ATR Advisors

ABSOLUTE TOTAL RETURN

FIRST QUARTER 2016 COMMENTARY

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V-Shaped Stock Market

The first quarter of 2016 showed a classic "V-shaped" pattern. After one of the worst starts in stock market history, in which the market dropped over 10% in a violent downturn, the market staged an equally dramatic recovery in February to end the quarter almost exactly where it started.

"Don't Fight the Fed Again!"

At the end of last year, we predicted that the market would respond strongly to the new monetary tightening regime announced by the US Federal Reserve last December. We made the following predictions:

1) Volatility would remain elevated, as the Fed choked off some of the liquidity that had previously squelched market volatility.
2) The yield curve would flatten, with long-term rates coming down and short-term rates going up.
3) The out-performance of growth stocks would reverse, and value stocks would return to favor.
4) There would be rotation out of cyclical sectors, into defensive sectors such as Equity REIT's, Utilities, Consumer Staples, Healthcare, and Telecoms.

How Did These Predictions Play Out?

1) The VIX Index, representing market volatility, went from 20.70 at the beginning of the year, to 28.14 on February 11. It then turned down with the market recovery, and ended the quarter at 13.95. We expect that it will turn back up again later in the year.
2) The yield curve flattened dramatically, with the yield on 10-year Treasury's falling from 2.27%, down to 1.77% during the quarter.

3) Value stocks and defensive sectors did indeed out-perform. The Dow Jones Utility Average was up 15.7% on the quarter. The S&P Telecom sector was up 15.1% in the quarter. Equity REIT's beat the market, returning 4.95% during the quarter.

So in many ways, the market returned to form and reacted predictably to the new Fed regime.

Unique Aspects

However, there were some unique aspects to the past quarter, which we did not predict:

1) Gold performed very well, going up around 16.5% in the 1st quarter.
2) The US Dollar stopped strengthening, going down around 4.1% versus its biggest trading partners.
3) The Euro common currency in Europe strengthened, going up around 4.9% versus the dollar.
4) Analysts' expectations for profit growth in the S&P 500 went down dramatically over the quarter, moving from plus 2.3% at the beginning of the quarter, to minus 6.9% at the end of the quarter.
5) The Fed loosened its projections of future rate increases, going from originally projecting a full percentage point of rate increase in 2016, coming down over the quarter to only projecting less than half this rate of rate increase.

What all of these unique factors indicate is that market uncertainty is higher than normal. The comfort of a Federal Reserve "floor" under the stock-market, has been replaced by the fear of what the market will do after the Fed removes the "training wheels" on the stock markets bicycle.

Wall of Worry

It has been said that the stock market often "climbs a wall of worry." This may well happen this year, as all of the above uncertainties eventually resolve themselves. If so, we are committed to protecting investors' capital, and taking advantage of the opportunities that the market brings.