Argent Wealth Management, LLC

Investment Outlook

WINTER 2016

2015 Quarterly Outlook | Year End 2015 Review; 2016 Outlook

Low returns and elevated volatility made for a challenging year | 2016 outlook is only moderately better.

The year 2015 was a particularly challenging one for any investor managing a diversified portfolio. Many more indices were negative than positive. One of the only bright spots in public markets was U.S. Large Capitalization Growth stocks. Even here, returns were concentrated in a handful of top performing large companies including Facebook, Amazon, Netflix, and Google (now Alphabet), or the "FANGs" (according to Ned Davis Research).

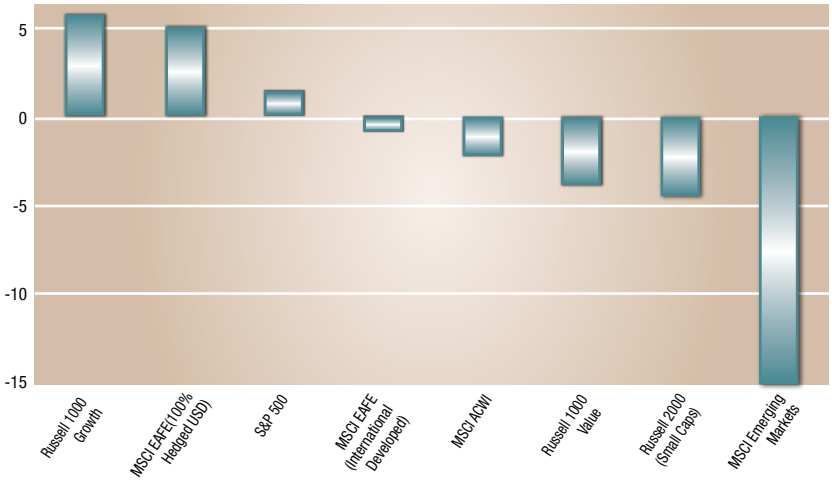
Both Private Equity and Private Real Estate returns were strongly positive; more about that later.

Many categories experienced declines of various magnitudes. While the higher grade Lehman Aggregate bond index was only moderately positive, the High Yield index as well as other "credit" sectors were sharply negative. Within equity markets, Smaller Capitalization stocks significantly underperformed Larger Capitalization. Within both larger and smaller stocks, Value strategies fared much worse than Growth. International markets had mixed performance, while Emerging markets experienced yet another terrible year. Commodity sectors dropped hugely. Finally, the Alternative sector (mainly Hedge Funds) did not distinguish themselves.

S&P 500 Index Versus FANG

Data: Ned Davis Research Group © 2016 Chart:Argent Wealth Management, LLC © 2016 FANGs Tickers: FB, AMZN, NFLX, GOOGL

Equity Index Returns 2015



Data: Morningstar Advisor Workstation Chart: Argent Wealth Management, LLC ©2016

A challenging theme that played out within both equity and fixed income markets was that higher yielding sectors had an awful time. The most extreme example of this was in the Master Limited Partnership (MLP) market. This has been a popular category for income seeking investors and one that had performed well until last year. Yield levels on these Energy assets (pipelines and other infrastructure) had dropped to levels that we could not understand. The market appeared to be paying for what was assured growth in Net Operating Income (NOI) that translated directly into increased dividend levels. As we examined the sector, many companies were paying out more than 100% of the cash flow that was generated, and were highly leveraged. The sector dropped 32.59% (Alerian MLP Index) with many companies and structures down much more than that. Fortunately, we did not have any exposure.

