CWA
CAIN WATTERS & ASSOCIATES

MONTHLY REPORT | JANUARY 2016

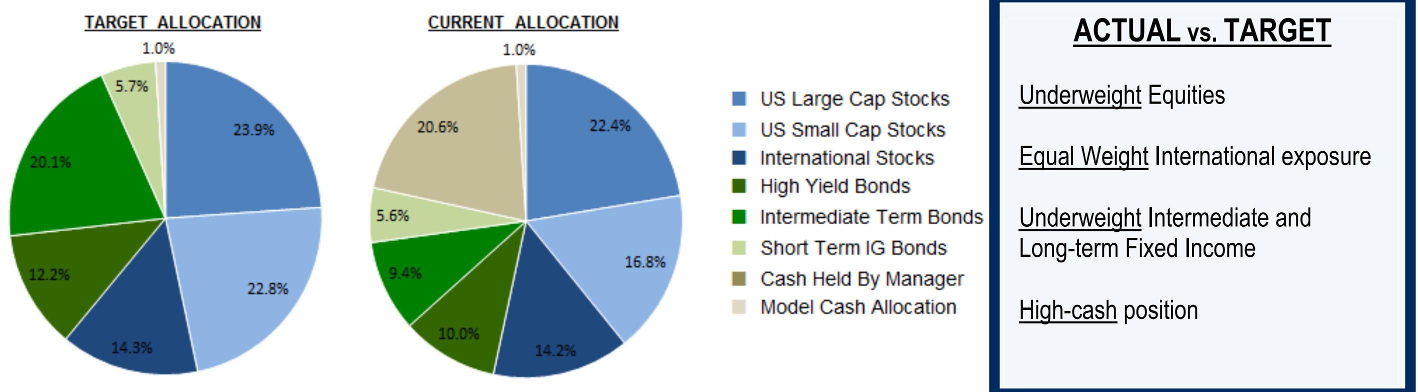
MODERATE GROWTH*

*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 1/31/16, the 7 year volatility (standard deviation) of Model 5 is 7.5%, versus. 14.5% 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 January, Model 5 (net of fees and expenses) outperformed (1) the Global 60/40 Index and "market perform" (1) when compared to the U.S. 60/40 Index and the S&P Moderate Growth Index, which posted the following returns:

PERFORMANCE	JAN.	COMMENTS
Global 60/40 Benchmark Index[2]	-3.14%	International stocks underperformed U.S. stocks and our portfolio had less international exposure than the benchmark. This caused us to underperform the U.S. benchmark and outperform the Global benchmark.
U.S. 60/40 Benchmark Index[3]	-2.42%	
S&P Moderate Growth Index[4]	-2.27%	

(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 p. 6. 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) U.S. 60/40 Benchmark is 60% S&P 500 Index & 40% Barclays U.S. 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. The equity markets – across the globe – started 2016 with a correction. Rapidly falling energy prices and fears about a slow-down in China spooked investors, sending them fleeing from equities and into fixed income and gold, during the first two and a half weeks of the month. Then, on January 21, European Central Bank (ECB) President Draghi made it clear that the ECB would continue and even accelerate its loose monetary policy to stoke European growth, causing markets to start a rally that resulted in a partial recovery in the global markets towards the end of the month. However, concerns abound about 2016. But, the last part of 2015 and the beginning of 2016 have firmly entrenched several interesting themes.

First, the equity markets and energy are – at the moment – significantly intertwined as a result of a general concern about global growth and, thus, energy demand. So, the energy markets are not only concerned about over-supply, but also about demand growth – which will be necessary to close the supply-demand gap. As investors become more bullish on global growth and consumption, energy and stocks have rallied (and vice versa). Further, fears about an energy (and commodities) collapse have hammered emerging markets that are dependent on commodities, sending investors fleeing to the U.S. Our view is that absent a recession, the energy markets will stabilize in the first half of 2016, and could rally significantly in the latter part of 2016 and 2017. Supply is being cut aggressively in the U.S. and other high cost regions, much quicker than the market realizes – in our opinion.

Second, despite what they say, we believe central bankers across the world are watching the markets and will use rhetoric and action to prop them up. The crisis of 2008-2009 began with the subprime meltdown and a bleed off in the equity markets, which fed upon itself until a panic set in. Right now, you can see a similar contagion that could happen if an energy collapse accelerated beyond fundamentals, putting pressure in emerging markets, banks and bondholders. We believe that this is unlikely, and that central banks will use their pulpit to talk the market off the ledge – if it gets there

Third, the U.S. has benefited from its "safe haven" status, handily outperforming most of the rest of the world (both fixed income and equities). As investors sell their equities, the capital has to go somewhere and that "somewhere" is and has been the U.S. We believe that until there is direction in the markets, the U.S. will continue to benefit from this trend. However, if a trend of global growth emerges, we believe that the U.S. stocks will start to lag, given currency and earnings headwinds. That time, is not upon us just yet.

