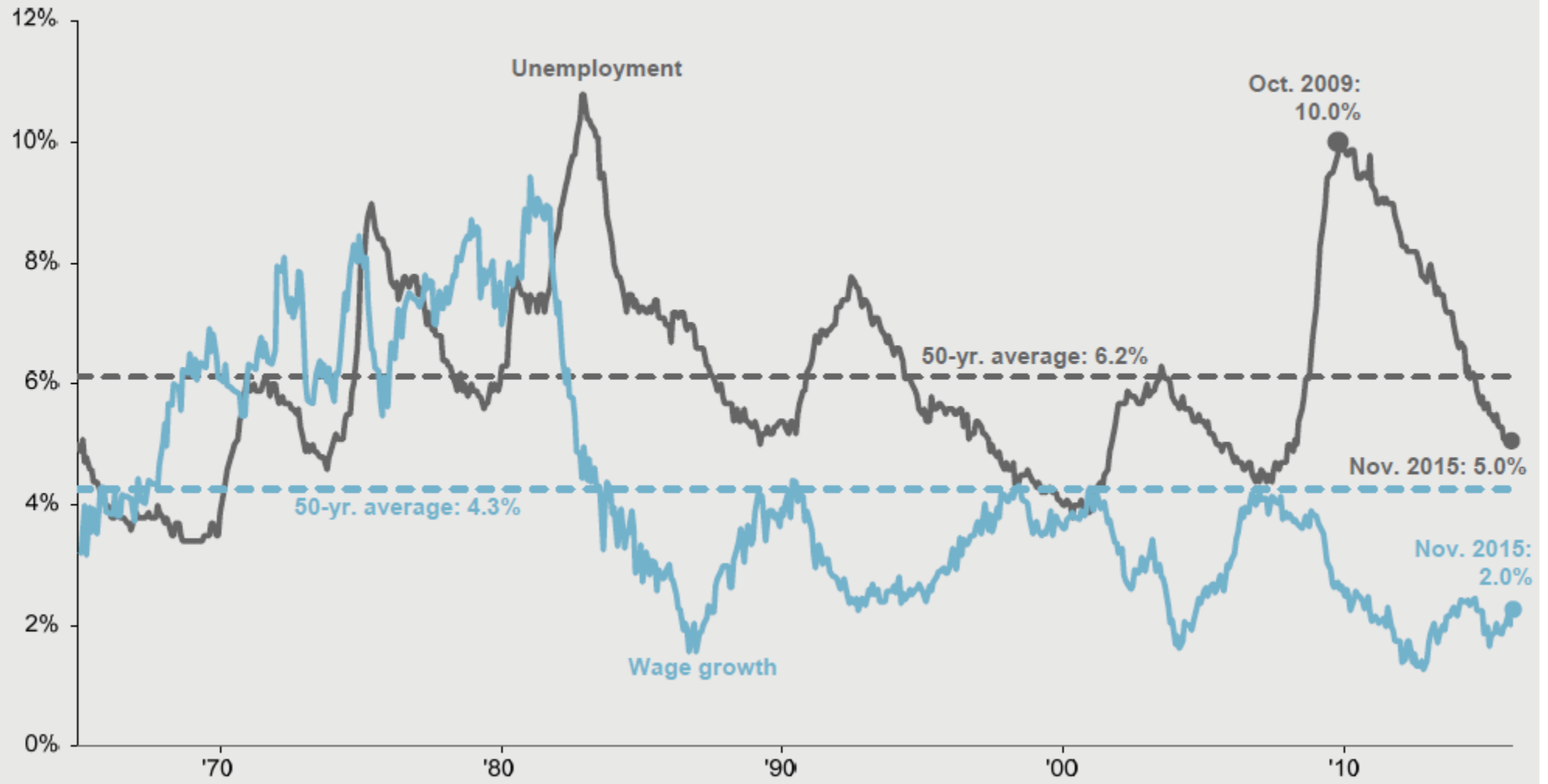
*Revolving includes credit cards. **4Q15 household debt service ratio and household net worth are J.P. Morgan Asset Management estimates.

Values may not sum to 100% due to rounding.

Guide to the Markets – U.S. Data are as of December 31, 2015.

Unemployment and Wages

Civilian unemployment rate and year-over-year growth in wages of production and non-supervisory workers
Seasonally adjusted, percent



Source: BLS, FactSet, J.P. Morgan Asset Management.
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China Paradox

China is transitioning to a consumer driven economy:

Good News:

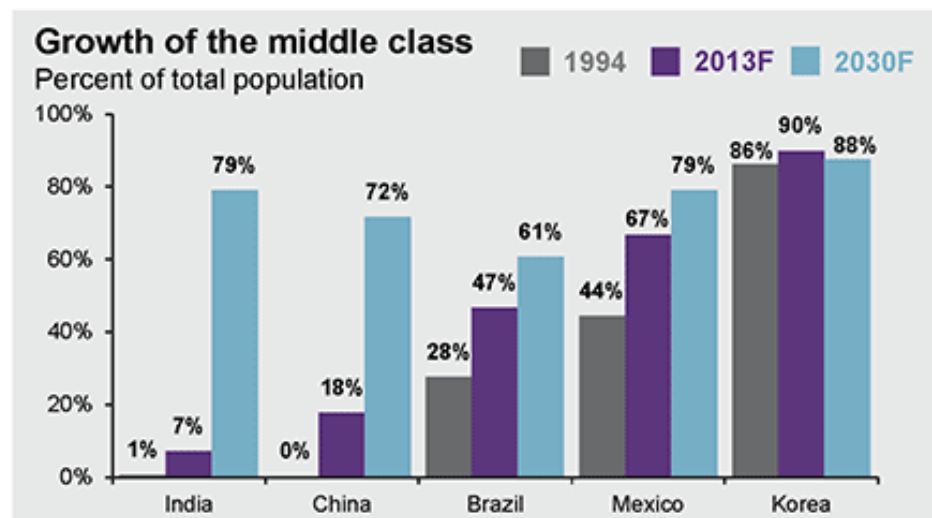
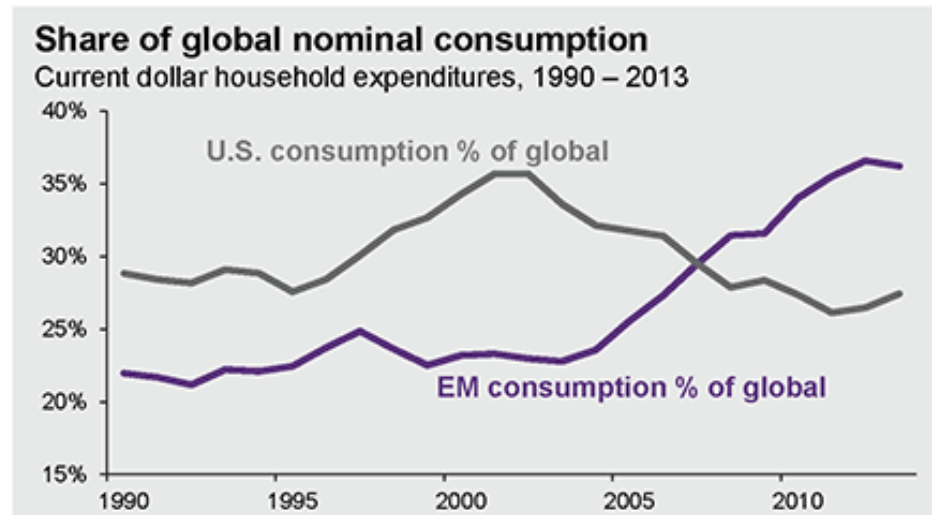
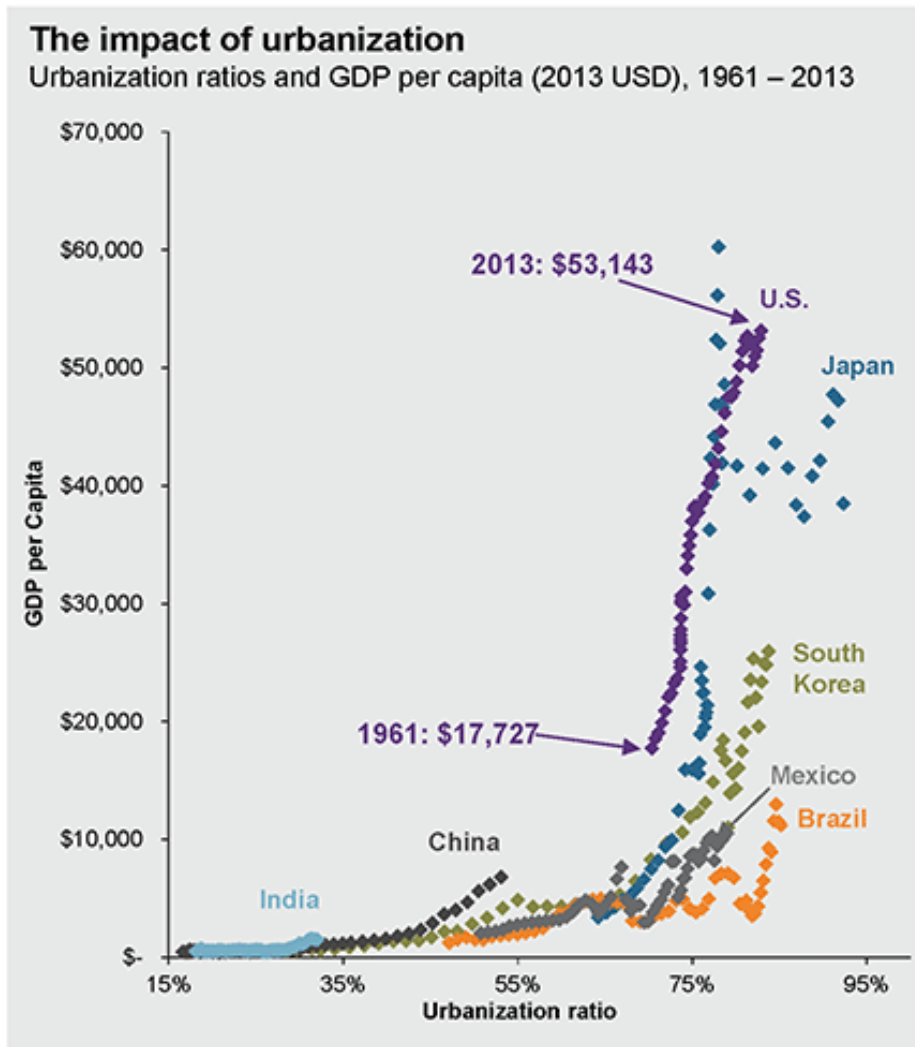
- Parallels with U.S. Industrial Revolution (i.e. messy but powerful).
- Growing Urban Middle Class.
- Low Direct Impact to U.S. Economy.

