CWA
CAIN WATTERS & ASSOCIATES

Monthly Report | April 2016

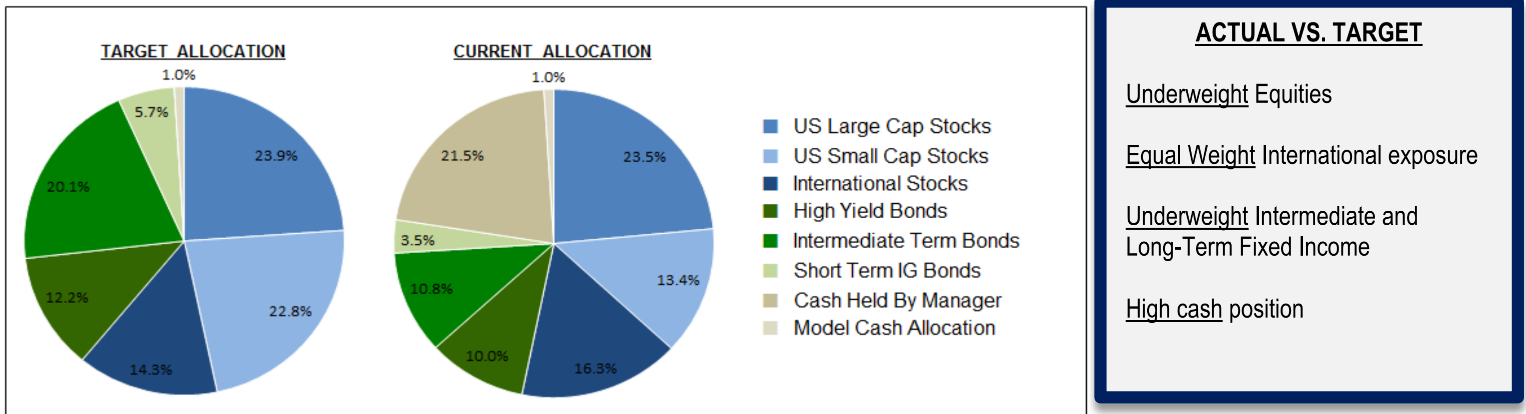
Moderate Growth

*General overall portfolio comments refer to the Moderate Growth allocations used in both the Pooled Fund Program and the Unified Managed Account Program. These general comments will be referred to as "Moderate Growth" throughout. Specific references to performance, current allocation, or comparison to indexes are derived from the CWA Model 5 Portfolio in the Pooled Fund Program; these specific comments will be referred to as "Model 5" throughout.

PORTFOLIO ANALYSIS

Overall Goal. We construct portfolios to generate a return that maximizes the probability that an investor will meet their retirement goals, as opposed to maximizing their asset base (which interjects significant risk). We believe that a value bias, international exposure and general diversification provide the best avenue to meet this objective. Our portfolios, have lower volatility†, but can go through periods where they do not keep pace with the U.S. equity markets (the most common benchmark) because of our focus on value, fixed income and international stocks.

The **Moderate Growth Portfolio** is intended to provide a balanced allocation, with a slight overweight to equities over fixed income. The goal is to provide a balance of growth and income with lower volatility than an all-equity portfolio. Our target and current portfolio asset class allocations for Model 5 are listed below.



LARGEST EQUITY AND FIXED INCOME POSITIONS

In normal market environments, Moderate Growth has a target allocation of 60% stocks and 40% bonds, with approximately 20% of the portfolio in international equities and fixed income. So, the portfolio is a global one – with a U.S. tilt. By design, the holdings are broadly diversified by location/country, by company size, by credit quality/yield and by maturity/duration. The investment managers have a degree of flexibility which allows them to respond to different market environments, and our equity managers are currently holding a large amount of cash (given current valuations).

† as of 4/29/16, the 7-year volatility (standard deviation) of Model 5 is 8.64%, versus 15.51% for the S&P 500 Index.

PERFORMANCE

The Moderate Growth portfolios in the Pooled Fund Program and the Unified Managed Account Program have slightly different investments, costs and thus returns. Accordingly, we direct you to your account statement for your individual performance.