Equities

As noted earlier, the global equity markets suffered declines in January:

PERFORMANCE	JAN.	MULTIPLE	COMMENTS
U.S. Equities(5)	-5.64%	18.57	There was broad-based selling among all but the very largest stocks. The Largest 100 stocks were up 1.4% for the month, while those remaining were down 11.4%. This continues an almost 2-year trend of divergence.
International Developed(6)	-7.21%	17.97	Foreign equities underperformed domestic markets, partly due to a strengthening dollar in January.
Emerging Markets(7)	-6.49%	11.40	Continuing currency wars, China's slowdown and global growth concerns weighed heavily on emerging markets.

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

The U.S. equity markets continued to lead the world. However, earnings season is upon us. In general, earnings have been mediocre, but there are significant headwinds for the rest of 2016. U.S. multinational companies are having to deal with softening economic growth across the globe and a strong U.S. dollar (which means that earnings from abroad are worth less in U.S. dollars). The energy sector also saw a collapse in earnings, weighing down overall corporate earnings. We believe – with a hint of growth in Europe or Asia – that international stocks are poised to outperform, given their very low valuations relative to the U.S.

The Moderate Growth portfolios have international exposure, which certainly hurt in January (and for the past several years). Further, Moderate Growth allocations are value tilted, which means their price to earnings multiple is lower than that of the S&P 500. However, as noted previously, value has dramatically lagged growth. Examples include the FANG stocks (Facebook, Amazon, Netflix and Google) which have significantly outperformed. Considering the value bias of our managers, the Model 5 exposure to these companies is limited, given their very high valuations.

Fixed Income. Fixed income easily outperformed equities in January. And, for those that hate bonds (and there are many that do), January – particularly the first 2.5 weeks – showed why they are an invaluable investment.

PERFORMANCE	JAN.	SPREAD OVER UST 10 YEAR	COMMENTS
U.S. Treasuries (Medium Duration)[8]	3.16%	-	U.S. 10-Year Yield was 1.92% at the end of January.
U.S. Treasuries (Longer Duration)[9]	5.23%	0.76%	Long-term treasuries benefited greatly from a flight to quality and capital outflows from emerging markets.
Global Fixed Income[10]	0.86%	-0.32%	A well-diversified, global allocation to investment grade bonds provided a positive portfolio anchor.
Emerging Fixed Income[11]	-0.02%	4.17%	Safety in sovereign debt was offset by currency devaluation.
High-Yield[12]	-1.61%	7.34%	After bottoming out in June 2014 at 3.5%, high-yield spreads widened further in January (by almost 1%).

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

The fixed income markets – once again – showed the value of high quality fixed income in most corrections (that, of course, are not driven by a fear of rising rates). In addition, it also showed the value of cash and/or longer duration fixed income. The Moderate Growth portfolios have cash, corporate and short term fixed income, along with high yield. Therefore, the Moderate Growth will outperform during periods when rates are rising or there is economic growth, but underperform modestly during a period of falling rates. For Model 5, if you factor in the cash position, the portfolio underperformed a higher quality, medium to longer duration fixed income portfolio, but generally performed in line with a fixed income portfolio with a similar composition.

Commodities and Real Assets. The Moderate Growth 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	JAN.	TREND	COMMENTS
Energy[13]	-9.21%	DOWN	Oil fell from $37.04/barrel to $33.62, as the dollar strengthened and demand fears escalated.
Real Estate[14]	-4.14%	DOWN	Potential rising rates are a headwind to profits and valuations.
Industrial Metals[15]	-1.57%	DOWN	The entire commodity complex continued its bear market.
Gold[16]	5.35%	UP	Gold benefited from the flight to safety, even in the face of a rising dollar.

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

WHAT DO WE EXPECT?

Global Markets; Economic Climate. We believe that the U.S. Federal Reserve and China will drive the narrative this year. Absent additional tightening by the Fed, we do not expect a global recession. We believe that China will muddle through, as it attempts to move from an export driven country to a consumer nation – along with slower growth. China's central planners have made moves that have both enhanced growth (relaxed lending requirements) and depressed it (reduced energy subsidies in a lower energy cost world). In addition, China has wisely backed away from intervention into its wildly volatile stock market, given that its intervention has caused more, not less, volatility (speculators will start to dump shares if they believe that Chinese authorities will halt trading of certain stocks).

