AlamoCapital

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Against the wind

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Recession or no recession

Recently, the focus for investors has been all over the map:

1. Oil prices
2. Corporate earnings
3. The global economy
4. China's economy
5. China's currency (the yuan)
6. Anxieties about banks (especially in Europe)
7. The Federal Reserve's next move
8. Global central banks that may be running out of ammunition to counter economic weakness.
9. Emerging market debt
10. "Brexit," -- the possibility Britain will exit the European Union this summer
11. Political uncertainty in the U.S.

It's not an all-inclusive list, but it adds up to a whole host of worries that investors are having to grapple with in the short term. Yet, U.S. stocks in February ended mixed as oil prices ticked higher and the economic data improved. Notably, the more positive economic reports come at a time when the global outlook is tepid at best. But it highlights that the driver of U.S. economic activity isn't coming from overseas. Instead, it is homegrown.

Let's grow the list by one more item: U.S. recession worries

If you listen to the pundits of doom and gloom, we're going to enter a recession this year that will take stocks to new lows. First, let me state the obvious and then I'll provide some examples in a moment. Economic forecasters do a pretty lousy job of calling turning points in an economic expansion. Thinks of it this way: Pile a bunch of seasoned sport analysts into a room and ask them who's going to come out on top of an important football or basketball game. While they will offer a thoughtful analysis of each team's strengths and weakness, and may even agree on many points, they will draw different conclusions as to the outcome. And their predictions for the final score--well, those will vary widely. The same holds true for economists.

Take former Fed Chief Alan Greenspan, who headed up the Federal Reserve from 1987 – 2006. In March 2007, Greenspan said there was a "one-third probability" a recession would take hold in the U.S. that year (Washington Post). By December, the U.S. would enter what would eventually be called the "Great Recession," according to the National Bureau of Economic Research.

Table 1: Key index return

	MTD %	2015 %	3-year* %
Dow Jones Industrial Average	+0.30	-5.21	+5.53
NASDAQ Composite	-1.21	-8.98	+12.98
S&P 500 Index	-0.41	-5.47	+8.45
Russell 2000 Index	-0.14	-8.98	+4.30
MSCI World ex-USA**	-1.65	-8.47	-2.82
MSCI Emerging Markets**	-0.28	-6.78	-11.13

Source: Wall Street Journal, MSCI.com
MTD returns: January 29, 2016—February 29, 2016
Annual Returns – December 31, 2015–February 29, 2016
*Annualized
**USD

So much for Dr. Greenspan's complex forecasting models. Still, any hunches he may have had at the time were more in line with what was eventually to pass.

His successor, Dr. Ben Bernanke, had just told Congress the economy might strengthen.Yes, the best and brightest are sometimes humbled by circumstances outside their control. I believe the legendary Warren Buffett does a great job of summing it up.
"The cemetery for seers has a huge section set aside for macro (economic) forecasters.

We have in fact made few macro (economic) forecasts at Berkshire, and we have seldom seen others make them with sustained success" (Bloomberg).

Why does all of this matter?

Let me repeat what I said a moment ago. There has been increased talk the U.S. economy may enter a recession later in the year. And recessions depress stocks.Yet, in no way is the recession chatter the consensus view. But it does add some uncertainty to the mix, and it has pushed out forecasts for a recovery in corporate profits (Thomson Reuters). If economic growth stalls later in the year, it would put added pressure on corporate profits and further delay any earnings recovery because historically corporate earnings have been a byproduct of what's happening in the economy.

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Upcoming Seminars

Thursday, April 21st
Alamo Capital, Walnut Creek
6:00pm - 7:00pm

RAGTX Fund Information Seminar by Walter Price, CFA, Senior Portfolio Manager and Managing Director with Allianz Global Investors.

Wednesday, April 27th
Alamo Capital, Walnut Creek
6:00pm - 7:00pm

Estate Planning Seminar with
Kirsten Howe, Estate Planning Attorney and Gary Watts, CFP®, Alamo Capital Vice President-Financial Advisor

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Perspective

As I've already said, economic forecasting is an inexact science. But I'll give you my opinion. We will descend into another recession. That's right, I said it. It may be in 2016 or 2017 or 2018 or beyond. But an eventual recession (and subsequent recovery) in a free market economy is to be expected. And when it happens, stocks will probably lose value since bear markets closely correlate with recessions (St. Louis Federal Reserve data).While the individual plans we recommend mitigate some of the risks, they do not eliminate risks.