In April, Model 5 (net of fees and expenses) out-performed[1] compared to the U.S. 60/40 Index, out-performed the S&P Moderate Growth Index, and market-performed[1] the Global 60/40 Index, which posted the following returns:

PERFORMANCE	MAR.	COMMENTS
Global 60/40 Benchmark Index[2]	5.56%	International bonds strongly outperformed domestic bonds for the month. International equities also strongly outperformed domestic equities in the month of April. All major global and domestic indices were positive for the month as tensions surrounding global central bank policy initiatives continued to ease.
US 60/40 Benchmark Index[3]	4.43%	
S&P Moderate Growth Index[4]	4.28%	

(1) "Market Perform" means within a range of +10 bps to -10 bps of the applicable index for the month (or +/- 8 bps per month for YTD performance); "Outperform" means more than +10 bps for the month (or more than +8 bps per month for YTD performance); "Underperform" means more than -10 bps for the month (or more than -8 bps per month for YTD performance). **Please note performance comparison comments are based upon Model 5 Pooled Fund Program data. There are inherent limitations in the use of model performance – please read the Model Disclosure found on page 7. Investors should consult their individual custodial statement for actual performance of individual portfolios. Actual performance comparisons may differ from model comparisons.**
(2) Global 60/40 Benchmark is 60% MSCI ACWI Index & 40% Barclays Global Aggregate Bond Index.
(3) US 60/40 Benchmark is 60% S&P 500 Index & 40% Barclays US Aggregate Bond Index.
(4) S&P Moderate Growth Index is 50% S&P Target Risk Moderate Index & 50% S&P Target Risk Growth Index.

MARKET PERFORMANCE

General Overview. In April, equities and bonds continued to show positive performance. Building on the tension relief in March following the G20 meeting, both equities and bonds were in the green, although volatility began to creep back in the last week of the month. High Yield bonds and Oil were two of the biggest sources of market strength, posting 3.9% and 15.5% gains, respectively.

Equities. As noted earlier, equities saw positive performance in April.

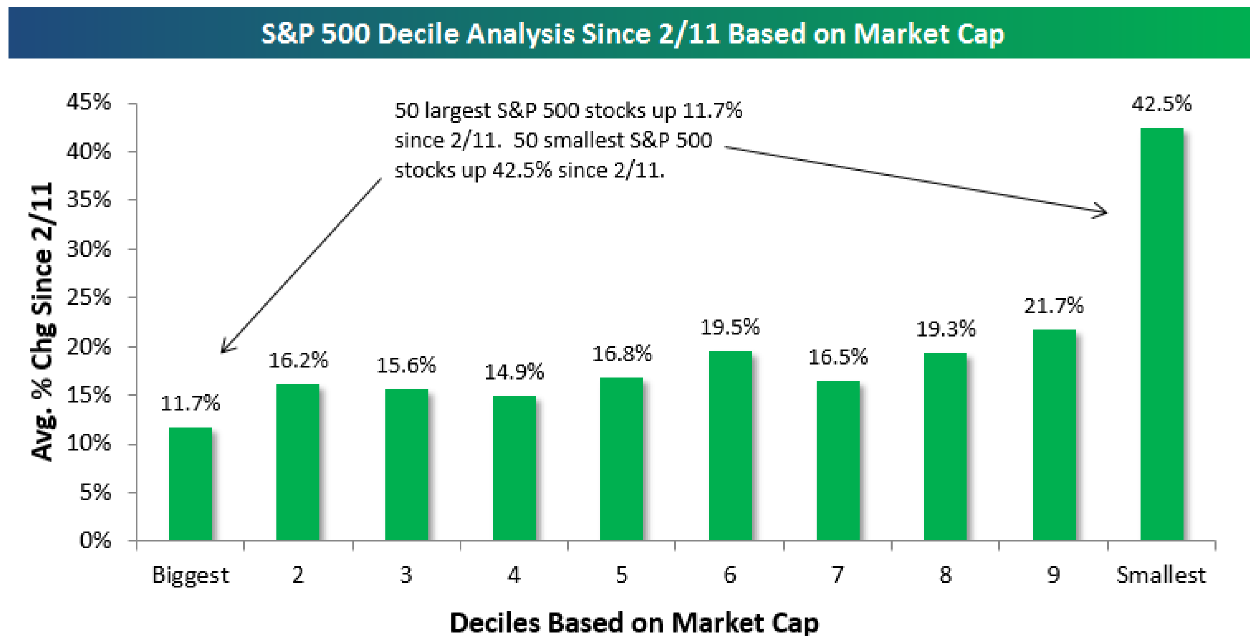
PERFORMANCE	APR.	MULTIPLE	COMMENTS
US Equities[5]	0.62%	19.2X	Domestic equities advanced; value continues to outperform growth
International Developed[6]	2.97%	22.7X	Foreign equities were very strong as global pressures eased and QE programs in Europe boosted asset markets.

