Argent
Wealth Management, LLC

Investment Outlook
SPRING 2016

2016 Quarterly Outlook | First Quarter 2016 Review; Second Quarter Outlook

Stealth Bear Market May Be Ending; Volatility Remains

Over the past quarter, ending returns around the flat line completely misrepresent the market environment. Equity markets had one of the worst starts in more than 80 years. Just as many prominent Wall Street strategists shifted to sensationally negative outlooks, the market staged an impressive bottom and a spectacular recovery.

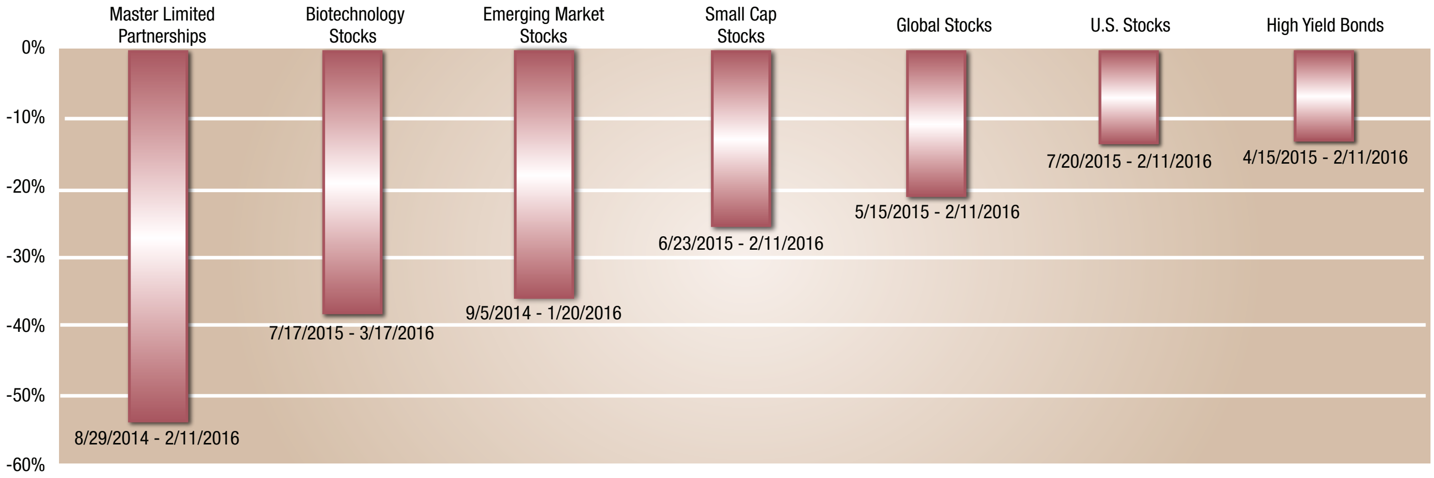
We have been steadfast in our outlooks that a healthy correction of 10% to 15% was well overdue. However, market conditions do not suggest a major bear market. We continue to strongly hold that view. Monetary conditions around the globe remain highly accommodative. Economic expansion continues, albeit at an uneven and unsatisfactory rate. While equity valuations are on the high side in some markets, they are not anywhere near "bubble" valuation levels that have preceded significant bear markets. The yield curve remains steep.

Importantly, the moderate returns in key U.S. equity benchmarks greatly understate the significance of this correction. Numerous markets did enter full-blown bear markets.

The size and ferociousness of these market declines are actually quite healthy. Many of the markets' excesses have been corrected. Investors have pulled back from conditions that could have led up to excessive euphoria. Most of the market areas that were approaching "bubble" type valuation levels have corrected violently. A healthy degree of skepticism has been restored and numerous overly leveraged investors have been "taken off the battle field." This kind of market adjustment reduces the probabilities of "waterfall" declines experienced last fall and this past quarter.

The U.S. and most other economies continue to be stuck in a "low nominal GDP" world. Nominal U.S. GDP has flat

Peak to Trough (%) Decline During Last Market Correction



Data: Yahoo Finance; Chart: Argent Wealth Management, LLC © 2016 lined in the 3.5% to 4.5% range for that past 5 years and is showing little promise for meaningful acceleration. Profit margins are at peak levels and are trending slightly lower as wage pressures build. Valuations remain reasonable, but by no means cheap, even when low interest rates are taken into consideration. This is consistent with the potential for mid-teens equity returns, in any given year, or another flat to moderately negative year. We do expect positive equity returns in the long run, so it is important to maintain equity exposure through volatility.