Bad News:

- China's Growth Rate is slowing as economy matures.
- Stock Market Volatility: Retail Investor Speculation (i.e. margin debt) and Government Missteps (i.e. intervention and currency management).
- End of Commodity Supercycle?
- Significant uncertainty about the future of China over the next few decades. Corruption enforcement still in early innings.

Chinese Government Intervention: Good News or Bad News?

Emerging Markets in Transition



Source: The Brookings Institution, World Bank, United Nations J.P. Morgan Asset Management.

Real GDP per Capita numbers are current U.S. dollar GDP per capita figures from the World Bank, adjusted by the 2013 U.S. dollar GDP deflator. Middle class is defined as \$3,600-\$36,000 annual per capita income in purchasing power parity terms. Historical and forecast figures come from the Brookings Development, Aid and Governance Indicators.

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Global Manufacturing Momentum

Global Purchasing Managers' Index for manufacturing

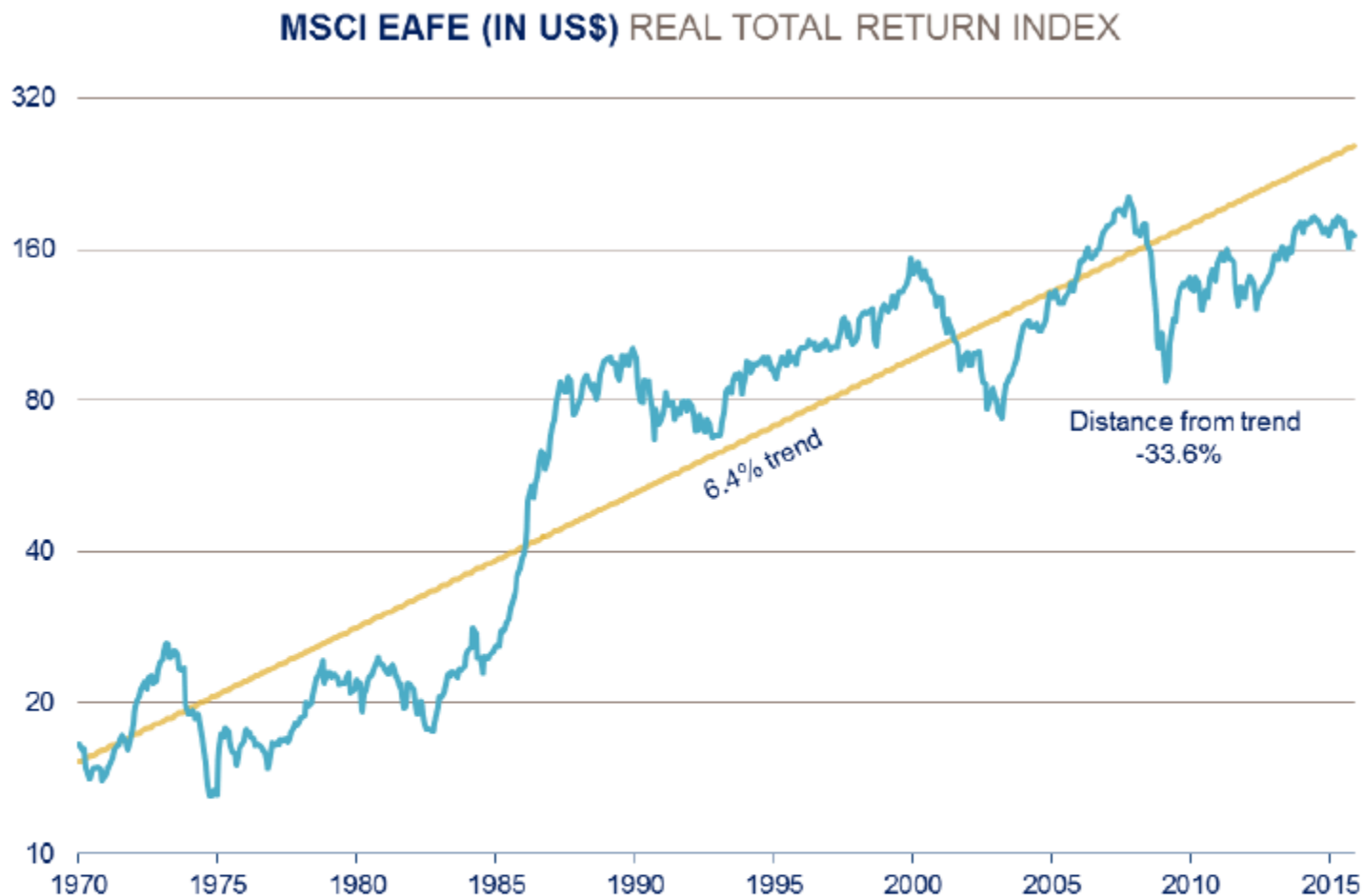
	Jan'14	Feb'14	Mar'14	Apr'14	May'14	Jun'14	Jul'14	Aug'14	Sep'14	Oct'14	Nov'14	Dec'14	Jan'15	Feb'15	Mar'15	Apr'15	May'15	Jun'15	Jul'15	Aug'15	Sep'15	Oct'15	Nov'15	Dec'15
Global	52.9	53.1	52.4	51.9	52.2	52.6	52.4	52.5	52.2	52.2	51.8	51.5	51.7	51.9	51.7	51.0	51.3	51.0	51.1	50.7	50.7	51.3	51.2	50.9
Developed Markets	54.6	55.5	54.3	53.2	53.5	54.1	53.2	54.1	53.6	53.5	52.8	52.4	52.5	52.8	53.0	52.1	52.4	52.1	52.5	52.4	52.1	53.1	52.6	-
Emerging Markets	50.6	50.0	49.6	49.5	50.1	50.4	51.2	50.5	50.4	50.5	50.6	50.4	50.8	50.9	49.8	49.3	49.4	49.2	48.8	48.3	48.3	48.9	49.0	-
U.S.	53.7	57.1	55.5	55.4	56.4	57.3	55.8	57.9	57.5	55.9	54.8	53.9	53.9	55.1	55.7	54.1	54.0	53.6	53.8	53.0	53.1	54.1	52.8	51.2
Canada	51.7	52.9	53.3	52.9	52.2	53.5	54.3	54.8	53.5	55.3	55.3	53.9	51.0	48.7	48.9	49.0	49.8	51.3	50.8	49.4	48.6	48.0	48.6	47.5
U.K.	56.6	55.9	54.8	57.2	56.6	56.9	54.9	53.3	51.8	53.0	53.5	52.6	52.9	53.8	53.8	51.7	51.9	51.5	52.0	51.8	51.7	55.2	52.7	51.9
Euro Area	54.0	53.2	53.0	53.4	52.2	51.8	51.8	50.7	50.3	50.6	50.1	50.6	51.0	51.0	52.2	52.0	52.2	52.5	52.4	52.3	52.0	52.3	52.8	53.1
Germany	56.5	54.8	53.7	54.1	52.3	52.0	52.4	51.4	49.9	51.4	49.5	51.2	50.9	51.1	52.8	52.1	51.1	51.9	51.8	53.3	52.3	52.1	52.9	53.2
France	49.3	49.7	52.1	51.2	49.6	48.2	47.8	46.9	48.8	48.5	48.4	47.5	49.2	47.6	48.8	48.0	49.4	50.7	49.6	48.3	50.6	50.6	50.6	51.4
Italy	53.1	52.3	52.4	54.0	53.2	52.6	51.9	49.8	50.7	49.0	49.0	48.4	49.9	51.9	53.3	53.8	54.8	54.1	55.3	53.8	52.7	54.1	54.9	55.6
Spain	52.2	52.5	52.8	52.7	52.9	54.6	53.9	52.8	52.6	52.6	54.7	53.8	54.7	54.2	54.3	54.2	55.8	54.5	53.6	53.2	51.7	51.3	53.1	53.0
Greece	51.2	51.3	49.7	51.1	51.0	49.4	48.7	50.1	48.4	48.8	49.1	49.4	48.3	48.4	48.9	46.5	48.0	46.9	30.2	39.1	43.3	47.3	48.1	50.2
Ireland	52.8	52.9	55.5	56.1	55.0	55.3	55.4	57.3	55.7	56.6	56.2	56.9	55.1	57.5	56.8	55.8	57.1	54.6	56.7	53.6	53.8	53.6	53.3	54.2
Australia	46.7	48.6	47.9	44.8	49.2	48.9	50.7	47.3	46.5	49.4	50.1	46.9	49.0	45.4	46.3	48.0	52.3	44.2	50.4	51.7	52.1	50.2	52.5	51.9
Japan	56.6	55.5	53.9	49.4	49.9	51.5	50.5	52.2	51.7	52.4	52.0	52.0	52.2	51.6	50.3	49.9	50.9	50.1	51.2	51.7	51.0	52.4	52.6	52.6
China	49.5	48.5	48.0	48.1	49.4	50.7	51.7	50.2	50.2	50.4	50.0	49.6	49.7	50.7	49.6	48.9	49.2	49.4	47.8	47.3	47.2	48.3	48.6	48.2
Indonesia	51.0	50.5	50.1	51.1	52.4	52.7	52.7	49.5	50.7	49.2	48.0	47.6	48.5	47.5	46.4	46.7	47.1	47.8	47.3	48.4	47.4	47.8	46.9	47.8
Korea	50.9	49.8	50.4	50.2	49.5	48.4	49.3	50.3	48.8	48.7	49.0	49.9	51.1	51.1	49.2	48.8	47.8	46.1	47.6	47.9	49.2	49.1	49.1	50.7
Taiwan	55.5	54.7	52.7	52.3	52.4	54.0	55.8	56.1	53.3	52.0	51.4	50.0	51.7	52.1	51.0	49.2	49.3	46.3	47.1	46.1	46.9	47.8	49.5	51.7
India	51.4	52.5	51.3	51.3	51.4	51.5	53.0	52.4	51.0	51.6	53.3	54.5	52.9	51.2	52.1	51.3	52.6	51.3	52.7	52.3	51.2	50.7	50.3	49.1
Brazil	50.8	50.4	50.6	49.3	48.8	48.7	49.1	50.2	49.3	49.1	48.7	50.2	50.7	49.6	46.2	46.0	45.9	46.5	47.2	45.8	47.0	44.1	43.8	45.6
Mexico	54.0	52.0	51.7	51.8	51.9	51.8	51.5	52.1	52.6	53.3	54.3	55.3	56.6	54.4	53.8	53.8	53.3	52.0	52.9	52.4	52.1	53.0	53.0	52.4
Russia	48.0	48.5	48.3	48.5	48.9	49.1	51.0	51.0	50.4	50.3	51.7	48.9	47.6	49.7	48.1	48.9	47.6	48.7	48.3	47.9	49.1	50.2	50.1	48.7

Source: Markit, J.P. Morgan Asset Management.

Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown.

Guide to the Markets – U.S. Data are as of December 31, 2015.