Emerging Markets[7]	0.56%	14.1X	As one would expect, the hardest hit investment area earlier in the year was the beneficiary of the largest rally. EM snapped back in a big way after pressure eased on local currencies.

(5) US Equities are represented by the Russell 3000 Index.
(6) International Developed is the MSCI EAFE Index.
(7) Emerging Markets is the MSCI EM Index.

U.S. Markets Continue to Lead the Developed Markets in 2016, but Emerging Markets Have Pulled Ahead: The U.S. equity markets continue to be healthier than the developed international markets (1.74% YTD for the S&P 500 vs. 0.04% YTD for the MSCI EAFE Index), however Emerging Markets have pulled ahead of the U.S. markets for the year. Much of this rebound is due to the depressed levels in which Emerging Markets began the year, however we would note that continued strength in EM would be a positive sign that the global economy is firming. EM countries are the most vulnerable to currency and liquidity shocks, and therefore are a good global barometer for risk assets.

Bigger Isn't Always Better: We have always championed the inclusion of small cap stocks in an equity allocation and for good reason. While small cap stocks are certainly more volatile, due in part to liquidity, they are continuing to prove to be a better source of long-term return than that of larger stocks. Due to the volatility it is important to have a healthy mix of larger companies, as they tend to be better sources of stable earnings, dividends and in general sport more robust balance sheets. The following chart shows returns following the market lows on Feb. 11, 2016, through April 30, 2016.



Source: www.bespokeinvest.com

Our Active Managers Are Continuing to Demonstrate Steady and Solid Performance: For the month, the equity managers in the Model 5 portfolio saw outperformance yet again. Cash positions are relatively unchanged during the rebound, yet security selection has allowed the managers as a group to outperform year to date.

Fixed Income. Fixed income indices continued to perform well, particularly in the global and high yield sectors, while the treasury market is on hold.

PERFORMANCE	APR.	SPREAD OVER UST 10 YEAR	COMMENTS
US Treasuries (Medium Duration)[8]	-0.08%	-	
US Treasuries (Longer Duration)[9]	-0.53%	0.65%	The curve steepened marginally as risk appetite has returned to the U.S. markets.
Global Fixed Income[10]	1.33%	-0.51%	Global sovereign bonds continue to show outperformance as QE programs in Europe soak up all issuance.
Emerging Fixed Income[11]	1.48%	3.39%	Emerging markets again rallied as global market risk aversion continued to cool.
High Yield[12]	3.92%	5.69%	High Yield continued to rally as liquidity pressures continued to ease in the sector.

(8) US Treasuries (7-10 Years), represented by the Barclays UST 7-10 Yr Total Return Index
(9) US Treasuries (20+ Years), represented by the Barclays UST 20+ Yr Total Return Index
(10) Barclays Global Aggregate Bond Index.
(11) Barclays Emerging Markets EMEA Total Return
(12) Barclays US Corporate High Yield Index.

The Investment-Grade Fixed Income portion of the Model 5 portfolio slightly out-performed the Barclays Aggregate Bond Index during the month. Positions in international bonds and emerging market bonds were the source of outperformance.

Quantitative Easing programs in Europe are rapidly buying up sovereign bonds – in fact, it is believed that the European Central Bank is currently buying 100% of the issuance in Europe. This has placed a strong bid for this type of credit and is driving the returns in Europe far in excess of the U.S. The flip side of that coin is any volatility in the foreign bond markets will be met with liquidity issues. However, for the time being, given the inherent demand underneath foreign market generated by QE we would expect outperformance in foreign bonds. Our positioning remains tilted to the U.S. from a relative value standpoint as we believe the U.S. is a better value on an absolute and risk adjusted basis in this environment.