Cyclically-Adjusted Price/Earnings

STOCK MARKET	CURRENT	HISTORICAL MEDIAN
U.S.	23.2	19.7
World	16.9	20.7
Europe	12.2	17.6
Emerging	10.9	18.1

Data: Ned Davis Research Group; Table: Argent Wealth Management, © 2016

Within the U.S. equity market, there was a distinct shift away from growth strategies this past quarter. We noted at year end how exceptional the outperformance of growth and how much of that contribution came from just a handful of superstar, so-called "FANG" stocks (Facebook, Amazon, Netflix, Google). We are watching this trend closely, as these kinds of shifts in equity style preference can become quite durable and can last a number of years. It is premature to make that call now; but we may well shift to value oriented equity managers in the coming quarters.

A second key takeaway from the past quarter was the better performance of non-U.S. equities, particularly Emerging Markets. A main driver of this shift was a lack of dollar appreciation (in fact a moderate decline). Favorable valuation comparisons of many non-U.S. equity markets and more accommodative central bank policy outside of the U.S., suggest that we certainly want to maintain appropriate weights in these markets. We would consider increasing Non-U.S. equity weights if there becomes evidence of a more impressive global economic recovery.

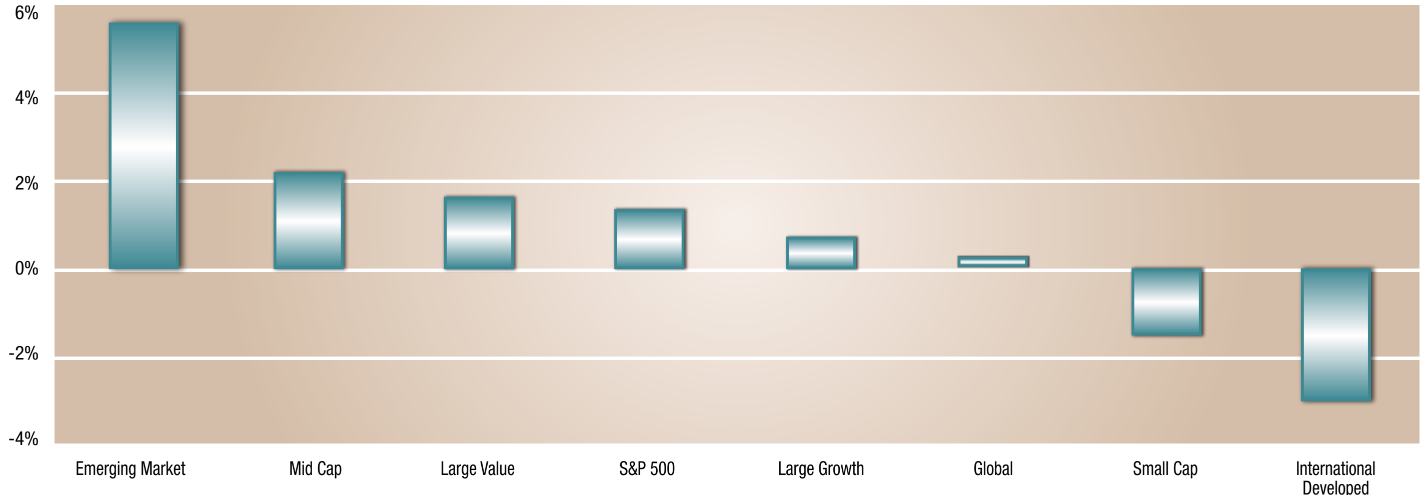
A final key theme was a strong recovery in High Yield and numerous other "credit" markets. We have been extremely bullish (on selective credit markets) and have suggested that there are compelling opportunities. We find certain sectors such as Senior Secured Loans and Preferred Equity to offer exceptional potential for relatively strong returns.

The Yellen Fed Alters Their Framework…Again

Enough already! Just when it seemed that the Fed had agreed upon and communicated a stable framework, their policy parameters and "markers" have been adjusted yet again.