Developed International Stocks Remain Below Long-Term Trend



Past Performance is no guarantee of future results.

Source: RiverFront Investment Group, MSCI. Data from Jan 1970 through Nov 2015. Investments in international and emerging markets securities include exposure to risks including currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability.

The MSCI EAFE Index measures the equity market performance of developed markets, excluding the US & Canada. The index consisted of indices from 22 developed markets. The index consisted of indices from 22 developed markets. MSCI presents the data for this index in terms of US dollars and in terms of local currencies. The chart above reflects index data in terms of US dollars. It is not possible to invest directly in an index.

RiverFront is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940. RiverFront manages a variety of asset allocation portfolios utilizing stocks, bonds, and ETFs. Opinions expressed in this presentation are those of RiverFront Investment Group and subject to change based on market, economic and other conditions.

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The pace of change
is increasing at **10 times the speed** of the
First Industrial Revolution
and the **power is 300 times**, which equals
3000 times the impact of
this Second Industrial Revolution
versus the last one.

– McKinsey and Co. 2015 Report

How Converging Super Trends Affected 2015

1. **Struggling top line company revenue growth** (demographic shifts, technology accelerators, globalization).
2. **Crashing energy prices** (technology accelerators, globalization).
3. **Deflation wrestles Inflation to a draw** (demographic shifts, technology accelerators, globalization).
4. **Unsettling job market shifts** (demographic shifts, technology accelerators, globalization).
5. **Germany becomes a compassion leader** (demographic shifts).
6. **China's sputtering growth** (globalization, urbanization, technology accelerators, demographic shifts).
7. **Strange U.S. Presidential Race** (demographic shifts, technology accelerators, globalization).

**What would it mean
to U.S. stock index funds
if 100 of the
Fortune 500 companies
went the way of
Eastman Kodak?**

Surviving the Greatest Change of Our Time

1. Learn more about the many tsunami waves of change that lie ahead – read:
No Ordinary Disruption (Dobbs, Manyika, Woetzel)
2. Consider how Super Trends converging will affect:
 - a) Your investments and other asset classes
 - b) The U.S. and global economy
 - c) Your career, business or retirement
 - d) Geo-political trends and U.S. Political trends
 - e) Your personal finance behaviors – watch for money script emotional landmines!



Would you rather surf the wave...

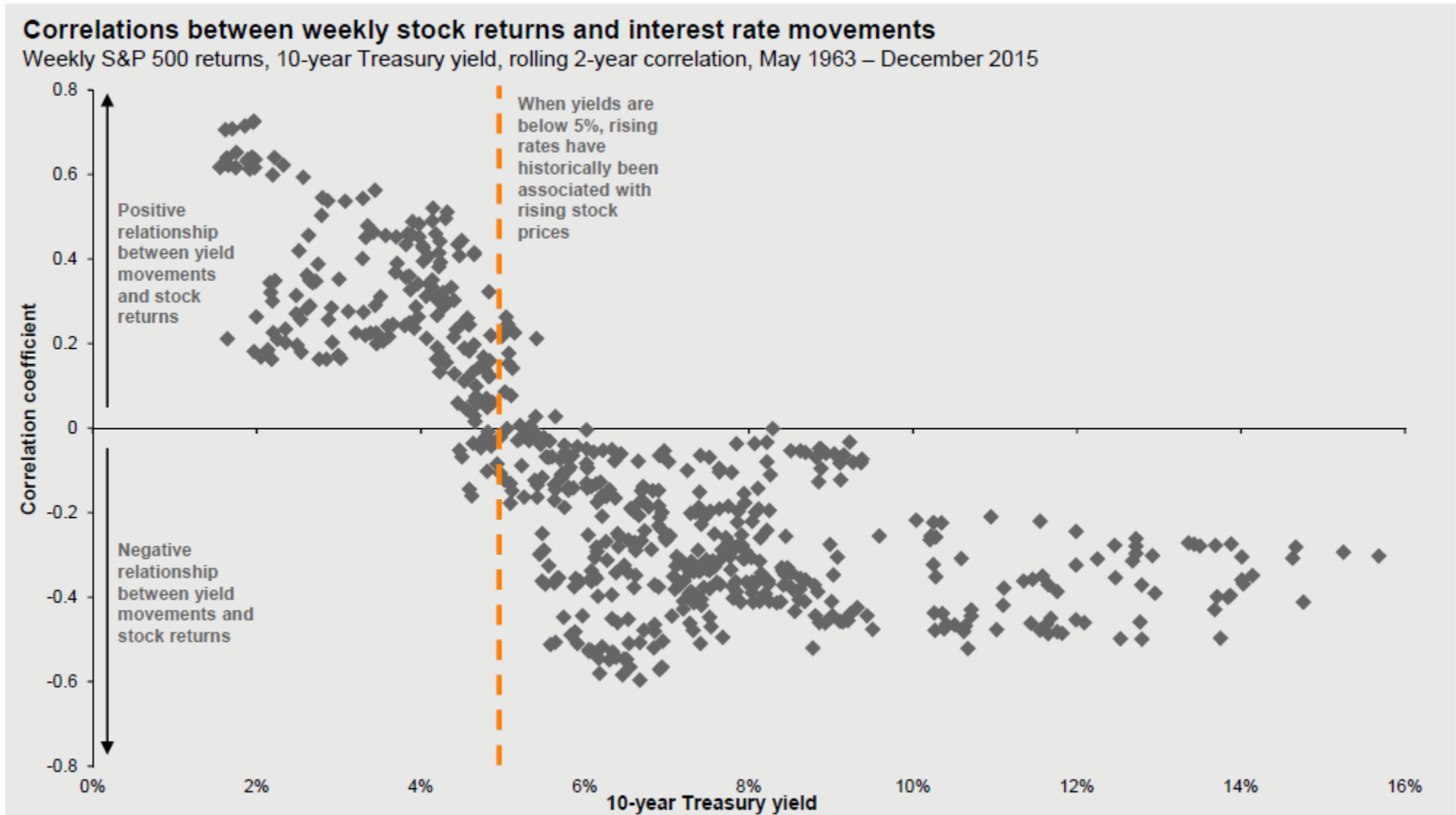
... or be crushed by it?



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Interest Rates and Stock Returns



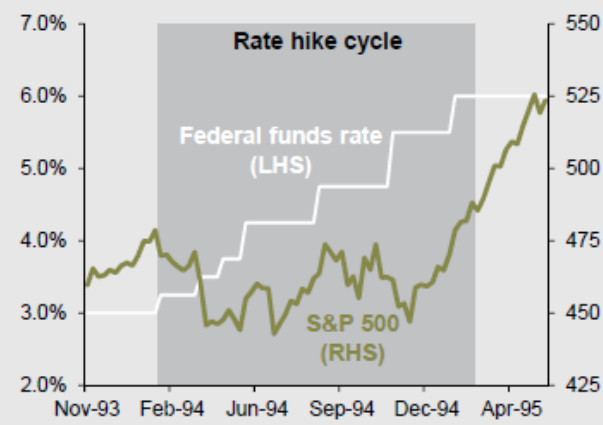
Source: FactSet, Standard & Poor's, FRB, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Markers represent monthly 2-year correlations only.
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Historical Impacts of Rate Increases

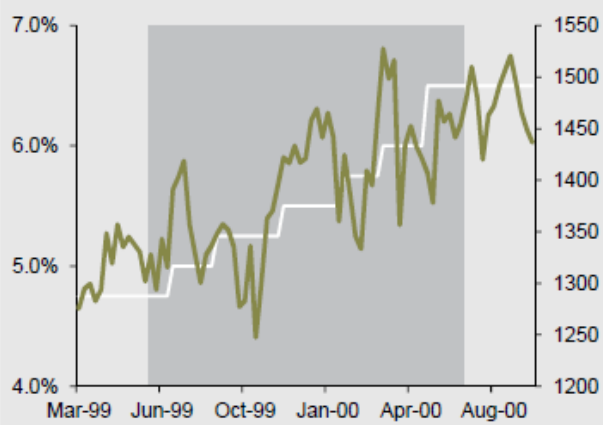
Returns and yield changes during rate hiking cycles

S&P 500 price index and 10-year U.S. Treasury yield over the last three rate hiking cycles

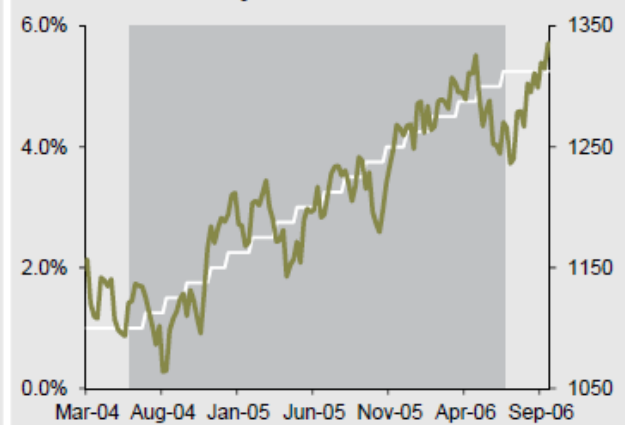
February 1994 – March 1995



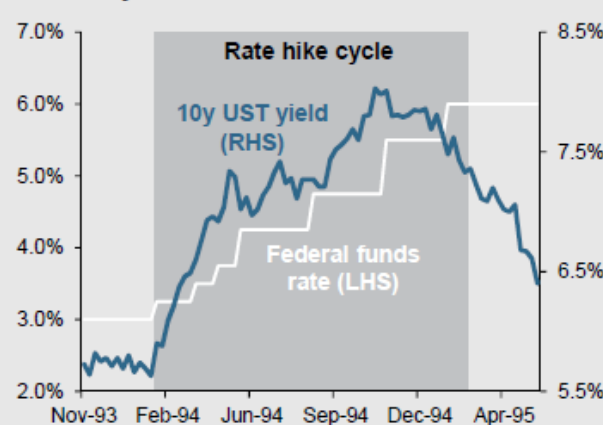
June 1999 – June 2000



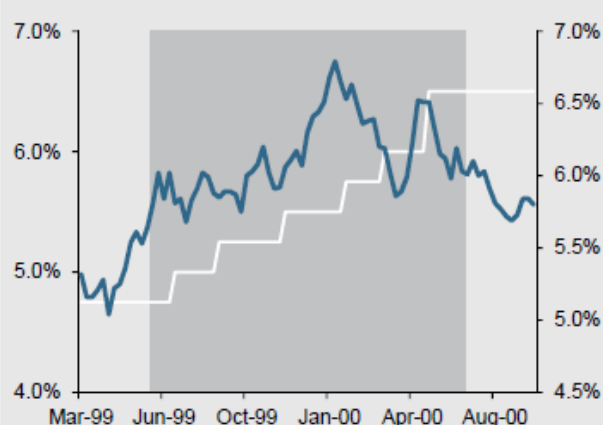
June 2004 – July 2006



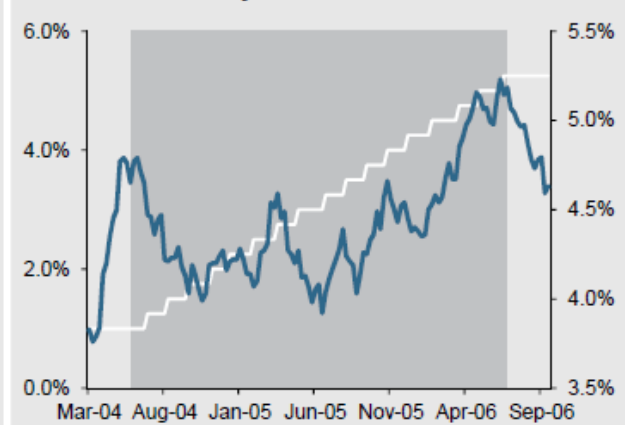
February 1994 – March 1995



June 1999 – June 2000



June 2004 – July 2006



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
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1999 Ground Hog Day?