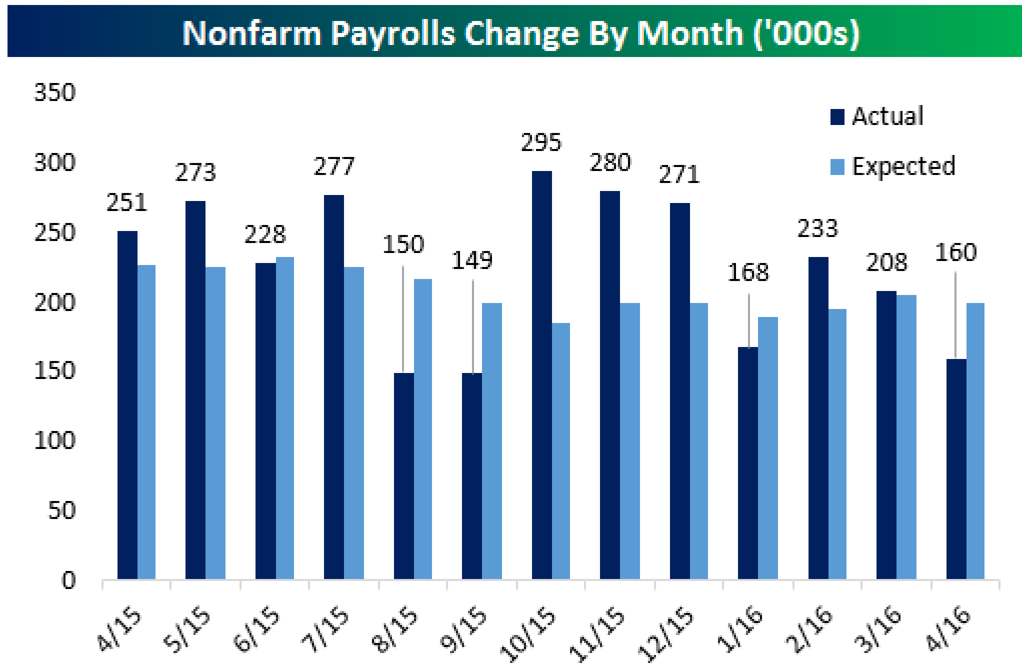
Corporate and High Yield credit were again the best performing domestic sectors during the month. High Yield, in particular, again saw large advances as liquidity pressures eased. High yield now seems to be approaching a much more fair value as we would not expect spreads to tighten to the bull market lows in this environment.

Commodities and Real Assets. The Model 5 portfolios do not have significant exposure to commodities, except indirectly. However, commodities and real assets (real estate) provide a good sense of global demand (in the case of industrial commodities) or fear (gold).

PERFORMANCE	APR.	TREND	COMMENTS
Energy[13]	15.13%	UP	An encouraging sign for the global economy, Energy strongly rebounded in the month of April.
Real Estate[14]	-1.71%	-	Real Estate modestly dropped in the month of April, but did not have a meaningful enough move to warrant concern.
Industrial Metals[15]	7.16%	UP	Industrial metals gained on easing global economic tensions, particularly in China.
Gold[16]	4.89%	UP	Gold bounced hard in April and continues to have a strong upward trend in an increasingly confusing market for global currencies.

(13) S&P GSCI Energy Total Return Index.
(14) Dow Jones US Real Estate Index.
(15) S&P GSCI Industrial Metals Total Return Index.
(16) Gold Spot Index in USD.

Payroll Numbers down but not out: Non-farm payroll numbers came in at 160,000 in April, which was below the 200,000 estimate. While this was a disappointing headline number, given the past variability of the results, it is still an encouraging number given the mature nature of this economic expansion. We continue to not lean to heavily on month-to-month employment and income numbers given their susceptibility to weather and seasonality, especially when the ISM Manufacturing Index – one of the best historical indicators of recession – remain above 50. The below chart illustrates the volatility of Payroll numbers for the prior year ended April 2016.



Source: www.bespokeinvest.com

What Do We Expect?

Global Markets; Economic Climate: While economically things continue to chug along at a slow but increasing pace, the large exhale in the global markets that happened post the G20 meeting in March (discussed in last month's letter) continued to carry markets in April. It is increasingly clear to us that the volatility in the markets stems from concerns abroad – particularly with China and Europe – and that the path of least resistance in the markets is up when the currency markets are calm. As long as China can keep a lid on their banking system and continue to maintain stability in their currency, we would expect calmer waters ahead until the Fed makes another rate decision in June.