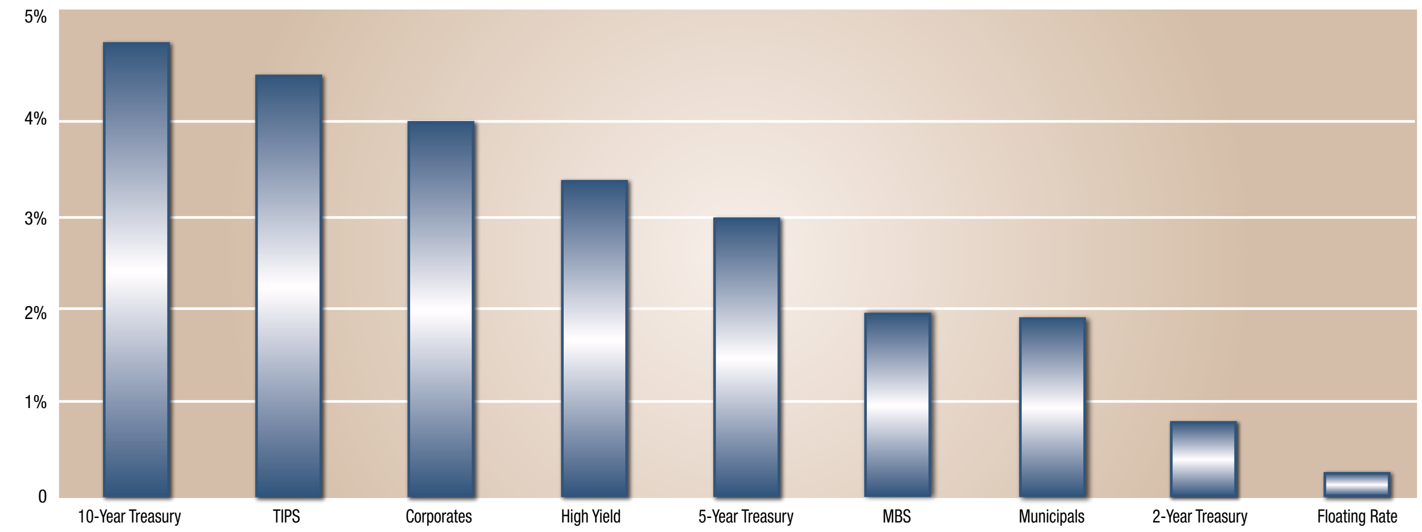
We believe that the most important aspect of this was the unanticipated and unwanted market volatility that followed the initial Fed move in December. The Fed never wants policy actions to come as a surprise and thought that communication was quite clear. While the Fed cited "international developments" numerous times during their most recent

Equity Returns YTD



Data: Morningstar AdvisorWorkstation, MSCI, S&P and Russell Indices used; Chart: Argent Wealth Management, LLC © 2016

Fixed Income Returns YTD



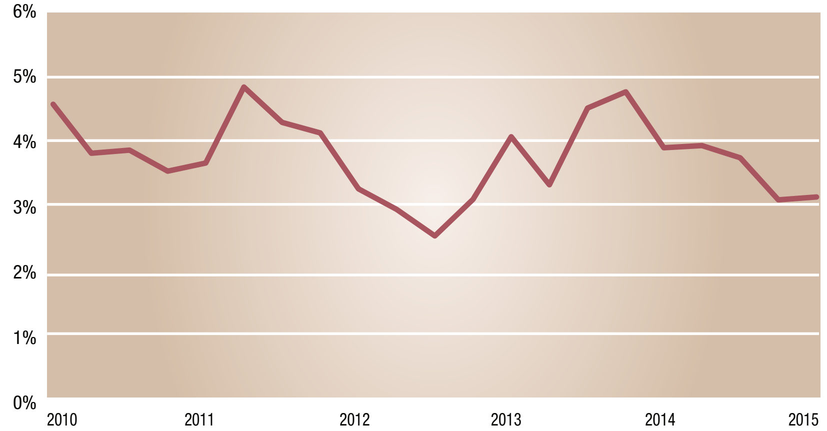
Data: J.P. Morgan; Chart: Argent Wealth Management, LLC © 2016

press conference that is really code for "credit contraction." Sharp widenings of credit spreads (as happened in December) have often been the precursor of recession.

Tightening credit conditions and Fed action seem to be creating a negative "feedback loop." A key aspect of this is dollar appreciation. Any time that the Fed appears more hawkish than other central banks, the dollar rallies. That in turn depresses commodity prices lower and weighs on the High Yield bond market (15% of which is within the Energy Sector).

While the Fed will never explicitly target dollar devaluation, they clearly wanted to break this feedback loop. Additionally, sharp dollar appreciation would effectively import deflationary conditions in Asia and Europe. That is every central bankers' nightmare.

