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OBERMEYER WOOD **NEWS**

FALL 2015

MARKETPOINT

In 2015's third quarter, the volatility of major global equity indices picked up significantly as investors fretted over Greece's status in the E.U., China's slowing economy, and the Fed's September 17th meeting. Despite the late summer swings, global equity returns have more than doubled since the lows seen in the spring of 2009.

Economic conditions in the U.S. remain stable and mostly positive despite international headwinds. Job openings in the U.S. surged to 5.8 million in July from 5.2 million in June. Consumer credit continues to expand at healthy levels, growing at a seasonally adjusted annual rate of 6.7% in July. And while most data has been positive, the latest report from the University of Michigan's Index of Consumer Sentiment went against the trend, logging its lowest reading since September 2014. This likely reflects financial markets' recent turbulence, which has offset the boost from lower gasoline prices and job growth.

The push and pull we have seen in markets may indicate that stocks are at a crossroads after nearly seven years of mostly unabated upward movement. Low interest rates have incentivized investors to shift out of low-risk assets, such as CDs and Treasuries, and into stocks and lower-quality bonds in a search for higher returns. While these capital flows have helped drive the stock market, equities also require support from rising corporate earnings. In recent months, some CEOs have warned that weaker growth overseas would hit profits in the latter half of the year. As earnings growth flattens out, P/E ratios will have trouble continuing to expand, so it's no coincidence that stocks have struggled for gains recently (see chart below). In addition, investor enthusiasm for stocks has cooled given pervasive concern over the potential for rising interest rates.

S&P 500 Price-to-Earnings Ratio
Trailing 12-Months

Source: Bloomberg

Easy monetary policy has clearly supported both the economic recovery and investor psychology since the financial crisis, but it has its limits. This is because many of the global economy's problems are structural, including aging demography and higher-than-historic debt levels. That said, a very gradual rise in interest rates will probably not do as much damage as investors fear. ›

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Despite the challenges that some companies face with uncertainty in China and parts of Europe, the U.S. economy has largely healed, providing the room and motivation for the Fed to move away from its current low interest-rate policy. The improved employment picture warrants a near-term tightening, but falling inflation expectations and a more fragile global environment support a case for the Fed to remain accommodative. While we can't predict exactly when rates will increase, it is clear that the Fed is trying to be transparent about its intentions and will proceed very cautiously as it begins the normalization process.

This combination of slowing earnings growth and a shift from accommodative monetary policy may limit the short-term upside in equity markets *as a whole*, but a pickup in volatility amidst uncertainty will allow investors to uncover select opportunities. For example, we are seeing solid revenue growth in the healthcare and technology industries. And many companies look attractively priced for the first time in a while, following the recent sell-off.

We expect markets to be resilient if the Fed tightens in the coming months. Savvy investors will stay focused on valuations and the fundamentals underlying each business. While volatility may continue, we believe it will create opportunities to buy companies with excellent long-term prospects at reasonable prices.

THE CHINA QUESTION

The press has made much of the sharp decline in the Chinese stock market and has pointed to a potential collapse of the Chinese economy. While we acknowledge that China is in a period of transition, we do not embrace the doomsday view that China's problems are as bad as suggested, or that they will bring down the rest of the world. The impact of a Chinese slowdown on trade and financial markets varies tremendously across countries and industries. As a whole, however, what happens in China is unlikely to have a disastrous economic effect in the U.S.

It is important to keep in mind that while the Chinese economy matters to overall global growth, the U.S. is more directly affected by our main trading partners (such as Germany, Canada and Mexico) than China. Exports to China account for only 0.7% of U.S. GDP. Further, profits earned in China by U.S. firms are roughly 0.5% of their overall corporate profits. For companies in the S&P 500, sales to China account for about 2% of the total. And in banking, U.S. banks only have 3% exposure to Chinese loans.[1]

If China slows down significantly from here, there are regions and industries that would be adversely impacted. The surrounding Asian economies would be affected by the local slowdown as these countries trade more with China than do Western economies. Even so, growth outside of the region is likely to remain resilient. Meanwhile, certain industries, including capital goods suppliers, materials and energy producers, travel and leisure operators, agriculture enterprises, and auto manufacturers, would further contract. However, the swift decline in commodity prices would likely boost consumer demand by reducing expenses for lower-income households, allowing them to spend more and drive global economic activity – potentially beginning a new cycle.

In the end, U.S. equity markets are at a point where investors have become more anxious about the near term due to slowing earnings growth and the Fed's stated plans of normalizing rates. This uncertainty is healthy as too much optimism can create excessive risk. This is the type of environment where those with a long view and the stomach for volatility can pick up bargains. At the same time, the possibility of further downside remains, so an appropriate asset allocation coupled with some caution and prudent diversification continues to be advised.

[1] Source: BCA Research.