The Fed Finally Achieves "Lift-Off" From Zero Interest Rate Policy (ZIRP)

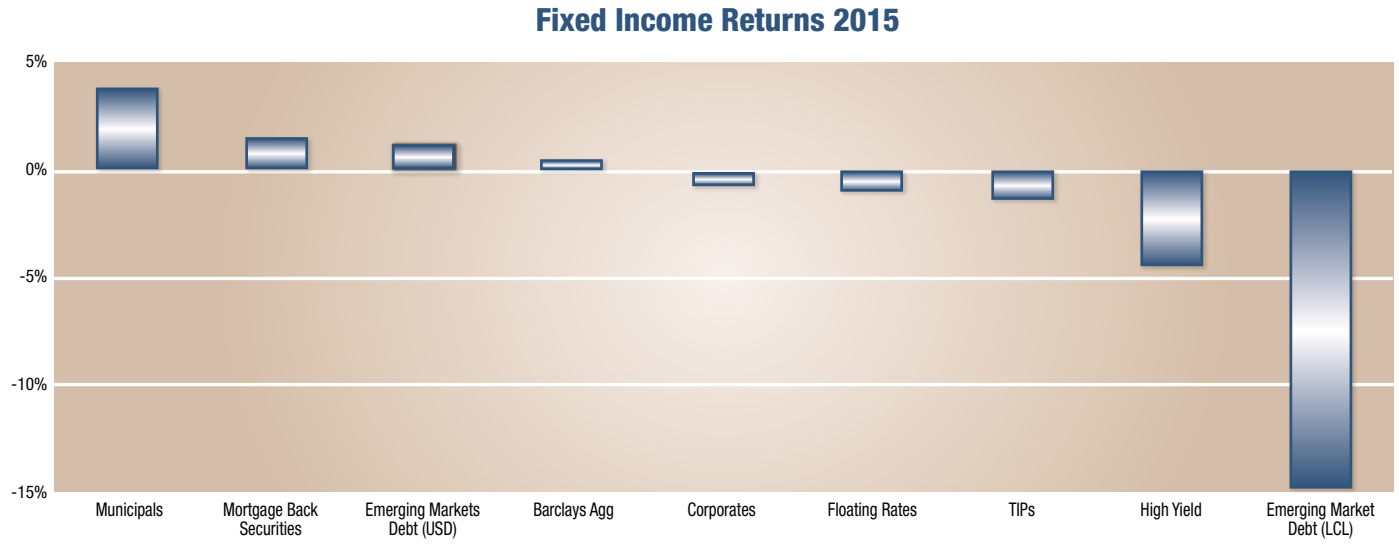
Finally! The Fed did move up the Federal Funds rate 25 basis points (.25%) at their most recent Open Market Committee Meeting. We believe that was an appropriate decision that followed numerous false starts, confusion and inconsistency in guidance. The Fed's credibility was definitely on the line.

The critical aspect of this decision, as Chairwoman Yellen has repeatedly pointed out, was in the forward guidance. It is all about the pace of increases (the slope) and the anticipated ending rate (terminal value). These are the factors that both equity and fixed income markets will obsess about in 2016.

We believe it is important to recognize that an environment of increasing shorter-term interest rates is profoundly different than the years of interest rates pinned at zero. ZIRP most certainly incentivized borrowing of all types. It also contributed to a feeling by market participants that the Fed

Major Limited Partnerships (MLPs) Adjusted Price

Source: Yahoo Finance, Historical Prices; Proxy: Alerian MLP ETF (AMLP) Chart: Argent Wealth Management, LLC © 2016



Data: J.P. Morgan Asset Management Chart: Argent Wealth Management, LLC © 2016

would respond to any wavering in markets or the economy with increased monetary stimulus. The so-called "Bernanke and Yellen put," is now gone. We expect the Fed will let both equity and fixed income markets act on their own and seek their own price levels. That is a big deal.

We believe the most obvious consequence is that market volatility will be higher. This does not necessarily mean negative returns or a bear market, but it does mean that the placid conditions of 2012 and 2013 of steady appreciation and limited volatility is not likely to be the pattern in the next several years. Average volatility in equity markets such as the S&P 500 is about 14.5% (past 30 years). We believe that investors should be prepared for a range from the high to the low over a 12-month period of at least that, and maybe materially more.

The actual path of Fed Funds rate will depend on inflation. Given that the Fed has consistently missed the mark over the past five years on their inflation forecast, their current forecast must be taken with skepticism. The Fed's current projection of about four increases in the Fed Funds rate, (25 basis point each) in 2016, assumes a moderately rising inflation rate. That is far from assured, and the actual inflation rate may well be materially lower or higher than that. We do not believe that The Fed, any strategist, or market participant could know with certainty what path inflation will take. We believe that the Fed's forecast of a moderate increase in the inflation rate is reasonable, for now. However, the Fed will stick to a commitment to be "data dependent." That will mean adjusting the path of rate increases as the data warrants.

