CURBSTONE FINANCIAL MANAGEMENT CORPORATION

From the Curb

Letter to Clients

Quarter Ending September 30, 2016

We are all acutely aware that we are in the middle of a national political election and nothing has been more disappointing as the discourse between those at the top of the ticket. As far as we can determine, it is very difficult to build any real correlations between political events, elections, party affiliations and long-term market performance for investors. It is, in our opinion, more important to focus on the primary drivers of market performance such as corporate earnings, interest rates and inflation.

Oil, one of the primary inflation drivers, has recently shown some signs of revival, but only to the $40 to $50 per barrel price range which is still 50% lower from whence it collapsed, at over $100 a barrel. There continues to be more worldwide supply relative to global demand, so this recent recovery is not likely to spawn new inflationary pressures.

Interest rates are being suppressed globally by aggressive central banks. There are signs that the Federal Reserve is ready to move in December, but most central bankers around the world are maintaining their accommodative stances. In the United States, the Fed is balancing the fear of recession with the building strength in various areas of the domestic economy. This lack of clarity is the source of great debate within the Fed, as to whether they should move to raise rates or not.

Corporate profitability is thus the most likely focus of investors in the short and intermediate terms. Analysts are now predicating that corporate profits for the S&P500 Index fell by 1.6% in the July through September calendar quarter. Indeed, if the earnings report aligns with consensus, it will be the first time since the third quarter of 2008 that the S&P500 recorded six consecutive quarters of year-over-year declines in earnings. (Note: Analysts have a near perfect record of underestimating corporate profits – a Wall Street phenomenon that allows companies to consistently announce that "profits beat street estimates".)

The U.S. will survive this troublesome election cycle. Interest rates will remain modest compared to any time in recorded history. And, although there are signs of inflation, we don't expect that rates will rise in any meaningful way. Corporate earnings may remain weak, which means we will closely be watching valuations; however, we do not believe further contraction in earnings translates to a recession. Instead, tepid earnings may simply be reflecting short-term concerns and headline news. We do believe that stable market performance is tied to investor confidence.

Whether you are an investor or a business owner of any size, uncertainty keeps money from flowing into financial assets and tempers business investment in capital expenditures and hiring. The greater clarity, the more friendly the investment climate and the greater probability of positive returns.

At the moment, investors are challenged to focus on issues that are news-related and temporary in nature versus those issues that are more likely to affect valuations over the long-term. We believe that investors will be best-served to focus on the dynamics that are more likely to influence long-term values and the impact on their portfolios. The potential for increased volatility could create some anxious moments; however, too little exposure to equities and other more risky assets could result in long-term return targets not being met. This is an important time for investors to fully understand their tolerance for risk and how that balances with the allocation of their assets.

We are enclosing your third quarter reports that make an ideal starting point for a discussion regarding your investment objectives and how those objectives support your financial goals. Please do not hesitate to contact us as we always welcome your thoughts, comments and questions