We still would expect one or two rate increases by the Fed this year, and would lean towards only one in the back half of the year given recent reticence by the Fed to upset the global market applecart. After attending the Milken Global Conference in California this week, which we attend every year, it is apparent that visibility into the directionality of Fed rate decisions - and more importantly their potential easing decisions – is murky at best. Over the past few years, after hearing the heads of most major economic research houses and investment firms speak at this event, we were able to walk away with a clear consensus on what the market had priced in relative to where Fed policy was headed. This year, there were more divergent opinions than we have ever heard. On any given panel of four individuals, all four would have differing talking points. We heard everything from "QE but spend the money on infrastructure", to the idea of "helicopter money", and even the idea of a suspension of the social security tax.

Our main take away is that, given the sheer number of differing opinions, we may be seeing the limits of the efficacy of monetary policy when rates have been this low this long, and that the narrative may be slowly shifting from one of the **expectation** of more Fed stimulus, to one of general **wariness** towards Fed stimulus. The only thing we were sure of is

that market participants think the Fed should do something, but that it better not be a certain subset of actions or they believe it spells disaster.

To us, this means to be prepared for more volatility and to continue to stay the course, using an all-weather investment portfolio that is poised to take advantage of market dislocations, and to let the game come to us in the interim.

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Further Reading

1) ***Death By A Thousand Cuts,*** A Wealth of Common Sense, May 3, 2016

This article outlines how many investment practices use consultants and how in doing so end up behind the 8-ball when it comes to utilizing active managers. We have been steadfast in our use of the same money managers for several years, and in doing so feel that we are putting our portfolios in better position to capture alpha over full market cycles.

http://awealthofcommonsense.com/2016/05/death-by-a-thousand-cuts/

2) ***The Fed Is Swimming Dangerously In Uncharted Waters***, Forbes, May 3, 2016

Scott Minerd, the CIO of Guggenheim, outlines some of the concerns regarding the directionality of monetary policy. We heard Scott speak several times at the Milken Global Conference, and he continues to be – in our estimation – one of the best CIO's in the business at positioning portfolios around Fed policy, and for being correct in his estimation of what the Fed will do next.

http://www.forbes.com/sites/scottminerd/2016/05/03/complacency-in-uncharted-waters/#11bf50415249

For questions, or to request additional information, please contact your CWA Financial Planner.

DISCLOSURES

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CWA Model 5 Moderate Growth Pooled Fund Program: The target allocation and portfolio data used throughout this presentation is for the CWA Model 5 recommended for participants in the Pooled Fund Program. This Model is the most common recommendation and is used here to illustrate the CWA methodology. Other CWA Recommended Investment Program models will vary in asset allocation and underlying manager and/or security selection. Clients should discuss these models and programs with their planner prior to selection.

Model Performance Disclosure Model performance is NOT an indicator of future or actual results. Performance does not represent the returns that any individual investor actually received. Cain Watters Investors may incur a loss. *Cain Watters Models*

contain allocations to several different common pooled trust funds. Each individual pooled trust fund has a defined investment strategy; usually designed around a specific asset class. Investment managers and their respective strategies are chosen to meet each of the pooled funds' objectives. Investors in the models pay a monthly asset based trust fee, based on their average investment balance during the month. Model performance is calculated using the reported net asset value of each individual pooled fund. Performance for the individual funds is then weighted according to the model target allocation. Model performance includes the reinvestment of dividends and interest. The annual trust fee of 1.05% is subtracted from gross returns on a pro-rated basis of 0.0875% per month; and includes trust fees, manager fees, and investment advisory fees. Model performance has inherent limitations in that it does not reflect the effects of significant cash flows, or take into account actual client asset allocation that may differ materially from the target allocation due to rebalancing policies and changes in market values. This model performance information is provided for illustrative purposes only. Cain Watters Model investors may experience materially different returns.

Use of Comparison Benchmark or Index: Indexes cannot be invested in directly. Index performance and statistics are provided for illustrative or comparison purposes and are chosen as commonly accepted representations of the performance of a particular segment of the market.