NADLER FINANCIAL GROUP

Investment and Financial Consultants

Nadler Financial Group, Inc.
155 North Pfingsten Road • Suite 160
Deerfield, Illinois 60015-4903
Phone: 847.940.4040 • Fax: 847.940.7246
www.nadlerfinancial.com

SECOND QUARTER 2016 ECONOMIC AND FINANCIAL MARKETS REVIEW

2016 began with a sharp stock market decline driven by investors' concerns regarding plunging oil prices, potential interest rate increases by the Federal Reserve Board, and declining corporate profit growth. Furthermore, worries about global economic growth and uncertainty surrounding the contentious presidential primaries created additional market turmoil. In March, the stock market began to recover as investors became confident that these concerns would not necessarily lead to a recession in the United States. Then in June, Great Britain unexpectedly voted to exit the European Union, leading to another global stock market decline due to great uncertainty regarding what this separation means for the global economy and the future of the EU. Ultimately, as a result of a last-minute rally, the U.S. stock market actually gained slightly during the first half of this year, as the S&P 500 Index increased 2.7% and the Dow Jones Industrial Average gained 2.9%. *

Despite historically low interest rates, U.S. bonds have generally gained more than stocks this year. The main reason for this is that foreign investors have been buying U.S. bonds because bond yields in many foreign countries are even lower than in the U.S. Also, uncertainty regarding the future of the EU and what the "Brexit" means for the global economy created a "flight to safety," with investors seeking the security of U.S. Treasuries. Even before the Brexit, the Fed indicated that they are not likely to raise interest rates as much this year as previously thought. Therefore, the risk of losing money in bonds as interest rates rise has been reduced. As a result, the Barclays Intermediate U.S. Government/Credit Bond Index returned 4.07% during the first half of this year. *

As in prior years, financial markets continue to be heavily dependent on the Federal Reserve Board's accommodative monetary policy. After their first interest rate hike in over nine years last December, the Fed indicated in January that they might raise interest rates up to four times this year. Higher interest rates could be harmful to stocks because it would increase borrowing costs for consumers and corporations, thereby potentially slowing the economy and harming corporate profits. It may also provide investors with higher yields on new fixed income investments, encouraging them to re-allocate funds from stocks to bonds.

However, the Fed continues to have trouble raising interest rates because poor economic data continues to suppress their will to do so. Now, with the recent decision by Great Britain to leave the EU, it is likely that the Fed will not be able to raise interest rates for some time to avoid further harming the global economy. Oddly, over the long-term, bad news related to the economy and geopolitics may be good news for the U.S. stock market because these conditions may continue to keep the Fed from raising interest rates aggressively. Low interest rates would continue to leave few alternatives to U.S. stocks.

Many investors are also concerned that the stock market could decline over the coming months due to uncertainty regarding the upcoming U.S. presidential election. It is possible that this contentious election season could create additional stock market volatility during the second half of the year. However, there is an old saying in the investment community: "If everyone already knows something, it is not worth knowing." This refers to the fact that financial markets are typically forward-looking. In other words, events and ideas that might affect the price of an investment are theoretically already factored into the current price of that investment. The stock market typically declines due to events that are unexpected and not anticipated by investors (such as the result of the recent referendum in Great Britain). Therefore, it is very possible that past and current negative news surrounding the election and other publicized geopolitical events may already be priced-in. Any good news, such as surprisingly positive corporate profits, may create a surprise rally in the stock market during the second half of this year.

Because many stocks and sectors in the markets have declined over the past year, many market strategists believe that a bear market has already occurred. Additionally, the negative market conditions over the past year have led to cheaper stock valuations. As long as the Fed does not raise interest rates aggressively to fight inflation and the U.S. economy does not slip into recession as a result of overseas geopolitical events, the stock market may "climb a wall of worry" and appreciate despite all of the recent, negative news.

If the outlook brightens, we may eventually want to become a bit more aggressive in portfolios for risk-tolerant investors by investing a bit more money in stocks. Large U.S. companies that pay dividends may continue to be attractive to global investors seeking higher yields than those that can be found in the fixed income markets. Additionally, if investors continue to be weary of turmoil overseas, small companies that derive most of their revenues in the U.S. may begin to perform well for the first time in several years. However, if it turns out that the stock market has not priced in all of the negativity, we may become even more conservative in our allocations.

In our fixed income allocations, we continue to invest primarily in short-term bonds rather than intermediate- or long-term fixed income securities. Long-term bonds are less liquid and do not offer much more in yield than short-term bonds right now. Moreover, when interest rates eventually rise in the future, existing long-term bonds are likely to lose value.

As always, please call us if you have any questions or concerns regarding the recent stock market volatility.

** Index returns were obtained from the Wall St. Journal and Barclays on July 1, 2016.*