- **Top 10 stocks** (by market capitalization) were **up 17%** in 2015.
- The **other 490 stocks** in the S&P 500 index were **down 5%** in 2015.
- **“FANG” effect** – Facebook, Amazon, Netflix and Google.
- **Similar to narrow U.S. stock market in 1999.** Note **“old economy” stocks outperformed** in the ensuing eight years.
- **Major wildcard:** U.S. Dollar

Source: *Tale of Two Cities*, Rosenau

Bear Markets ex-Recession are Rare

Characteristics of past bear markets

◆	Market Corrections	Cycle Peak	Bull Market Duration (Months)	Decline from All-time High	Recession	Commodity Spike	Aggressive Fed Tightening	Extreme Valuations	Commentary
1	Crash of 1929	Aug 1929	37	-84%	◆			◆	Excessive leverage, irrational exuberance
2	1937 Fed Tightening	Feb 1937	22	-74%	◆		◆		Premature monetary tightening
3	Post WWII Crash	May 1946	48	-54%	◆			◆	Post-war demobilization, recession fears
4	Flash Crash of 1962	Dec 1961	14	-22%				◆	Flash crash, Cuban Missile Crisis
5	Tech Crash of 1970	Dec 1968	73	-29%	◆	◆	◆		Economic overheating, civil unrest
6	Stagflation	Dec 1972	29	-43%	◆	◆			OPEC oil embargo
7	Volcker Tightening	Nov 1980	31	-19%	◆	◆	◆		Extremely high rates to rein in inflation
8	1987 Crash	Aug 1987	59	-27%					Program trading, overheated market
9	Tech Bubble	Aug 2000	118	-42%	◆			◆	Extreme valuations, mostly in tech stocks
10	Global Financial Crisis	Oct 2007	55	-51%	◆	◆	◆		Leverage, housing, Lehman collapse

Source: FactSet, NBER, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.

*A bear market represents a 20% or more decline from the previous market high using a monthly frequency.

Periods of "Recession" are defined using NBER business cycle dates. "Commodity Spikes" are defined as significant rapid upward moves in oil prices.

Periods of "Extreme Valuations" are those where S&P 500 last twelve months P/E levels were approximately two standard deviations above long run averages.

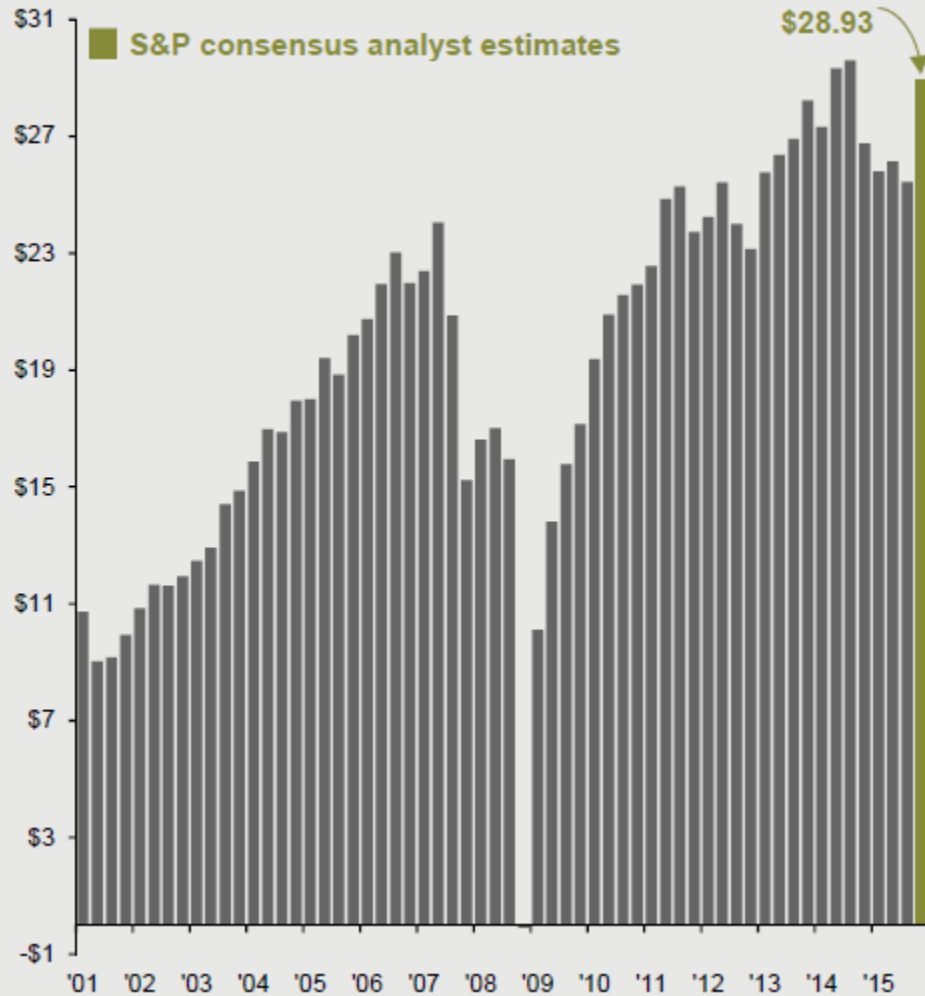
"Aggressive Fed Tightening" is defined as Federal Reserve monetary tightening that was unexpected and significant in magnitude.

Guide to the Markets – U.S. Data are as of September 30, 2015.