Over the longer-term, however, I am confident they have you on the path to your financial goals.Given the volatility that strikes the market from time to time, I want to encourage you to avoid watching the daily gyrations in stocks. Again, Buffett offers another valuable piece of insight—"Games are won by players who focus on the playing field—not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays" (Bloomberg).That brings me to the next point. "Markets over a long period of time are going to go up," Buffett said in a late February interview on CNBC.

His advice is an excellent foundation for those with a long-term perspective. While none of us enjoy seeing the market decline, let's remember that it never goes up in a straight line. Do the math—that means 60-80% of your investments are outside of stocks. By definition, they are more conservative in nature, which limits the downside in turbulent markets. Still, I continue to recommend some exposure to equities, which allows us to capture some of the upside when stocks rise.

Bottom line

There is plenty of uncertainty in the world (hasn't that always been the case?) and we are bombarded with bad news daily, but I believe this comment from Buffett's just-released 2015 annual letter to Berkshire Hathaway shareholders reflects my sentiment: "For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honored and perhaps made more generous. And, yes, America's kids will live far better than their parents did."I hope you've found this review to be educational and helpful. As I always emphasize, it is my job to assist you! If you have any questions or would like to discuss any matters, please feel free to give me or any of my team members a call.

More Uncertainty in Chicago

Kevin Reich
Fixed Income Specialist

The city of Chicago is home to the nation's fourth largest school district, and it has been struggling to meet its financial obligations since the fall of 2015. The Chicago Public School system is faltering behind a staggering $1 Billion deficit. Harsh budget cuts continue to unsettle both teachers and staff, and the future for the Windy City's school system is starting to look quite unstable.

The cash strapped city has long awaited a promised $480 million in state appropriated funding, but it looks as if that money may never arrive. As in many problems, the trouble starts at the top. The governor of Illinois, Bruce Rauner, has yet to pass his state's 2016 budget. The Republican governor is knocking heads with his Democratic majority House, and as long as the budget remains unpassed, the Chicago Public School system's money will never arrive. In order to get through the year, the Chicago Board of Education tapped the municipal debt market for a $700 million loan. The bond sale came at a hefty price, a whopping 8.5%.

Matters are starting to get even worse. In the first week of March, the Illinois House passed a bill to place the city's school board into a city election process. Previously, members could only reach the board if they were personally appointed by the mayor. Now this bill will be passed onto the state senate, where it awaits final approval. Very simply, if this passes, the mayor could lose control of his own school board. Other news also added to concerns over the troubled school district. The Chicago Public School system's chief executive officer, Forrest Claypool, publicly announced that he is planning to furlough workers, and shorten the school's calendar year by three days. One might think that closing schools for three days would only have a minimal effect, but it will save the Chicago Board of Education $30 million.

The city also has to deal with an angry teacher's union, which just so happens to be the third largest in the country. The Chicago Teacher's Union is threatening to strike as early as April 1st. This measure comes in response to the three- day furlough combined with a reduction in system wide pension contributions. The usage of a strike is not a new tactic for the Windy City's unionized teachers. They successfully utilized a strike back in the fall of 2012, and it helped them gain ground in non-financial arguments against the city.

Illinois Republican Governor Bruce Rauner continues to battle his democratic majority led House, as he tries to pull together a 2016 budget. His state's largest city is slowly sliding towards insolvency, and rumblings of a state school system takeover have even surfaced- yet it is unclear if it is legal for Illinois to gain control of the city's schools. Rauner believes the state's own board of education has the right to do so, but Chicago Mayor Rahm Emmanuel claims it would be illegal. For now, we will wait to see if the board member voting bill gets passed in the senate, and also watch out for the potential teachers' strike. Political gridlock continues to hinder any progress in Chicago. Hopefully it is not long before a solution is reached.

For information about Alamo Capital Financial Services or your account, call us Monday through Friday from 7a.m to 5p.m. PST.

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