Private Real Estate and Private Equity

Our Private Real Estate and Private Equity assets produced excellent returns. This was particularly critical during a period when returns were so difficult to come by in many traditional asset classes.

It is important to note that Private assets are illiquid and not appropriate for many investors. Holding periods are long and investors must carefully evaluate their capacity for illiquidity within the context of a diversified portfolio.

Private Real Estate was one of the top performing categories. While real estate markets continued to perform well, a sub-category that is generally referred to as "Value Added Private Real Estate" was particularly outstanding. These strategies involve buying real estate assets that are not performing well and making improvements to realize the potential for the building. A sale occurs after improvements are made, occupancy increased, and the potential for the asset is realized. Often there is substantial cash-flow during the holding period.

Prices of certain private categories are now becoming more expensive and the current investment cycle more extended. While there are still selective opportunities, there are also more risks. Being highly selective is mandatory for success.

High Yield and Senior Secured Loans

In our view, a number of factors has created a nice opportunity. The combination of a continued decline in oil prices

and anxiety about the Fed's initial increase in the Fed Funds rate, has resulted in continued massive redemptions by retail investors.

The resulting spread levels are detached from fundamentals. Current spread in the High Yield market are now more than 700 basis points (7%) above comparable Treasury bonds. That is the widest spread and best value going all the way back to the dark days of 2009. Such extra yield "premium" has only occurred historically during periods of surging or peaking default rates. Typically, peak default rates of 10% per annum or more have been associated with major recessions. With current default rates at just 2% and not likely to rise much above about 4% (even with dire assumptions about energy prices), we believe that implied default rates of 40% cumulative over three years do not make sense.

	Average	Latest
High Yield Spreads	5.90%	7.60%
High Yield Default Rate	3.90%	2.40%

Source: J.P. Morgan Asset Management;
Table: Argent Wealth Management, LLC ©2016

A particularly sweet spot of opportunity is within the Senior Secured Loan category. These are generally floating rate securities that may benefit from increases in the Fed Funds rate. Senior Secured Loans have much less exposure to the energy sector (about 1/3 of High Yield). Default rates are historically quite low and recovery values quite high due to the senior status of the loans. The average Senior Secured Loan trades at about 91 cents on the dollar and yields about 5% above the Treasury yield. That is a bargain by any way that we know how to measure it.

The most attractive vehicle for this opportunity is within certain closed-end funds. Many of our most preferred funds are trading at abnormal discounts to the calculated value of the assets (NAV). These closed-end funds trade on an exchange, just like a stock. They can trade above or below the value of the assets, unlike an open-end fund.

Importantly, closed-end funds do not experience any cash flow. They can also have a moderate amount of leverage, typically in the range of 25% to 30%. We find this structure relatively attractive versus open-end funds that must deal with cash flow, both into and out of their funds. Given the high transitional costs that many open-end funds are experiencing, this is a major advantage of the closed-end structure. With many super solid funds trading at yields of 8% to 9% and available at discounts of more than 10% to NAV, this is one of the best entry points that we have seen in a very long time.

"A particularly sweet spot of opportunity is within the Senior Secured Loan category."

Strategy and Positioning

This is not a time to elevate risk levels or to stretch for returns. It is critical to be broadly diversified and recognize the potential for continued heightened volatility.

We always stress having fully diversified portfolios. This does not mean diversifying blindly or indiscriminately. There are categories that have much better return potential versus risk taken.

We believe that being flexible and adaptive to changing market conditions and market circumstances will be critical to success. Market volatility will most certainly create value in numerous market sectors. It will be necessary to make selective adjustments to allocate to the most favorable return versus risk opportunities.

Argent Wealth Management, LLC

404 Wyman St., Suite 375 | Waltham, MA 02451
T 781-290-4900 | F 781-290-4920
www.argentwm.com | contact@argentwm.com

All of us at Argent thank you for your continued support and confidence. If you know of anyone that might benefit from Argent's services, we would welcome the opportunity to discuss their particular situation with them.