Impact of Energy and U.S. Dollar on S&P 500 Earnings

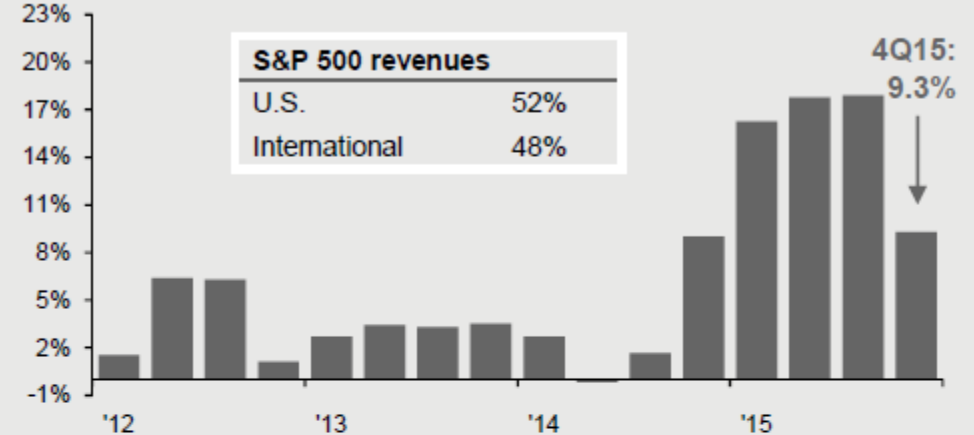
S&P 500 earnings per share

Index quarterly operating earnings



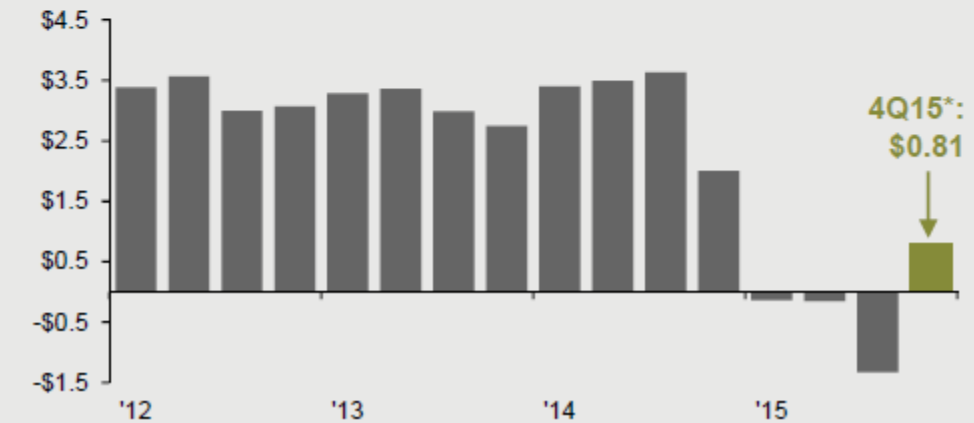
U.S. dollar

Year-over-year % change, quarterly, USD major currencies index



Energy sector earnings

Energy sector contribution to S&P 500 EPS, quarterly



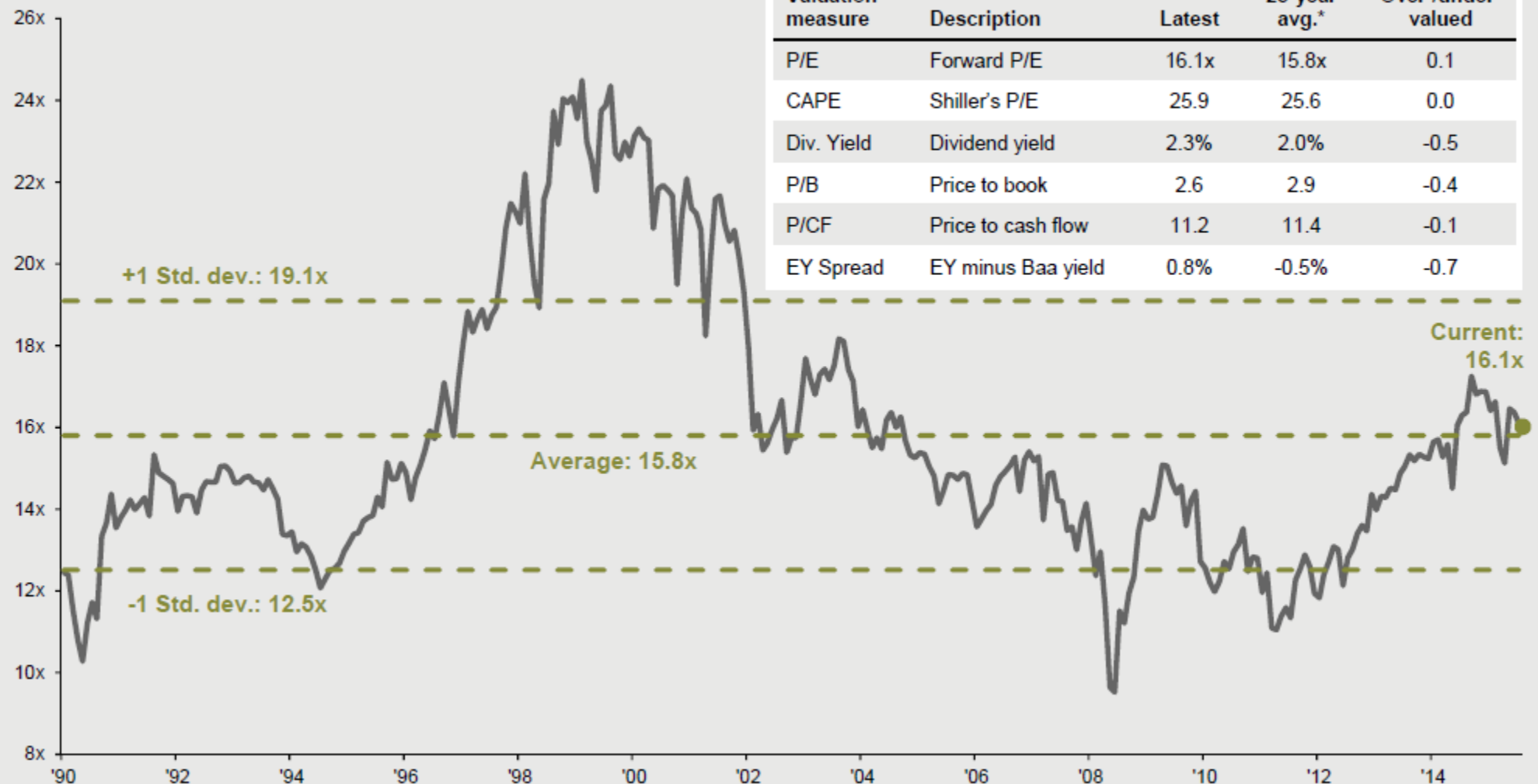
Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Top right) Federal Reserve, S&P 500 individual company 10k filings, S&P Index Alert.

EPS levels are based on operating earnings per share. *4Q earnings estimates are Standard & Poor's consensus analyst expectations. Past performance is not indicative of future returns. Currencies in the Trade Weighted U.S. Dollar Major Currencies Index are: British pound, Euro, Swedish kroner, Australian dollar, Canadian dollar, Japanese yen and Swiss franc.

Guide to the Markets – U.S. Data are as of December 31, 2015.

S&P Valuation Measures

S&P 500 Index: Forward P/E ratio



Source: FactSet, FRB, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.

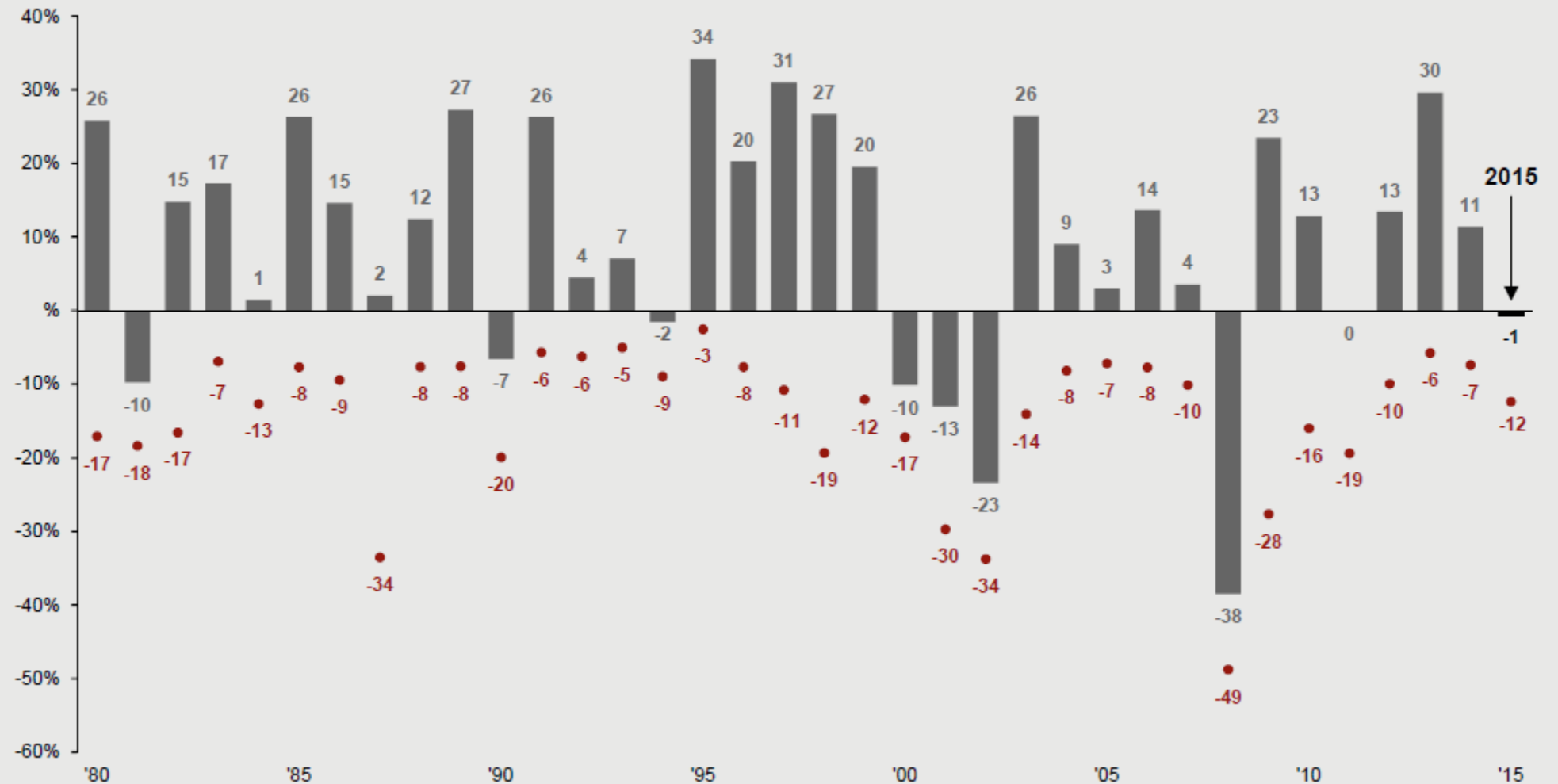
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Price to book ratio is the price divided by book value per share. Price to cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure. *P/CF is a 20-year average due to cash flow data availability.

Guide to the Markets – U.S. Data are as of December 31, 2015.

S&P 500 Annual Returns and Intra-Year Declines

S&P 500 intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.2%, annual returns positive in 27 of 36 years

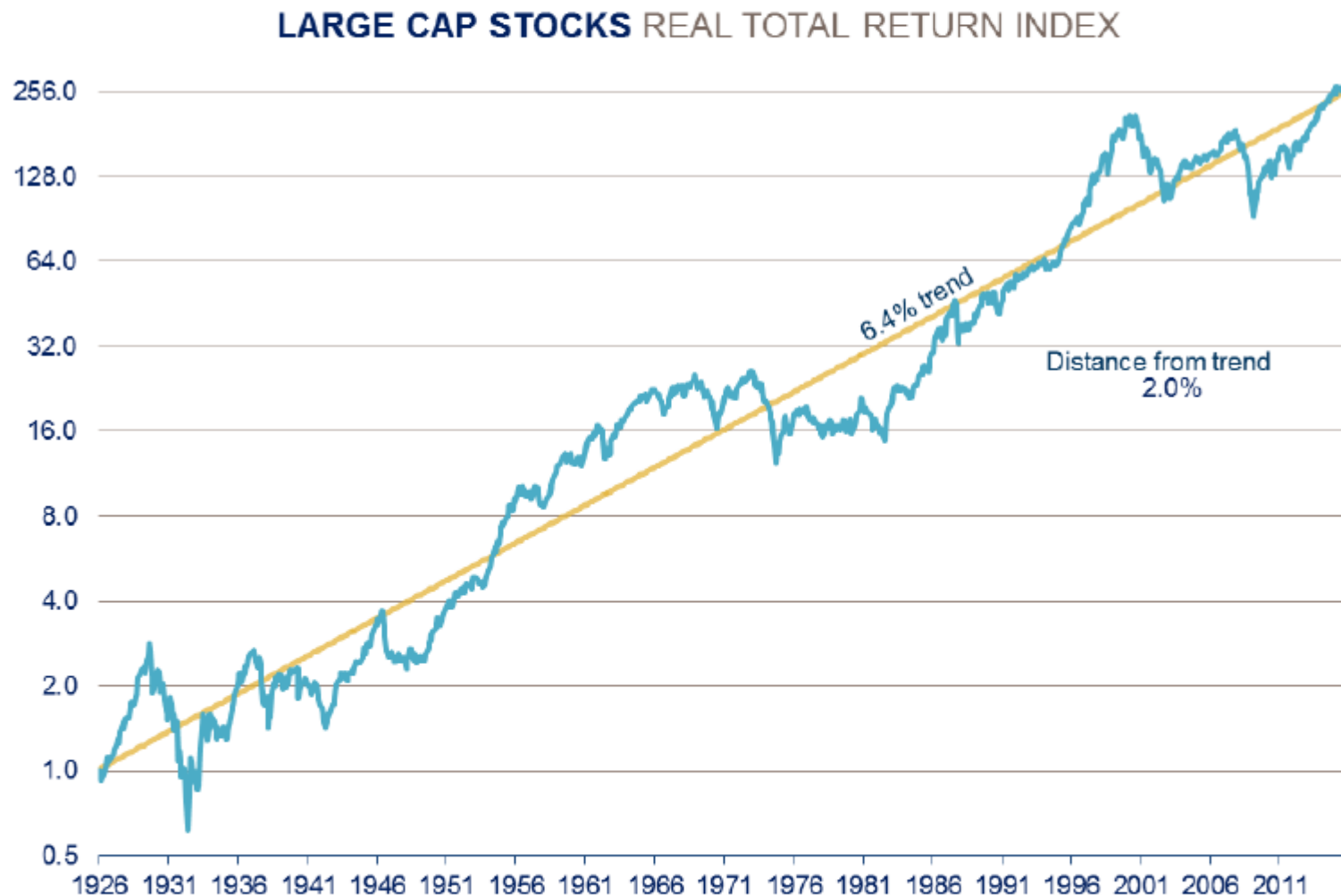


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2015.