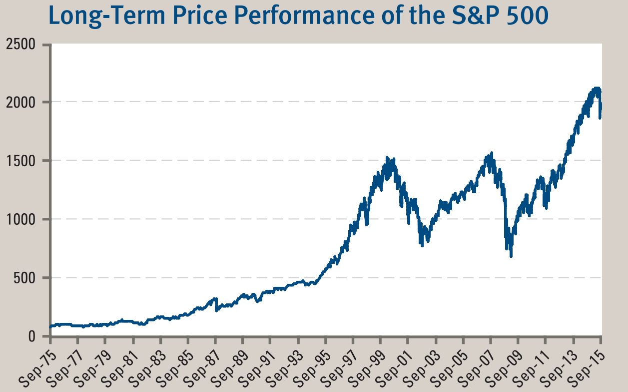
TOP OF MIND

KEEP YOUR EYES ON THE HORIZON: INVESTING FOR THE LONG TERM

We are increasingly barraged with news updates through social media and media outlets. While helpful during a real emergency, the escalated tone and frequency can create unnecessary anxiety during market corrections. While corrections do occur, bull markets have also surprised to the upside with greater gains and longer periods of price appreciation. Stock returns, as measured by the S&P 500, over rolling 10-year holding periods have been positive since 1936 with only one exception: the Great Recession.[2] With this in mind, we encourage you to take a long-term view when contemplating your investment horizon.

Declining oil prices, a stronger dollar, and a transition from zero interest rates have caused choppiness in the markets. The S&P 500 declined 12% from its May 21, 2015, peak to the most recent bottom at the end of August, then rallied by almost 7% through mid-September before declining again. While uncomfortable, these pullbacks are part of a healthy investment environment. These downdrafts also happen more frequently than we remember; investors experience declines of at least 5% an average of four times a year. Some investors hastily sell off their portfolios during these corrections, thereby locking in losses and losing out on subsequent gains. Rather than fear these occasional declines, we encourage our clients to view pullbacks as opportunities to buy excellent companies at bargain prices.

Long-Term Price Performance of the S&P 500



Source: Bloomberg

The below-left chart illustrates the benefit of staying the course and maintaining patience. Given time, stocks can recover from dips. So far in 2015, the average price difference between an S&P 500 company's high and low prices has been 45%. Individual stocks' swings are tempered when part of a well-diversified portfolio, though the overall portfolio value can still vary significantly over short periods. The goal is to focus on one's long-term investment direction rather than on temporary fluctuations.

> "… we encourage our clients to view pullbacks as opportunities to buy excellent companies at bargain prices."

Mindfulness of our investment horizons can enable us to ignore sensationalized headlines and invest with less anxiety. When we do experience moments of panic, it is important to acknowledge positive data that points to a growing economy, improving job situation, and a better financial position for most U.S. consumers. While this data isn't as attention-grabbing as Greece and China headlines, it should be given equal weight. The long-term trend for the global economy has been and will likely continue to be sustainable economic growth. Ultimately, this is what drives stock price appreciation and gives us the confidence to be patient.

[2] Source: *Investing with composure in volatile markets*, JP Morgan Asset Management, February 2015.

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FIRM UPDATE

CELEBRATING 1 YEAR

We are thrilled to be celebrating our one-year anniversary as Obermeyer Wood Investment Counsel. We can't thank our clients enough for their loyalty and partnership as we integrated operations. Reflecting on these first twelve months, we believe our deepened capabilities and expanded resources have augmented our ability to serve our clients' evolving needs. We have fine-tuned responsibilities, expanded our research tools, added a new team member, moved offices, integrated phone and computer systems, and streamlined our overall processes. An overarching goal behind these efforts has been to deliver consistent service and advice to our clients; we hope these changes have been relatively seamless to you. We know we are only successful if our clients feel they are well-served; we always welcome comments and suggestions on how we can further improve.

EDUCATING THE NEXT GENERATION

One service we offer is to help educate our clients' children and younger relatives about investments and other financial matters. We often accomplish this by participating in a family meeting or visiting with the next generation individually. Our team enjoys these broader family discussions, and we are always interested in hearing the younger generation's investment ideas as they often offer a fresh perspective. We applaud the desire to encourage good investing behavior at a young age and are available to help champion these efforts.

OBERMEYER WOOD INCLUDED IN *BARRON'S* TOP 100 INDEPENDENT FINANCIAL ADVISORS LIST

We are excited to share the news that Obermeyer Wood was included in *Barron's* Top 100 Independent Financial Advisors list for 2015. Published annually, this ranking evaluates advisors on various criteria including assets under management and the overall quality of the practice. This is Wally's 8th year on the "Indie" list, and it is the first inclusion of Obermeyer Wood Investment Counsel. Also of note, only two advisors on the list are from Colorado. We are incredibly honored to be included on this list and want to thank our outstanding group of clients for their ongoing support.

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