Nominal GDP Year over Year % Change



Data: Ned Davis Research Group; Chart: Argent Wealth Management © 2016

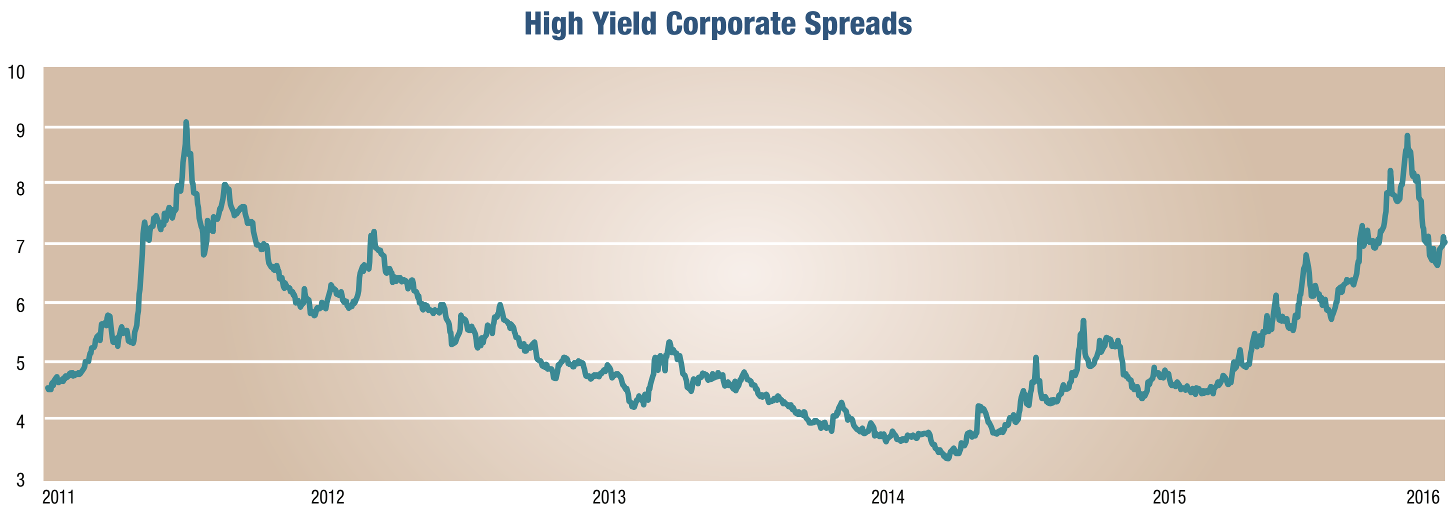
The Fed appears to have abandoned the goal of moving earlier and more gradual than normal. They have made it clear they would rather be late than early in raising rates. That is a big deal.

Most markets benefit from lower interest rates and firmer inflationary expectations, as long as inflation remains contained. We saw both growth and defensive assets rally since the Fed announcement.

However, this short-term benefit is not without a cost. Many inflationary measures (most notably wages) are in fact firming. Core CPI is nearing the point that the Fed was targeting and employment conditions are already well beyond what had been the Fed's desired marker. A contained dollar may move inflation more rapidly above the Fed's desired goals and could well result in a steeping of the yield curve as the market may quickly conclude that the Fed is falling behind the curve. Ultimately, that could result in a "later and larger" policy reaction and a Fed induced cyclical recession. We will be watching indicators closely.

Searching For Income in All the Right Places

Low to negative interest rates across the globe have made the search for income more challenging than it has ever been. However, blindly seeking income without appropriate con-



Data: St. Louis Federal Reserve; Chart: Argent Wealth Management, LLC © 2016
BofA Merrill Lynch US High Yield Option-Adjusted Spread

sideration of the risks is one of the most common mistakes that we see. There have been plenty of mistakes made.

Most of the problematic areas have one or more of the following characteristics:

1. Highly leveraged; amplifying both the rewards and the risks.
2. Over distribution. Unusually high income distributions may be funded by paying out more than the underlying assets are generating.
3. Paying too much.

Even a sound structure can become problematic if investors pay too much or are too complacent about risks.

Perhaps the best example of this was the Master Limited Partnership (MLP) sector. These flawed structures (in our opinion) were highly leveraged, paid out around 100% of the underlying earnings and were reliant on continued access to debt and equity capital to fund growth. As commodity prices dropped and access to capital evaporated, these structures imploded.

Fortunately, the resulting "contagion" across these sectors creates opportunity. Redemption activity has been huge within High Yield, Senior Secured Loans and Emerging Debt. This selling pressure has pushed valuation in selective sectors well beyond what fundamentals would suggest.

We prefer areas such as Senior Secured Loans, the upper credit tiers of High Yield and Preferred Equity. Each of these areas are characterized by generally low default ratios and sound credit quality.

Certain closed-end structures are exceptionally attractive, in our view. For example, the Nuveen Senior Secured Loan Fund (ticker JQC) is trading at an unusually large discount to its Net Asset Value (NAV) of 12%. This fund has a number of compelling strengths; an 8.5% yield, excellent management, solid credit quality, a rising distribution and a portfolio that is generating more than the current distribution of income.

Generous spread levels across a wide swath of sectors suggests that it is not necessary to stretch to find excellent value.

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.

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