Guide to the Markets - U.S. Data are as of December 31, 2015.

Large Cap U.S. Stocks vs. Long-Term Trend

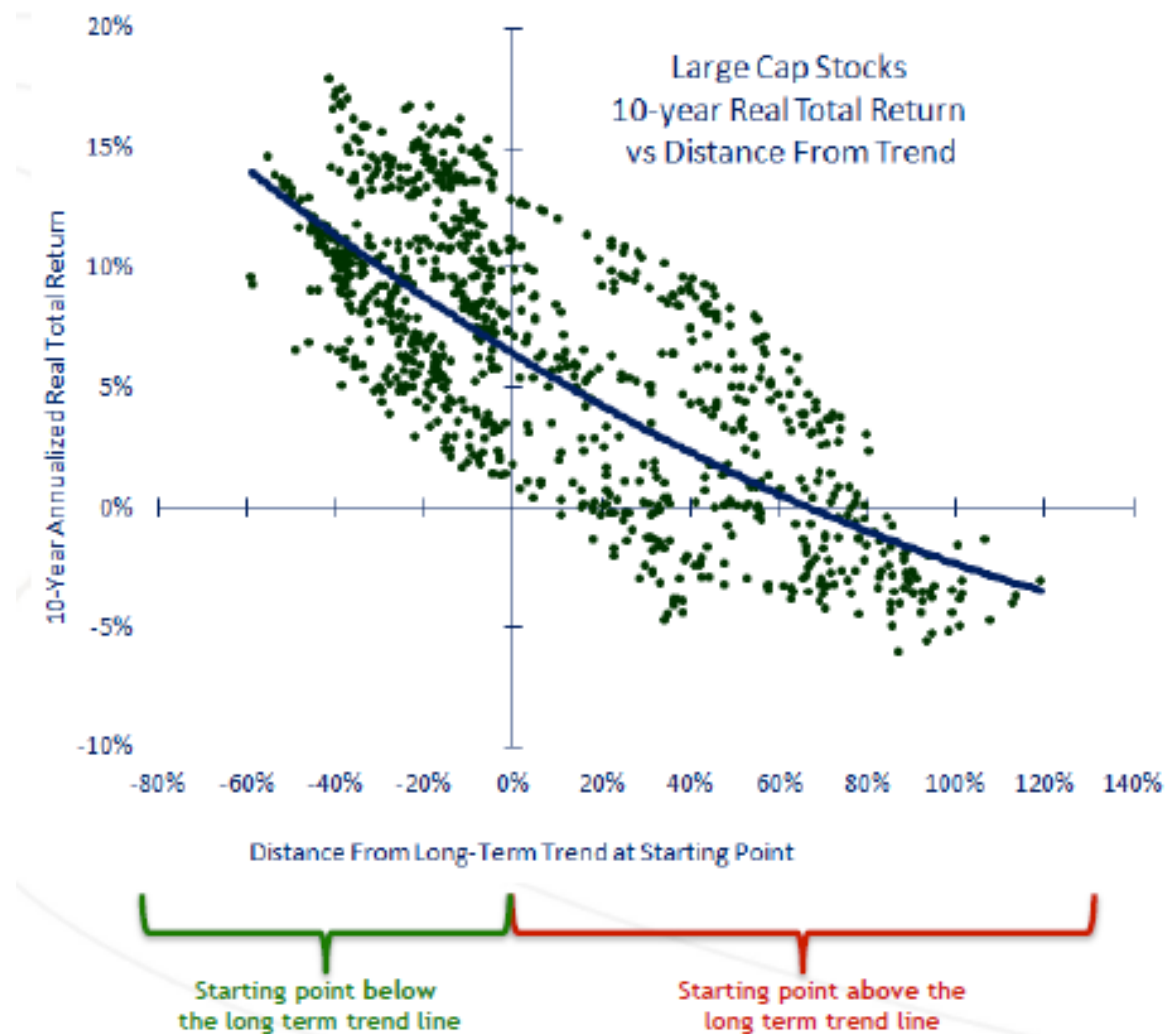


Past Performance is no guarantee of future results.

Source: RiverFront Investment Group, calculated based on data from CRSP 1925 US Indices Database ©2015 Center for Research in Security Prices (CRSP®), Booth School of Business, The University of Chicago. Data from Jan 1926 through Nov 2015. It is not possible to invest directly in an index. Large Cap Universe used in the charts is defined by CRSP based on market capitalization. CRSP Stock File Capitalization Decile Indices are calculated for each of the Stock File Indices market groups. In these Market Segment Indices all securities (excluding American Depositary Receipts) on a given exchange or combination of exchanges are ranked according to capitalization and then divided into ten equal parts each rebalancing period. The largest securities are placed in portfolio 10 and the smallest in portfolio 1.

RiverFront is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940. RiverFront manages a variety of asset allocation portfolios utilizing stocks, bonds, and ETFs. Opinions expressed in this presentation are those of RiverFront Investment Group and subject to change based on market, economic and other conditions.

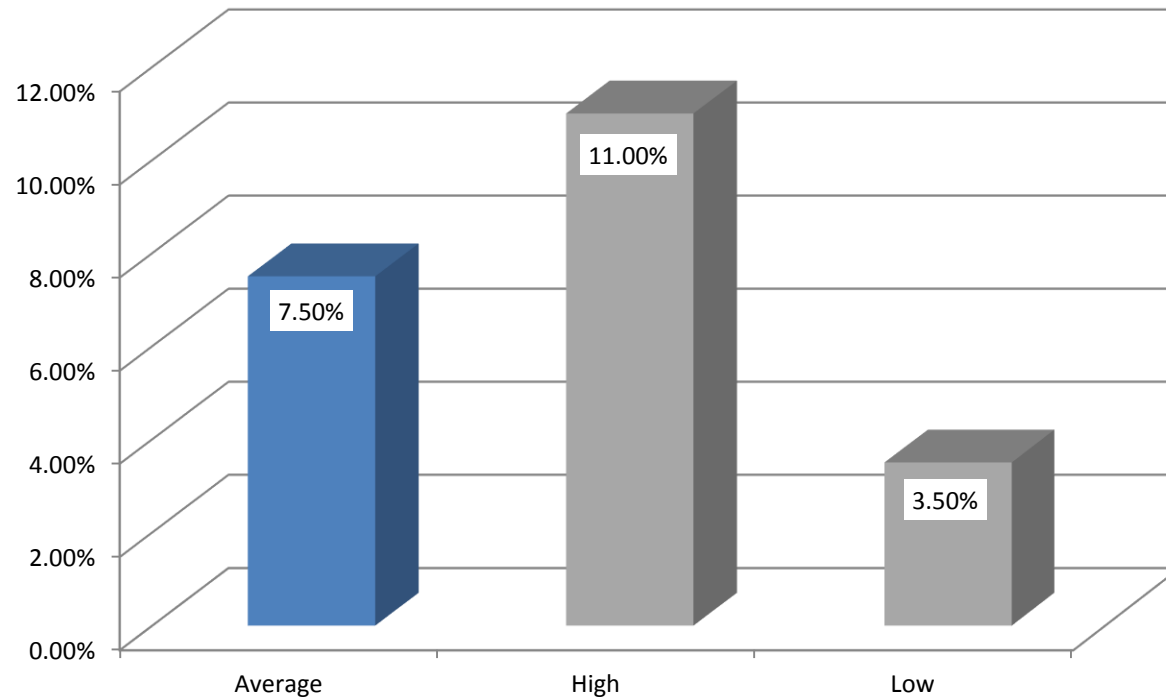
U.S. Large Cap Stock Returns Over Rolling 10-Year Periods



Source: RiverFront Investment Group, calculated based on data from CRSP 1925 US Indices Database ©2015 Center for Research in Security Prices (CRSP®), Booth School of Business, The University of Chicago. Data prior to 1926 from Robert J. Shiller. Past performance is no guarantee of future results. It is not possible to invest directly in an index. Data as of June 30, 2015.

10-Year Forward Projections

S&P 500 Stock Index



PROS

- Good potential returns in the next 10 years. Low return scenario in high quality stocks will likely exceed highest return scenario for bonds.
- Moderately tax efficient option with regular portfolio pruning.
- Excellent option for those with modest living expenses who can live off dividends alone.

CONS

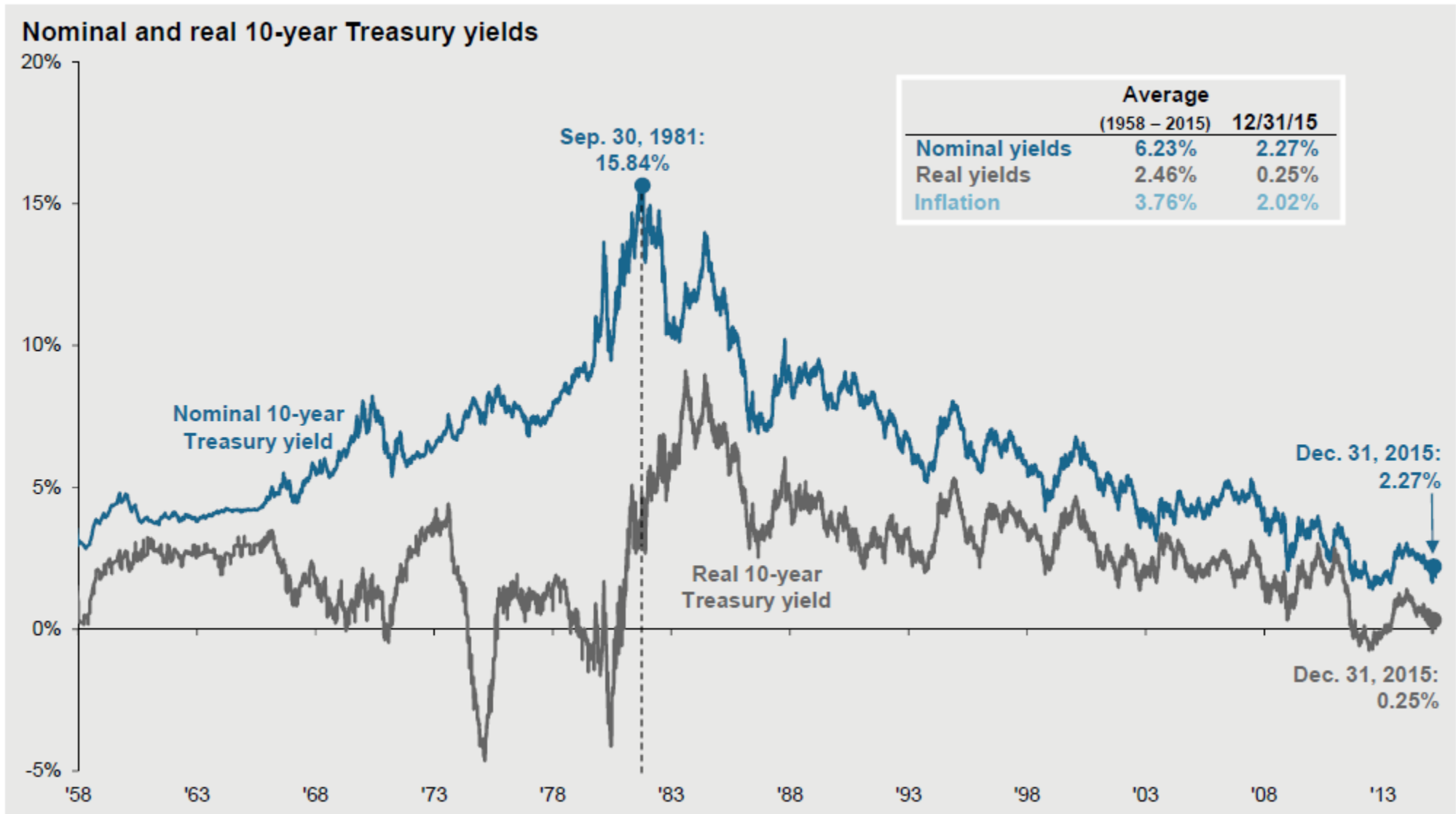
- Forward looking volatility may be 20-50% higher than the previous three years.
- Higher withdrawal rate retirees are not advised to have a high % in stocks, even if some alternatives are mixed in. Stocks sold for withdrawals during downturns never have ability to recover.
- Careful selection and pruning needed in Super Trend world.