As for Europe and elsewhere, we believe that central bankers across the globe will continue to use rhetoric and their balance sheets to stimulate growth, though we remain concerned that the Fed will try to prove a point by tightening (though there is no good reason to do so, given the tenuous. state of the world economy). Absent a Chinese or Fed induced recession, we believe that the energy markets will start to stabilize, if they have not already done so, as supply and demand come into balance. Oil is experiencing its worst bout of a supply driven correction since the 1980s. And, the equity markets are following energy, though not as sharply down. But, we believe that the energy markets are much more flexible and less oversupplied than the 1980s, and that the U.S. – in particular – will see a dramatic decline in production in the second half of 2016 and first half of 2017 (losing as many as 1 million barrels per day in production) – before U.S. production starts a steady climb back up. Indeed, the U.S. (driven by the market, not central planners) will become the world's "swing producer" of energy.

And, we believe – at some point later this year or early next – that Russia will join OPEC, adding 10-11 million barrels a day to the cartel. In this event and a subsequent cut in production, energy prices could rebound north of $50 per barrel and OPEC could indeed institute some form of price "targeting" much like the Fed targets interest rates. In any event, we believe that the energy market will start to sense this late this year, and prices will start recovering (absent a recession).

CWA Moderate Growth Portfolios. As for the allocations for the Moderate Growth portfolios, we believe we are well-positioned. Managers have been very defensive. Further, the portfolios have international exposure, which has dramatically underperformed the U.S. We believe that – given valuations – this should start providing excess returns (relative to the U.S. indices) based on currency benefits and, hopefully, stability outside the U.S.

High-Beta Stocks and Swimming Naked. During the recovery after the Financial Crisis, high-beta stocks - and high-beta stock pickers - have seen very high returns. In the investment world, "beta" defines (in general) how much of a stock's return can be explained by market fluctuations. For example, if a stock has a beta of 1, then it should go up and down (generally) in line with the market. So, if the market is up 10%, the stock should go up by about 10% (generally speaking). The higher a stock's beta, the more volatile it is - a stock with a beta of 1.5 would see returns of 15% during a 10% market return and vice versa. High-beta stocks are great to own during times of "reflation" - when the markets are going straight up. However, they can be deadly during market downturns, assuming that their beta is being driven by high leverage and/or significant economic sensitivity. For example, a company with a lot of debt may react to market conditions like a house with a small down payment and a big mortgage. For example, if you buy a house for $100,000 with a 10% down payment and the housing market increases by 10%, you have made $10,000 (on paper) on just $10,000 of equity (100% return). How awesome is that? However, if the housing market corrects by 5%, you have (conversely) lost 50% of your equity (on paper). This is what we experienced during the housing meltdown. We had a lot of debt, with the assumption that the housing market would never go down - a faulty assumption. The same holds true with companies with a lot of debt that are economically sensitive. It's only a matter of time.

Our philosophy is that a higher quality, value-oriented portfolio - quality companies with reasonable balance sheets and a reasonable valuation - will do better over time. It has caused the U.S. to lag a bit during the last few years, but we believe that slow and steady wins the race. And, we are ever mindful of what Warren Buffett said about investing, "*Only when the tide is out do you discover who's been swimming naked....*" We intend for our clients to always have a swimsuit on, even when the party is at its height.

FURTHER READING

1.) ***Market Distress Boils Down to CORE (China, Oil, Recession fears, and Earnings Slowdown)***, Forbes, January 21, 2016

This article discusses the overhangs that have plagued the equity markets over the past several weeks. (It should be noted that our portfolios have little exposure to China and oil.)

http://www.forbes.com/sites/davidbahnsen1/2016/01/21/market-distress-boils-down-to-core-china-oil-recession-fears-and-earnings-slowdown/#6505b1f223dd

2.) ***Junk Bonds Signal 44% Recession Risk in 2016, Fridson Says***, Bloomberg Business, January 12, 2016

This article discusses the stress in the high-yield market, which has seen interest rates sky-rocket (and prices plummet). This should be contrasted with the "high-quality" fixed income markets, particularly U.S. Treasuries, which have seen rates fall. This article underscores the point that not all fixed income is equal, and that high-yield interest rates (which are rising to compensate investors for greater perceived risk) can be a sign of an impending recession.

http://www.bloomberg.com/news/articles/2016-01-12/junk-bonds-signal-44-chance-of-recession-in-2016-fridson-says

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

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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.