NOTE: Downside and Upside do not reflect "worst case" and "best case," respectively. Returns illustrated are based on reasonable forward-looking guidance but are **not** guaranteed. Portfolio construction reflects globally diversified allocation to the various asset classes.

Today's Agenda

- U.S. Economic picture is solid, but not spectacular.
- Should we worry about China?
- Global Economy – more modest growth with central bank support could create a “Goldilocks” environment.
- Super Trend forces are converging – disruptive innovation is growing.
- Federal Reserve interest rate hikes are a good thing.
- Stock markets have become more volatile – what does the future hold?
- **Bond uncertainty: myth or reality?**
- What is an “Alternative” investment?
- Putting it all together – Action Plan.

Interest Rates and Inflation



Source: BLS, Federal Reserve, J.P. Morgan Asset Management.
 Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for December 2015, where real yields are calculated by subtracting out November 2015 year-over-year core inflation.
 Guide to the Markets – U.S. Data are as of December 31, 2015.

Four Bond Strategies for an Uncertain Future

All the following strategies **supplement “core” bond holdings:**

Strategy #1 – Go short-term

Strategy #2 – Use hybrids

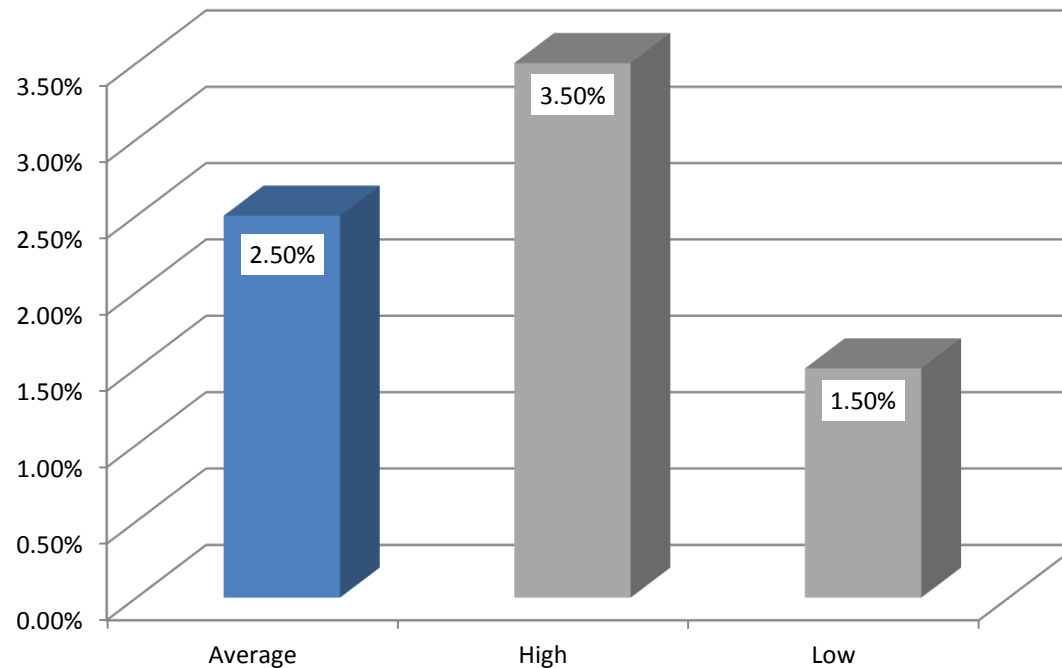
Strategy #3 – Underweight bonds and higher income securities

Strategy #4 – Substitute alternatives for bonds

Most individuals and institutions will want to use a combination of all 4 strategies.

10-Year Forward Projections

100% Bonds



PROS

- Rising interest rate environment makes this strategy more complex.
- Balance of high quality and special niche bonds will provide moderate protection in major market meltdowns.

CONS

- High net worth investors can "tread water" with short maturities – expect purchasing power loss of 12-15% in the next 10 years.
- Best and most stable returns will not be as tax efficient in the next 10 years.

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**Principal
Loss**

**Purchasing
Power
Loss**



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Alternative Investments

SFG Definition: any investment that provides diversification and return benefits that are **substantially different** than traditional cash, bonds and stocks. They can be liquid, semi-liquid or illiquid for varying time frames.

Not all alternatives are created equal.

SFG's View of the Alternative Landscape

Favorable:

- **Income-producing investment real estate** – currently prefer niche opportunities, diversified and single properties on case-by-case basis, low leverage (more conservative) to moderate leverage. Semi-liquid to illiquid.
- **Mezzanine lending** – niche and high-quality preferred.
- **Niche diversified funds** – good opportunities where big Wall Street firms and banks don't distort markets.
- **Private equity funds** – prudent risk, seasoned leadership.
- **Venture capital** – good people, good ideas, solid game plan – only for more aggressive investors.

SFG's View of the Alternative Landscape

Skeptical/Cautious:

- **Most hedge funds** – best funds are closed to new investment, many funds closing down in 2015, dismal returns and actual risk hedging in the last five years, substantially higher fees to justify, greater leverage and ability to mistime volatile markets.
- **High income investments with questionable structures** – these have proliferated as investors seek more income without regard to risk.
- **Real estate** – less skilled or experienced leadership, buying in overheated markets. Overvalued liquid REITs.
- **Directional funds** – usually high fees, sink or swim results. Oil and Gas direct ownership, high risk lending.

SFG's View of the Alternative Landscape

Unfavorable:

- **Real estate** – overvalued (high cap rate) income strategies.
- **Most annuities** – high fees, gimmicky structures, “airline points” interest guarantees, “can’t lose” propositions.
- **Tax dodges** – tax shelters have begun to reappear. If tax benefits outweigh economics, assume it will be challenged by the IRS.
- **Anything that smells like week old tuna or is the latest Wall Street “financial engineer” concept** – prevalent today as investors seek returns beyond stocks and bonds.

SFG's View of Unpopular "Alternatives"

- **High yield bonds** – recent sell-off has been overdone. Look for higher quality “junk.”
- **Pipeline MLPs** – collapsing prices have created some interesting opportunities. 70/30 that energy prices end 2016 higher.
- **Commodities** – multi-year decline has left many commodities (including oil) at levels that some say will be bargains in hindsight. Unclear if these markets have truly bottomed.
- **Emerging markets** – severe downturn in commodities has triggered the sell-off in emerging market stocks and bonds. Would wait for bottom in the next 12-18 months or focus on “go anywhere” small/mid international exposure.

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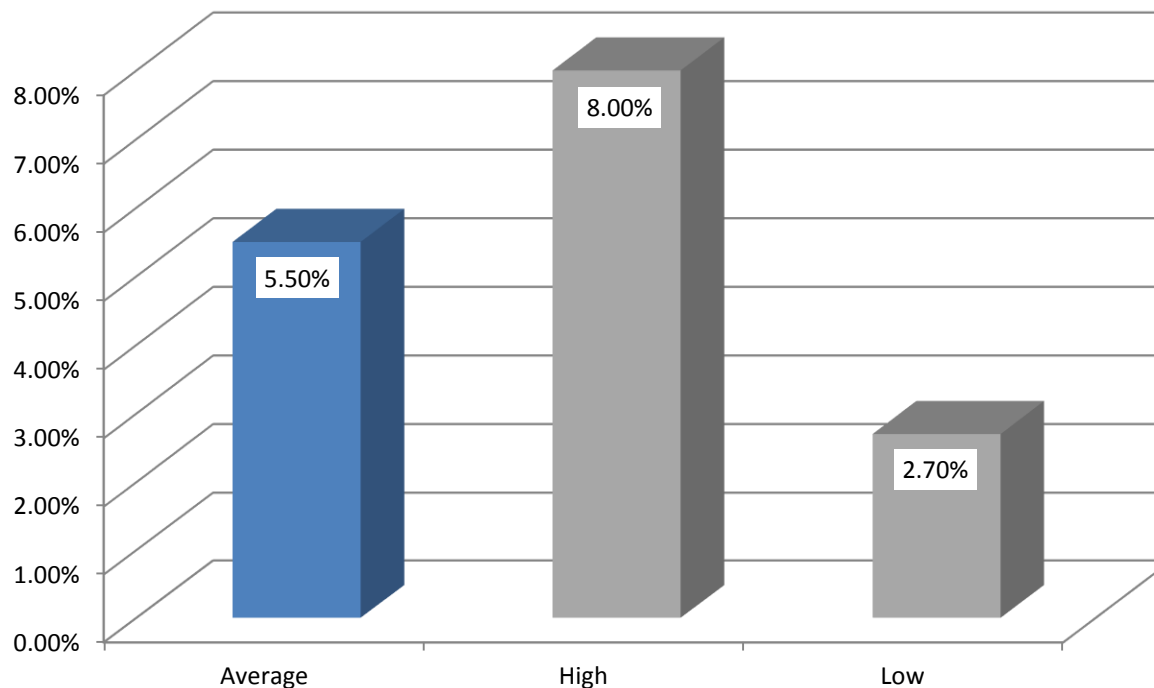
SFG 2016 Scenarios

SFG 2016 Forecast

Scenario Type	Base Case	Bear Case	Bull Case	
Concept	<i>Global economy continues to expand, albeit at a subpar pace, as global central bank policies remain accommodative even as the Fed gradually raises rates. Low interest rates continue to support risk assets.</i>	<i>Global growth decelerates due to deflationary pressures, policymaker missteps and/or a breakdown in a major region, such as Europe, Japan, or China. Geopolitical tensions remain a threat.</i>	<i>Global growth surprises, buoyed by accommodative central bank policies and improving economic and corporate fundamentals. Business and consumer sentiment improves while inflation remains stable. Risk of a future market selloff remains elevated.</i>	
Probability	55%	30%	15%	
U.S. GDP Growth	2.25% to 2.75%	0.75% to 1.5%	2.75% to 3.5%	
Fixed Income	U.S. 10 Year Interest Rate	2.50%	1.70%	3.00%
	U.S. 10 Year Total Return	Essentially Flat	7% to 8%	-4% to -5%
Global Equity Markets	<i>Modest potential gains as low interest rates and S&P earnings are supportive and P/E ratios grind higher. Volatility likely to continue.</i> <i>S&P 500 will end 2016 at 2150 representing an approximate 7% total return.</i>	<i>Global growth decelerates reigniting market's "worst case scenario" fears. Strong dollar weighs on corporate profits as foreign central banks continue to provide stimulus in support of their respective economies.</i> <i>S&P 500 will end 2016 at 1650 representing an approximate -17% total return.</i>	<i>Global growth surprises and P/E ratios expand. Interest rates and inflation pick up more than expected and begin to create headwinds for bonds. International equity markets outperform U.S., play "catch-up" following past few years of underperformance.</i> <i>S&P 500 will end 2016 at 2350 representing an approximate 17% total return.</i>	
Unemployment	4.8%	5.5%	4.6%	
Oil	\$45-\$55	\$30-\$40	\$55-\$65	
Inflation (Core CPI)	1.75% to 2.25%	1.25% to 1.75%	2.25 to 2.75%	

10-Year Forward Projections

60% Stock / 40% Bonds



PROS

- 60/40 allocation is the gold standard for retirees seeking a balance of growing income and principal with reasonable downside hedging.
- Lower volatility is appropriate for retirees or those with higher withdrawal rates.

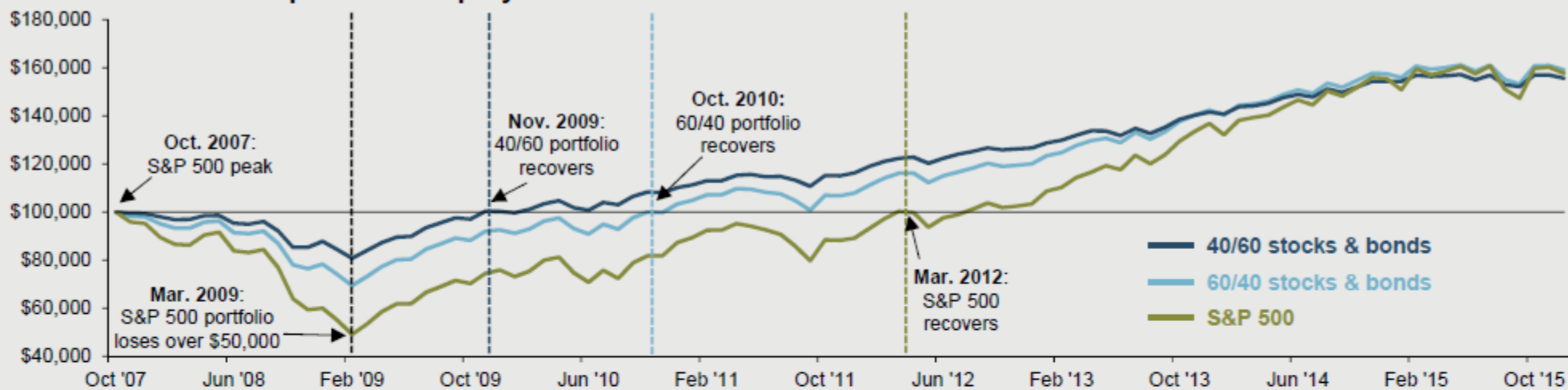
CONS

- Very unlikely returns going forward in a standard 60/40 portfolio will be as good as the last 10 years.
- If one spouse has long life expectancy, 60/40 may struggle to maintain purchasing power.
- Carefully manage bonds to achieve positive returns with continued downside risk protection.

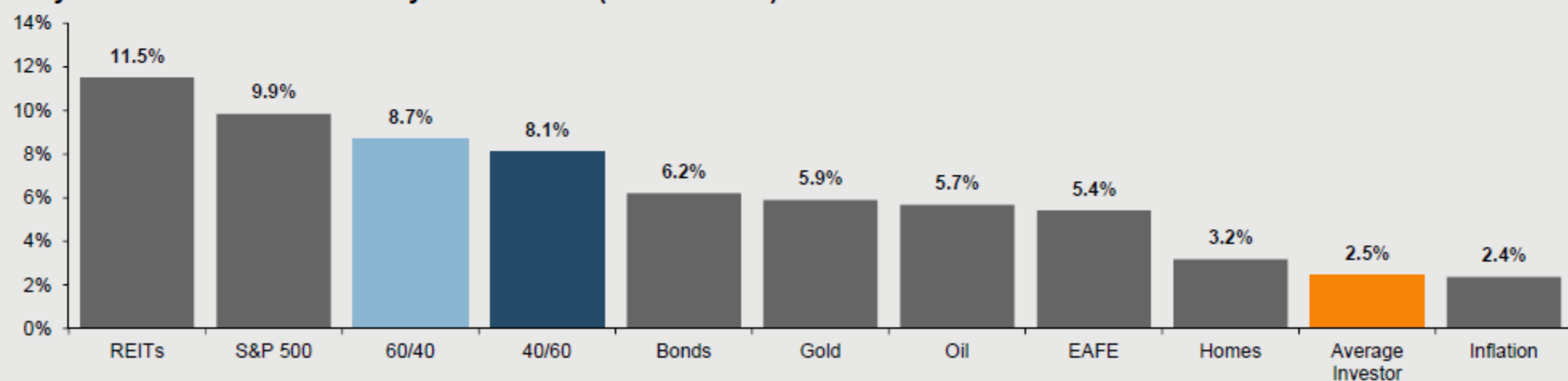
NOTE: Downside and Upside do not reflect "worst case" and "best case," respectively. Returns illustrated are based on reasonable forward-looking guidance but are **not** guaranteed. Portfolio construction reflects globally diversified allocation to the various asset classes.

Diversification and the Average Investor

Portfolio returns: Equities vs. equity and fixed income blend



20-year annualized returns by asset class (1995 – 2014)



Source: J.P. Morgan Asset Management; (Top) Barclays, FactSet, Standard & Poor's; (Bottom) Dalbar Inc.

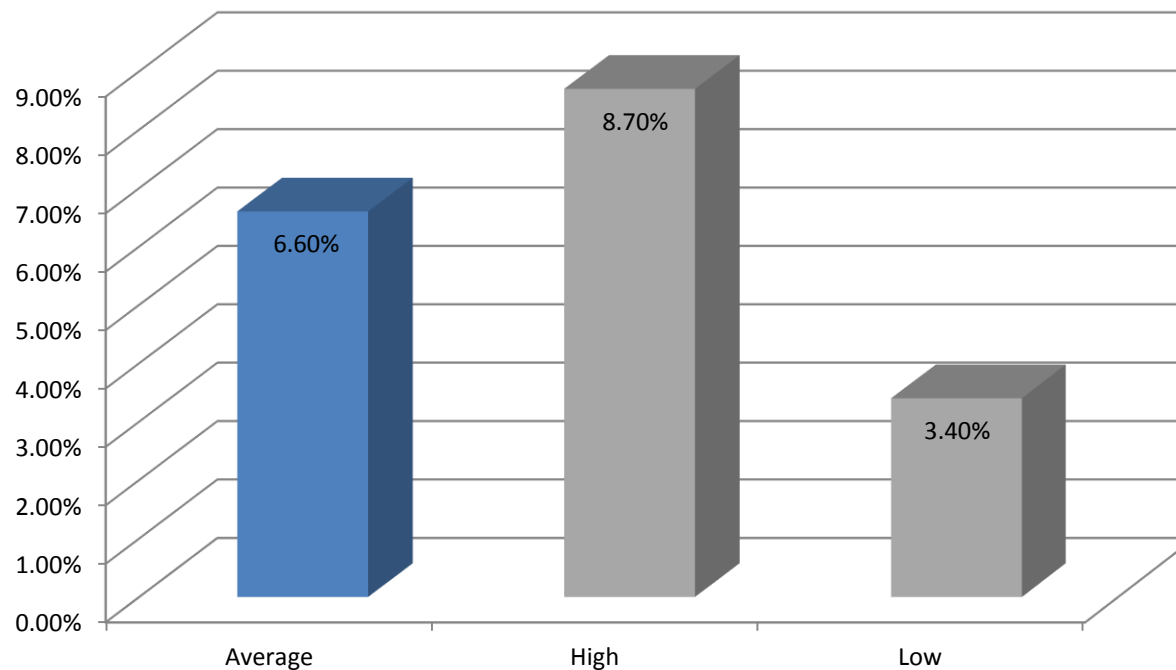
Indexes used are as follows: REITs: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Barclays Capital U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz, Inflation: CPI. 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high quality U.S. fixed income, represented by the Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior.

Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/14 to match Dalbar's most recent analysis.

Guide to the Markets – U.S. Data are as of December 31, 2015.

10-Year Forward Projections

60% Stock / 20% Bonds/ 20% Alternatives



PROS

- Using well diversified alternative investments provides better return potential for moderate-high net worth investors and those who don't mind a mix of liquid/illiquid portfolio assets.

CONS

- Alternatives generally have higher expense ratios.
- Caution must be exercised in current environment as liquid and illiquid alternatives are becoming high demand items.
- Higher withdrawal rate retirees need special balancing of bonds and alternatives.

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Potential Scenario Surprises in 2016

(considered low probability events by consensus view)

1. One party wins control of both the Presidential and Congressional races.
2. U.S. and international stocks end the year modestly lower as a result of too many economic and geopolitical headwinds converging.
3. Despite rising interest rates (perhaps less than being telegraphed by the Fed), the forces in #2 result in many bond sectors doing better than stocks.

2016 Scenario Prescription

1. More conservative investors should **hold more cash than normal** (at least 5-15%, depending on unique circumstances) and stay well diversified, don't make many concentrated allocations. Maintain **good shock absorber protection** in defensive sectors, multi-sector global holdings.
2. More aggressive investors should **diversify overweight areas**. Hold more cash than normal for opportunities.
3. Higher net worth investors should **carefully consider liquid, semi-liquid and illiquid alternatives** to traditional stocks and bonds.
4. **Pay attention to Super Trend and Micro-Trend forces** in your portfolio and your career or business. **What is your overall personal "moat" rating?**

Questions?



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